



COMMERCE COMMISSION

Decision No. 595

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

Fulton Hogan Limited

and

GJ Beynon Contracting Limited

- The Commission:** David Caygill
Peter JM Taylor
Gowan Pickering
- Summary of Application:** The acquisition by Fulton Hogan Limited (Fulton Hogan) of the contracting assets, quarry and land of G J Beynon Contracting Limited (G J Beynon).
- Determination:** Pursuant to section 66(3) (a) of the Commerce Act 1986, the Commission determines to give clearance to the proposed acquisition.
- Date of Determination:** 19 December 2006

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EXECUTIVE SUMMARY

1. On 20 October 2006 the Commerce Commission (the Commission) registered an Application for clearance from Fulton Hogan Limited (Fulton Hogan or the Applicant) to acquire the contracting assets, quarry and land of G J Beynon Limited (G J Beynon).
2. Associated with the proposal is the acquisition by Fulton Hogan of the 50% of shares in Westland Asphalt Limited (WAL) not currently owned by Fulton Hogan.
3. The Commission sought extensions of time to consider the Application and these were agreed between the Applicant and the Commission, meaning the Commission had until 20 December 2006 to make its determination.
4. The Commission considers that the relevant markets in this case are those for:
 - the provision of resurfacing services on the West Coast of the South Island; and
 - the provision of general paving services on the West Coast of the South Island.
5. In the absence of Fulton Hogan acquiring G J Beynon, the Commission is of the view that G J Beynon would most likely be sold to a third party already operating in the market for the provision of resurfacing services on the West Coast.
6. The Commission has identified the relevant entry conditions, or factors that could impact on entry as:
 - non-price attribute requirements imposed by tenderers;
 - the costs of establishing a local base and/or the cost of transporting equipment to the West Coast;
 - equipment and staffing requirements; and
 - access to bitumen supply.
7. The Commission considers that for some firms that bid for resurfacing contracts on the West Coast, these conditions are more difficult to satisfy than for others. In addition, the Commission recognises that the competitive constraint provided by each potential bidder is dependent on its willingness to compete for contracts. In particular, potential bidders located outside the West Coast have tended to bid for West Coast resurfacing contracts on a sporadic basis.
8. The Commission considers that Transit New Zealand and the Territorial Local Authorities (TLAs) have the ability to exert a degree of countervailing power by altering various aspects of the contracts in order to promote competition, such as, rejecting bids, encouraging new bidders, and negotiating with the winning bidder.
9. On balance, the Commission considers that:
 - potential bidders would provide a degree of constraint on the combined entity;
 - Transit has a degree of countervailing power through its ability to alter the terms of its contracts in order to promote competition; and

- TLAs also have a degree of countervailing power, albeit to a lesser extent than Transit.
10. Accordingly, the Commission concludes that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the markets for:
- the provision of resurfacing services on the West Coast of the South Island; and
 - the provision of general paving services on the West Coast of the South Island.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 20 October 2006. The notice sought clearance for the acquisition by Fulton Hogan Limited (Fulton Hogan) of the contracting assets, quarry and land of G J Beynon Limited (G J Beynon).
2. Included in the proposal is the acquisition by Fulton Hogan of the 50% of shares in Westland Asphalt Limited (WAL) not currently owned by Fulton Hogan. The remaining 50% of shares in WAL is owned by two existing shareholders of G J Beynon.

PROCEDURE

3. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. The Commission sought extensions of time to consider the Application and these were agreed between the Applicant. Accordingly, the Commission had until 20 December 2006 to make its decision.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's *Mergers and Acquisitions Guidelines*.¹

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal will have, or would be likely to have, the effect of substantially lessening competition in the market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.²
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held:

We accept that an absence of market power would suggest there had been no substantial lessening of competition in a market but do not see this as a reason to forsake an analysis of the counterfactual as well as the factual. A comparative judgement is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, i.e. dominance has been attained. We consider, therefore, that a study of likely outcomes, with and without the proposed Alliance, provides a more rigorous framework for the comparative analysis required and is likely to lead to a more informed assessment of competitive conditions than would be permitted if the inquiry were limited to the existence or otherwise of market power in the factual.³
7. In determining whether there is a change along the spectrum that is significant the Commission must identify a real lessening of competition that is not minimal.⁴ Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening

¹ Commerce Commission, *Mergers and Acquisitions Guidelines*, January 2004.

² *Foodstuffs (Wellington) Cooperative Society Limited v Commerce Commission* (1992) 4 TCLR 713-722.

³ *Air New Zealand & Qantas Airways Ltd v Commerce Commission*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and K M Vautier, Para 42.

⁴ *Fisher & Paykel Limited v Commerce Commission* (1996) 2 NZLR 731, 758 and also *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554.

of competition and the creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the anticipated price increase relative to what would otherwise have occurred in the market has to be both material, and ordinarily able to be sustained for a period of at least two years or such other time frame as may be appropriate in any give case.
9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening, of competition, these also have to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

10. The Commission applies a consistent analytical framework to all its clearance decisions. The first step the Commission takes is to determine the relevant market or markets. As acquisitions considered under s 66 are prospective, the Commission uses a forward-looking type of analysis to assess whether a lessening of competition is likely in the defined market(s). Hence, an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
 - with the acquisition in question (the factual); and
 - in the absence of the acquisition (the counterfactual).
11. The impact of the acquisition on competition is then viewed as the prospective difference in the extent of competition in the market between those two scenarios. The Commission analyses the extent of competition in each relevant market for both the factual and the counterfactual, in terms of:
 - Existing competition;
 - Potential competition; and
 - Other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Key Parties

Fulton Hogan Limited (Fulton Hogan)

12. Fulton Hogan is an unlisted public company based in Dunedin. Shell New Zealand Holding Company Limited is the largest shareholder of Fulton Hogan owning 36.7% of the shares. Fulton Hogan employs 3,450 people across 16 regions, with branch offices and depots situated throughout New Zealand.
13. Fulton Hogan is involved in a broad range of business activities, including road construction and surfacing; quarrying; highway maintenance for local and national government; and the production of asphalt, bitumen products and emulsion.
14. Fulton Hogan's total revenue from its road and general contracting operation over the 2005/06 period was [].

G J Beynon Limited (G J Beynon)

15. G J Beynon is a privately-owned company based in Greymouth. G J Beynon carries out bitumen surfacing work for Transit New Zealand, TLAs and other parties for roads, carparks and driveways, primarily in the Grey and Westland Districts of the West Coast of the South Island. It is also a quarry operator that produces and sells aggregates.

Westland Asphalt Limited (WAL)

16. WAL is a joint venture company currently owned by Fulton Hogan and two existing shareholders of G J Beynon. WAL manufactures and sells asphalt on the West Coast of the South Island.

Other Parties*Ferguson Brothers Industrial Division Limited (Ferguson)*

17. Ferguson is a privately-owned family business based on the West Coast of the South Island. Ferguson is involved in highway maintenance, road construction, pot-hole repairs, river protection, and aggregate crushing on the West Coast. Ferguson employs 75 people and has a turnover of approximately [] per annum.

Works Infrastructure Limited (Works)

18. Works is a division of Downer Group, which is an Australian listed company involved in engineering and infrastructure management. In New Zealand, Works is involved in the construction and engineering of roads, tunnels, bridges, hydro schemes, and electricity infrastructure.
19. Works employs 3,000 employees throughout New Zealand and generates annual sales of around [].

The Isaac Construction Company Limited (Isaacs)

20. Isaacs is a privately-owned business based in Christchurch. Isaacs is involved in road construction and resurfacing, as well as industrial and residential construction, primarily in the Canterbury region. Isaacs employs approximately 150 people.

Oldfields Asphalt Limited (Oldfields)

21. Oldfields is a privately-owned company based in Masterton. Its business activities include: civil construction; road maintenance and engineering; road construction; and the production of aggregate, ready-mixed concrete, cement, asphalt and bitumen surfacing.
22. Oldfields recently expanded its regional presence through the acquisition of Ross Asphalts, Richmond Readymix, and Peter Gibbons contractors in Nelson, and McCormick Asphalts in Wellington.

Blacktop Construction Limited (Blacktop)

23. Blacktop is a privately-owned company based in Hamilton that is involved in road maintenance, bitumen surfacing, construction and asphalt production. Blacktop operates in the upper North Island out of its Hamilton office, and in Otago and South Canterbury out of its recently established Timaru facility.

Transit New Zealand (Transit)

24. Transit operates and maintains the state highways in New Zealand. This role involves the management and oversight of construction, maintenance and resurfacing projects for 10,800km of state highway. Transit appoints external contractors to undertake road construction and maintenance. Transit has an annual budget of approximately \$1 billion, which is funded in full by Land Transport New Zealand.
25. Transit manages the state highway system as twenty-four separate network management areas, of which there are three on the West Coast:
 - Buller;
 - Central West Coast; and
 - Westland.

Buller District Council

26. The Buller District Council is responsible for building and maintaining all roads that are not state highways in the Buller region. This amounts to 580 km of road. The Buller District Council appoints external contractors to carry out construction and maintenance work on its roads and funding for the work is shared by the Buller District Council (through local rates) and Land Transport New Zealand, with the latter contributing [] of the costs.

Grey District Council

27. The Grey District Council is responsible for building and maintaining all roads that are not state highways in the Grey region. This amounts to 613 km of road. The Grey District Council appoints external contractors to carry out construction and maintenance work on its roads. Funding for the work is shared by the Grey District Council and Land Transport New Zealand, with Land Transport New Zealand contributing [] for maintenance projects and [] for road construction projects.

Westland District Council

28. The Westland District Council is responsible for building and maintaining all roads that are not state highways in the Buller region. This amounts to 632 km of road. The Westland District Council appoints external contractors to carry out construction and maintenance work on its roads. Funding for the work is shared by the Westland District Council and Land Transport New Zealand, with Land Transport New Zealand contributing [] of the costs.

INDUSTRY BACKGROUND

29. In New Zealand, roads are typically sealed with either a combination of bitumen and aggregate (chip seal), or asphalt. Concrete is sometimes used in urban areas where traffic levels are high.

Bitumen and Aggregate

30. Bitumen is black viscous material used in the construction of roads. Bitumen is derived from the distillation of crude oil, and has no close substitutes as an input into the road sealing process. Bitumen is typically sourced from supply tanks near major ports and transported in heated tankers to the road-sealing site.

Heated tankers are used to prevent the bitumen from cooling down en-route to the site and, as a result, becoming too thick to apply.

31. Aggregate is shingle or 'chip' made by crushing rock. Standard aggregate is used to form the base of a road. Road chip is the small, sharp edged rock, embedded on the top of the road. Road chip is processed aggregate that is shaped and sized specifically to suit the surface to which it will be applied. Road chip is between two and three times the price of standard aggregate.
32. Asphalt is produced by mixing bitumen and aggregate into a single mass.

Road Surfacing / Sealing

33. Resurfacing is the process of overlaying an existing road with a new surface using either chip seal or asphalt. Chip sealing involves spraying a road surface, either new or previously sealed, with hot bitumen and then spreading aggregate across the surface. As the bitumen cools, it solidifies, binding the aggregate to the surface of the road to form a tough, durable surface.
34. Asphalt laying involves mixing heated bitumen and aggregate to produce asphalt, then applying layers of asphalt to the surface. Asphalt is a higher value product than chip seal because it is more durable and quieter to drive on. Asphalt sealing is preferred in metropolitan areas where there is high traffic volume and noise reduction is important.
35. According to industry participants, asphalt sealing is approximately three times more expensive per square metre than chip sealing.
36. Chip seal and asphalt are also used for small scale jobs such as the sealing of driveways and car parks.

Tender process for road resurfacing contracts

37. Transit and Territorial Local Authorities (TLAs) are the main purchasers of road resurfacing services in New Zealand. Transit and local authority resurfacing contracts are tendered annually by Transit and by individual TLAs. Transit awards regional contracts for resurfacing sections of state highways. TLAs award contracts for the resurfacing of other publicly-owned roads within their respective regions.
38. Tenders are evaluated based on specific criteria chosen by Transit or the TLA. The criteria used for tender evaluation will depend on the requirements of the customer. There are two tender evaluation methods commonly used by Transit and TLAs:
 - The Price Quality Method considers a range of price and non-price attributes, and assigns a weighting to each. The bidder that scores highest over both price and non-price attributes wins the contract. Grey District Council and Westland District Council use this method when tendering resurfacing contracts.
 - The Lowest Price Conforming method (LPC) awards the contract to the lowest priced bidder. Transit and TLAs require that contractors register and pre-qualify in order to become eligible to bid for LPC tenders. In order to pre-qualify as an eligible bidder, a contractor must demonstrate that it is capable of carrying out the type of work for which it is bidding. Transit and Buller District Council use this method when tendering resurfacing contracts.

39. Transit and TLAs also tender road construction contracts on an ad-hoc basis. These contracts involve building roads and bridges, replacing sections of existing roads, and shape correction, which is the reconstruction of sections of road involving excavation, surface preparation, and sealing.

PREVIOUS COMMISSION DECISIONS

40. The Commission previously considered the road construction and maintenance industries in *Decision No. 322: Works Civil Construction / Bitumix, 1998*, under the former dominance threshold in the Act. Works Civil and Bitumix were both large national operators in the road construction and maintenance industry. Bitumix also supplied bitumen and asphalt to other road construction companies.
41. In that Decision, the Commission defined a market for the provision of road construction and maintenance services in New Zealand. The Commission considered that in the factual scenario the combined entity would be constrained by existing competition, as well as by the countervailing power of large customers (Transit and TLAs).
42. The Commission concluded that the proposed acquisition would not result, nor would be likely to result, in any person acquiring or strengthening a dominant position in the market for the provisioning of road construction and maintenance services in New Zealand.
43. The Commission considered the road construction industry again in *Investigation Report J4929: Fulton Hogan Predatory Pricing Allegation (2002)*. The investigation was initiated following the receipt of a complaint from a road construction business in [] alleging that Fulton Hogan had engaged in predatory pricing. The Complainant alleged that Fulton Hogan had submitted tender prices that were less than the cost of undertaking the work.
44. Fulton Hogan submitted that the supply of bitumen sealing works could be divided into major works (over \$150,000 in value) and small to medium works (less than \$150,000 in value). However, the Commission did not define the markets on this basis. Instead, it considered the markets for:
- the supply of asphalt sealing services in the South Island; and
 - the supply of chip sealing services in the South Island.
45. In that investigation, the Commission considered it likely that Fulton Hogan had a substantial degree of power in those markets, but considered that Fulton Hogan had not taken advantage of its market power.
46. More recently, in *Decision 513: Holcim (New Zealand) Limited/Atlas Resources Limited (2003)*, the Commission considered the Auckland market for quarrying, and the wholesale supply of aggregate for making ready-mixed concrete.
47. Holcim is a cement manufacturer that owns quarries and sells aggregate in the Auckland area. Atlas is a producer of ready-mixed concrete, sand, and aggregate, in the Auckland area.
48. The Commission defined a market for the wholesale supply of aggregate in Auckland. The Commission considered that existing competition would be likely to constrain the combined entity in the factual scenario, and that the acquisition would not be likely to have the effect of substantially lessening competition in any market.

MARKET DEFINITION

49. The Act defines a market as:⁵
- ... a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
50. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.
51. The Applicant submitted that the markets affected by the proposed acquisition are:
- chip sealing services for major contracts above \$150,000 in the South Island, but also New Zealand-wide (the major chip sealing market);
 - minor construction including asphalt and chip sealing services for small to medium contracts below \$150,000 on the West Coast of the South Island (including Westland, Grey and Buller Districts) (the minor construction and sealing market); and
 - quarrying and aggregate production on the West Coast of the South Island.

Product Dimension

52. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.
53. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
54. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

Road Resurfacing

55. Fulton Hogan and G J Beynon both provide chip sealing and asphalt laying services to Transit, TLAs, and various other customers (general contractors, schools, property developers, hospitals etc), although Transit and TLA contracts are typically larger works.
56. The Applicant submitted that a distinction should be made between chip sealing services for major contracts above \$150,000, and minor construction including asphalt and chip sealing services below \$150,000. The Commission considers that defining product markets using a monetary amount is arbitrary and is not consistent with the views of industry participants.

⁵ S 3(1) of the Commerce Act 1986.

57. The Commission considers that the scale of the work (and associated equipment) carried out in fulfilment of large resurfacing contracts is significantly greater than that involved when performing general sealing and paving jobs, such as driveways and car parks.
58. The value of Transit and TLA resurfacing contracts ranges from approximately \$500,000 up to \$2 million per annum. In order to undertake resurfacing work on this scale, an operator needs trucks, mechanical rollers, a loader (tractor with shovel), a large bitumen sprayer, and at least one bitumen tanker. While some of this equipment can be hired, bitumen sprayers of the size needed for these contracts are specialised machines, and cost approximately \$500,000 new. In addition, parties wishing to compete for contracts of this type need to have staff with expertise in large scale bitumen/asphalt sealing projects.
59. As a result, Transit and TLA resurfacing contracts typically attract operators that specialise in road resurfacing, rather than general contractors.
60. In contrast, general contracting and paving work typically does not involve the use of specialised equipment, nor the level of expertise required to undertake large scale resurfacing contracts. Rather, general contractors typically undertake relatively small-scale jobs, like the construction of driveways and footpaths that can typically be carried out without significant investment in plant or machinery. Larger jobs such as car parks and subdivisions may require equipment such as paving machinery, and cement trucks.
61. For example, participants informed the Commission that asphalt paving jobs of up to 100 square metres can be laid without large equipment, whereas asphalt paving machinery is required for a larger surface (such as a large service station forecourt). Industry participants note that the equipment necessary to undertake larger paving projects is not specialised, and can easily be purchased or hired.
62. As a result, general paving and contracting work can be undertaken by general contractors, builders, and landscapers as well as specialised roading contractors such as Fulton Hogan and G J Beynon, whereas, for the reasons discussed above, large-scale resurfacing services are typically provided only by specialised road resurfacing contractors.
63. Accordingly, the Commission considers that defining a separate product market that encompasses large-scale resurfacing work such as Transit and TLA contracts is appropriate for the purpose of this analysis.
64. Chip seal and asphalt are the two most common types of seal used in large-scale resurfacing works in New Zealand. In some cases concrete is used to build roads, particularly in high traffic areas and urban environments where the surface of the road is required to be more durable. However, the Applicant submitted that concrete is not a suitable substitute for chip seal or asphalt on the West Coast. The Commission agrees with this view, particularly given the low volume of traffic on the West Coast roads and the comparatively high price of concrete.
65. Industry participants advised the Commission that asphalt is approximately three times more expensive than chip seal (per square metre) but that it has different functional attributes that make it better suited for high traffic areas and urban environments. As noted previously, asphalt is a harder wearing material than chip seal and will therefore tend to last longer. Additionally, traffic travelling on an asphalt surface creates less road noise than traffic on a chip seal

surface. Accordingly, the type of material selected by Transit or the TLAs for a reseal will typically depend on the traffic volumes, and on the proximity of the reseal site to townships.

66. Industry participants advised the Commission that due to the low population density and low traffic volumes on the West Coast, most of the resurfacing carried out in the region is chip seal rather than asphalt.⁶ However, Dave Bates, National Operations Manager of Transit, noted that asphalt is occasionally used in town centres in the region, and on patches of road that are prone to significant wear.
67. The Commission acknowledges that chip sealing and asphalt laying are two distinct services that require different equipment and staff expertise. However, Transit and TLAs often bundle the asphalt laying and chip sealing services into a single annual resurfacing contract.
68. Some chip sealing contractors are not equipped to lay asphalt. For example, Mackley Ferguson, Manager of Ferguson, informed the Commission that Ferguson presently does not have the equipment or expertise to lay asphalt. Mr Ferguson noted that G J Beynon has an asphalt plant on the West Coast, and that Ferguson would not build an asphalt plant because there is not enough asphalt work on the West Coast to support a second plant. Therefore, Mr Ferguson advised the Commission that if it were to win a resurfacing contract that involved asphalt laying, it would sub-contract a third party to perform that work.
69. The Commission notes that other parties who have from time to time laid asphalt on the West Coast have transported the asphalt from Christchurch.
70. However, it is common for resurfacing contractors to provide both chip sealing services and asphalt laying services. For example, Fulton Hogan and Blacktop both provide chip sealing and asphalt laying services. The tendency of resurfacing contractors to provide both chip sealing and asphalt laying services indicates that a degree of supply-side substitutability exists between the provision of the respective services.
71. Accordingly, the Commission considers it appropriate for the purpose of this analysis to define a product market that includes both chip sealing and asphalt laying.
72. In addition to the annual resurfacing contracts, Transit and TLAs tender road construction contracts on an ad-hoc basis. These contracts involve building roads and bridges, replacing sections of existing roads, and shape correction work.
73. Road construction contracts typically attract general contracting businesses, such as Fulton Hogan and Works. Some general contractors are not set up for chip sealing or asphalt laying, so are required to sub-contract the sealing component of the project to a specialised bitumen sealer. For example, Coastal Contractors is a contractor based in Greymouth that carries out Transit and TLA road construction projects on the West Coast. Jeff Powell, Manager of Coastal Contractors, advised the Commission that Coastal Contractors is not set up to

⁶ Dave Bates (National Operations Manager of Transit) and Rob Daniels (Operations Manager of Westland District Council).

provide bitumen sealing, and that it usually sub-contracts the sealing component of the work to G J Beynon.

74. The Commission understands that there are approximately 12-15 road construction contracts issued by Transit and TLAs on the West Coast each year, and that the surfacing component of these contracts makes up only a small portion of the total value of the road construction contracts. Jeff Powell advised the Commission that the sealing component of road construction contracts on the West Coast would typically amount to one day's work, and be valued at between \$60,000 and \$100,000.
75. To some extent, Fulton Hogan and G J Beynon are in competition for these sealing sub-contracts when they arise. However, the Commission considers that any competition issues that would be likely to arise from the acquisition in respect of the sealing portion of these contracts would also be identified in a market that included the provision of resurfacing services. As such, the Commission does not consider it necessary to define or analyse a market specifically relating to the sealing portion of general road construction contracting.

General paving services

76. Fulton Hogan and GJ Beynon are both asphalt layers and chip sealers. Asphalt and chip seal are used in the construction of driveways, car parks, outdoor sports venues, subdivisions, and footpaths (general paving services).
77. As noted in the previous section, general paving services can be carried out by specialised road resurfacing contractors like Fulton Hogan, as well as by builders, landscapers, and general contractors.
78. Industry participants informed the Commission that there are a range of materials that can be used in this type of construction, including concrete paving and pre-cast concrete blocks.
79. For certain types of construction, a particular type of material may better serve the requirements of the customer. For example, Rob Daniel of Westland District Council advised the Commission that asphalt is a good product for resurfacing worn chip seal footpaths. However, Mr Daniel noted that if the price of asphalt were to increase, Westland district would have a number of other options for resurfacing the footpath, including concrete or a fine chip seal.
80. The Commission considers that customers would be likely to switch from asphalt to other materials, such as chip seal or concrete, in response to an increase in the price of asphalt, for general paving work.
81. Consequently, it is appropriate to define a market for general paving services that includes asphalt, chip seal, and concrete paving.

Conclusion on Product Market

82. The Commission concludes that for the purpose of assessing the competition implications of the proposed acquisition, the appropriate product markets are those for:
 - road resurfacing (includes chip sealing and asphalt laying services); and
 - general paving.

Geographic Dimension

83. The Commission defines the geographic dimension of a market to include all of the relevant, spatially dispersed sources of supply to which buyers would turn should the prices of local sources of supply be raised.

Resurfacing Services

84. The Applicant argued that the geographic market for chip sealing services is primarily the South Island, but also New Zealand-wide.
85. In reaching this conclusion, the Applicant submitted that there has been a trend for North Island contractors to enter the South Island market by bidding for and winning major chip sealing contracts. The Applicant referred to Blacktop, Heb Contractors Limited (Heb) and Oldfield as examples of North Island contractors who had entered the South Island.
86. However, the Commission understands that Blacktop, Heb, and Oldfield all have bases in the South Island, and typically undertake work in proximity to their respective bases. They therefore cannot be considered as only North Island operators.
87. Industry participants have informed the Commission that it is advantageous, but not essential, for a contractor carrying out resurfacing work to have a business branch in the vicinity of the work site⁷.
88. The scale of the resurfacing work carried out on the West Coast is small compared with neighbouring regions, and requires only short-term employment of resurfacing crews and equipment during the summer season. For this reason, contractors such as Fulton Hogan and Works do not have resurfacing equipment and personnel permanently based in the West Coast. Fulton Hogan and Works both have branches on the West Coast, but those branches are not equipped to carry out resurfacing work.
89. In the last 5 years, the only resurfacing division located permanently on the West Coast has been G J Beynon's. Fulton Hogan does not have a resurfacing division permanently on the West Coast. Instead, it has sent crews and equipment from its Nelson, Marlborough, Christchurch, Dunedin, and Invercargill branches to service its resurfacing contracts on the West Coast. Works has serviced its West Coast contracts out of Christchurch, Nelson, Blenheim, Marlborough, Dunedin, Invercargill, and Alexandra. In carrying out the resurfacing work on the West Coast, Fulton Hogan or Works will typically team up their specialised resurfacing crew from the larger branch outside of the West Coast with its general contracting unit on the West Coast.
90. Industry participants have informed the Commission that having a local operational branch (not necessarily a resurfacing division) near the work site helps to maximise the productivity of the resurfacing crew. Resurfacing crews that are working a long way from their operational branch can be left idle when wet weather prevents resurfacing work from being carried out. This problem is particularly relevant on the West Coast where rainy conditions are prevalent. If the reseal site is located near the resurfacing team's operational branch, the team can be reallocated to other tasks during rainy weather, such as aggregate crushing or general contracting work.

⁷ David Faulkner, Fulton Hogan; and Brett Beagley, Works Infrastructure.

91. Having an operational branch near the reseal site helps the supplier to take advantage of small gaps in the bad weather, which means they have to rely less on long spells of good weather to undertake work.
92. Having a local presence can also reduce the costs associated with board, travel, and cartage. However, these costs are often unavoidable on the West Coast due to its geographical remoteness and relative vastness. Resurfacing sites on the West Coast are often located a long way from any contractor's depot, including those contractors located in other parts of the West Coast.
93. Oldfields advised the Commission that
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94. Isaacs reported that
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95. The Commission considers that for the purposes of the present Application, the relevant competition effects are best identified by defining the geographic market as the West Coast, rather than the South Island, on the basis that if no competition concerns are identified within the narrowly defined market, they are unlikely to arise in a more broadly defined market.

General Paving Services

96. General paving services are typically smaller in scale and of lower value than Transit and TLA resurfacing contracts. For this reason it is unlikely that contractors based outside of the West Coast region would compete for the majority of general paving jobs on the West Coast.
97. Large-scale general paving services on the West Coast have occasionally been provided by operators from outside of the area. For example, a recent tanker park development at the Westland Milk Products dairy facility in Hokitika was serviced by a contractor from Christchurch. However, the Commission considers that most general paving jobs on the West Coast are not large enough to attract contractors from outside the West Coast region.
98. Therefore, the Commission considers it appropriate to define a West Coast geographic market in respect of general paving services.

Functional Dimension

99. The Commission considers that in this instance, the functional dimension of the relevant markets is the provision of services.

Temporal Market

100. In respect of general paving services, competition occurs on a day-to-day basis, as contracts are advertised or sought by buyers.
101. Competition for resurfacing contracts occurs annually when Transit and the TLAs call for tenders. Resurfacing is typically carried out in the dryer seasons because asphalt and chip seal cannot be applied in wet weather. Due to the wet and volatile weather conditions on the West Coast, the seasonal window within which resurfacing work can be carried out is limited to the period between

October and March. West Coast annual contracts are usually tendered and awarded by Transit and TLAs between June and December for that period.

102. Accordingly, the Commission will assess the competition effects when competition occurs, namely, at each annual tender round.

Conclusion on Market Definition

103. The Commission concludes that the relevant markets for the purpose of analysing the proposed acquisition are those for:
- the provision of road resurfacing services on the West Coast of the South Island (“road resurfacing services market”); and
 - the provision of general paving services on the West Coast of the South Island (“general paving services market”).

COUNTERFACTUAL AND FACTUAL

104. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgement considering the likely outcomes between two hypothetical situations, one with the acquisition (the factual) and one without (counterfactual).⁸ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

105. In the factual scenario, Fulton Hogan would acquire the contracting assets, quarry and land of G J Beynon. Therefore, G J Beynon would cease to compete for road resurfacing contracts, and would no longer provide general paving services, on the West Coast.

Counterfactual

106. G J Beynon is a long-standing family business. Jack Beynon, part-owner and Manager of G J Beynon, advised the Commission that the joint owners of G J Beynon want to retire, and therefore wish to sell the business.

107. [

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108. The Commission does not consider it necessary to determine which of the possible purchasers is likely to acquire GJ Beynon in the counterfactual scenario. Rather, the Commission considers it sufficient for the purposes of this analysis to draw the general conclusion that one of the potential purchasers outlined above would be likely to acquire GJ Beynon in the counterfactual scenario.

⁸ *Air New Zealand & Qantas Airways Ltd v Commerce Commission (No.6)*, unreported HC Auckland, CIV 2003 404 6590, Hansen J and KM Vautier, Para 42.

COMPETITION ANALYSIS

Road Resurfacing Services Market

Introduction

109. In a typical market, where transactions occur (effectively) on a continuous basis, ideas like “entry” and “existing competitors” have conventional meanings. A feature of the market in this case is the periodic contests for single-provider contracts. This means that an important part of competition will be ‘for’ the market at the time of the contracting round, rather than ‘in’ the market. In this scenario, it could be argued that the only relevant point at which competition occurs is when Transit and the TLAs request bids for the next round of contracts for the provision of resurfacing services.
110. At this point, it seems that all potential providers, including the present incumbents, become “potential competitors” bidding for the provision of the services. Two considerations follow from this realisation. First, the Commission’s standard analysis of “existing competition” and “potential competition” should be abandoned, and instead the analysis of competition should be conducted within a "bidding market" framework. Here the focus is on identifying the likely bidders for future contracts, and on the extent of competition these bidders would provide in the factual and the counterfactual scenarios.
111. Secondly, the assessment of the extent of the competition to be expected from different bidders must include an assessment of their costs relative to those of the present contract holders. It may be that the incumbents have a cost advantage over other possible bidders, for a range of reasons relating to: incumbency; familiarity with the customer's requirements; having a West Coast base; access to lower cost local materials; and the like. If that were the case, they might not be constrained as to price by the presence of higher cost bidders. Although costs are difficult to assess directly, inferences can be made by reference to presence or absence of bids, actual bidding patterns and a firm's ability to supply in what is a remotely located market.
112. A further consideration in this case is the potential countervailing power of the buyers - Transit and the TLAs.

Current Competitors

113. Five West Coast contracts are tendered each year. Transit tenders two West Coast resurfacing contracts each year: the Transit Northern and Central West Coast contract covers the Buller region and the top part of the Grey region; and the Southern contract covers the bottom half of the Grey region and the Westland region. In addition, the Buller, Grey and Westland District Councils each tender a resurfacing contract on an annual basis.
114. The results of the Transit and West Coast TLA resurfacing contracts for the 2006/07 season are presented below in Table 1.

Table 1: West Coast Resurfacing Contracts 2006/07

Company	No. of contracts	Value (\$)
G J Beynon	3	[]
Fulton Hogan	1	[]
<i>Combined Entity</i>	4	[]
Blacktop	1	[]
Total	5	[]

115. Table 1 shows that, presently, Fulton Hogan, G J Beynon and Blacktop hold resurfacing contracts on the West Coast of the South Island.
116. The 2006/07 Northern and Central West Coast contract was valued at approximately [], and was won by Fulton Hogan for the third consecutive year. [] also bid for this contract.
117. The 2006/07 South West Coast contract was valued at [], and was won by G J Beynon for the third consecutive year. [].
118. The 2006/07 Buller District Council contract was valued at [], and was won by Blacktop, with [] also placing bids. Fulton Hogan won this contract in each of the five years preceding this tender. This is the first year that Blacktop bid for a resurfacing contract on the West Coast.
119. The 2006/07 Grey District Council contract was valued at [], and was won by G J Beynon for the sixth consecutive year.
[]
[]
120. The 2006/07 Westland District Council contract was valued at [], and was won by G J Beynon for the fifth consecutive year. [] also placed bids for this contract. Ferguson bid price was not considered because the bid failed to meet the non-price attribute requirements of the tender.
121. Overall, it should be noted in 2006/07 that there were five bidders, but only three won contracts. Hence, the figures in Table 1 do not provide a satisfactory indicator of competition, given that the market is a “winner takes all” bidding market

Current and Historical Bidding Patterns

122. Table 2 below provides a more detailed historical account of tender results on the West Coast.
123. Table 3 below provides a historical account of tender results on the West Coast using an index scale, where the winner’s bid equals 100. This shows the degree to which unsuccessful bidders bid too high.

Table 2: Current and Historical Bidding Information

	Transit Northern & Central WC		Transit Southern WC		Buller District Council		Grey District Council		Westland District Council	
	Bidders	\$	Bidders	\$	Bidders	\$	Bidders	\$	Bidders	\$
2001/02					Fulton Hogan	[]	GJ Beynon	[]	Works	[]
					GJ Beynon	[]	Fulton Hogan	[]	GJ Beynon	[]
									Road Ex	[]
									Fulton Hogan	[]
2002/03					Fulton Hogan	[]	GJ Beynon	[]	GJ Beynon	[]
					Road Ex	[]	Fulton Hogan	[]	Road Ex	[]
							Road Ex	[]	Fulton Hogan	[]
2003/04					Fulton Hogan	[]	GJ Beynon	[]	GJ Beynon	[]
					GJ Beynon	[]	Fulton Hogan	[]	Fulton Hogan	[]
					Works	[]				
2004/05	Fulton Hogan	[]	GJ Beynon	[]	Fulton Hogan	[]	GJ Beynon	[]	GJ Beynon	[]
	GJ Beynon	[]	Fulton Hogan	[]	GJ Beynon	[]			Fulton Hogan	[]
	Works	[]			Works	[]				
2005/06	Fulton Hogan	[]	GJ Beynon	[]	Fulton Hogan	[]	GJ Beynon	[]	GJ Beynon	[]
	GJ Beynon	[]	Fulton Hogan	[]	Oldfields	[]	Fulton Hogan	[]	Fulton Hogan	[]
	Works	[]			Works	[]				
	Oldfields	[]			GJ Beynon	[]				
2006/07	Fulton Hogan	[]	GJ Beynon	[]	Blacktop	[]	GJ Beynon	[]	GJ Beynon	[]
	GJ Beynon	[]	Fulton Hogan	[]	Works	[]	Blacktop	[]	Works	[]
	Works	[]			Fulton Hogan	[]	Ferguson	[]	Ferguson	[]

Note: Winning bidder is highlighted

Table 3: Index Scale of Current and Historical Bidding Information

	Transit Northern & Central WC		Transit Southern WC		Buller District Council		Grey District Council		Westland District Council	
	Bidders	Index	Bidders	Index	Bidders	Index	Bidders	Index	Bidders	Index
2001/02					Fulton Hogan	100	GJ Beynon	100	Works	100
					GJ Beynon	[]	Fulton Hogan	[]	GJ Beynon	[]
									Road Ex	[]
									Fulton Hogan	[]
2002/03					Fulton Hogan	100	GJ Beynon	100	GJ Beynon	100
					Road Ex	[]	Road Ex	[]	Road Ex	[]
							Fulton Hogan	[]	Fulton Hogan	[]
2003/04					Fulton Hogan	100	GJ Beynon	100	GJ Beynon	100
					GJ Beynon	[]	Fulton Hogan	[]	Fulton Hogan	[]
					Works	[]				
2004/05	Fulton Hogan	100	GJ Beynon	100	Fulton Hogan	100	GJ Beynon	100	GJ Beynon	100
	GJ Beynon	[]	Fulton Hogan	[]	GJ Beynon	[]			Fulton Hogan	[]
	Works	[]			Works	[]				
2005/06	Fulton Hogan	100	GJ Beynon	100	Fulton Hogan	100	GJ Beynon	100	GJ Beynon	100
	GJ Beynon	[]	Fulton Hogan	[]	Oldfields	[]	Fulton Hogan	[]	Fulton Hogan	[]
	Works	[]			Works	[]				
	Oldfields	[]			GJ Beynon	[]				
2006/07	Fulton Hogan	100	GJ Beynon	100	Blacktop	100	GJ Beynon	100	GJ Beynon	100
	GJ Beynon	[]	Fulton Hogan	[]	Works	[]	Blacktop	[]	Works	[]
	Works	[]			Fulton Hogan	[]	Ferguson	[]	Ferguson	[]

Note: Winning bidder is highlighted

124. Table 2 shows the results of the two Transit contracts over the last three years and it also shows the results of the Buller, Grey and Westland District Councils' contracts over the last six years.
125. Table 2 shows that in the last three years of Transit contracts and the last 6 years of local authority contracts, with the exception of two tenders out of 24, the incumbent operator won the tender.
126. In general, G J Beynon was the incumbent in the Transit Southern contract, Grey District Council contract and the Westland District Council contract, except in 2001/02 when Works won the Westland District Council contract. Fulton Hogan was the incumbent in the Transit Northern contract and the Buller District Council contract, except for 2006/07 when Blacktop won the Buller District Council contract.
127. From Table 3 it would appear that Fulton Hogan has a cost advantage over other operators when bidding for the northern contracts. For example, Fulton Hogan has won the Transit Northern contract for the last three years, and the next closest bid has been at least [] Fulton Hogan's bid.
128. The same applies to G J Beynon; it appears to have a cost advantage over other operators when bidding for the southern contracts. For example, G J Beynon has won the Transit Southern contract for the last three years, and the next closest bid has been at least [] G J Beynon's bid.
129. From the information in Tables 2 and 3, it would appear that in the past, Fulton Hogan and G J Beynon have both had a cost advantage over other operators when bidding for resurfacing contracts on the West Coast. However, the evidence from the 2006/07 tender shows that this may no longer be the case. Blacktop was successful in winning the Buller District Council Contract and placed a lower bid for the Grey District Council contract, but lost to G J Beynon, because it scored lower than G J Beynon on non-price attributes. Ferguson has also emerged as a bidder and Works has consistently bid for contracts on the West Coast []. These operators, along with others, are considered as potential bidders and are described below.

Potential Bidders

130. The Commission has identified the following parties as potential bidders for contracts in the resurfacing market on the West Coast:
- Fulton Hogan/G J Beynon (Combined Entity);
 - Blacktop;
 - Ferguson;
 - Works Infrastructure;
 - Oldfields; and
 - Isaacs.

Requirements to Bid

131. The Commission has identified a number of requirements that potential bidders need to meet when attempting to win resurfacing contracts on the West Coast. These requirements are: non-price attributes; establishing a local base or transporting equipment to the West Coast; equipment and staffing and access to bitumen supply. The Commission considers that these requirements would be

more readily met by some providers than others, and that the burden of the requirements varies between different bidders. The discussion that follows provides an elaboration on the ability of each potential bidder to meet the following requirements:

Non-price Attribute Requirements

132. As well as price, bidders are graded on the non-price attributes of their bids. In order to be eligible to win a Transit or TLA contract, a service provider must demonstrate that it has the relevant expertise and equipment required to complete the contract. The extent to which non-price attribute requirements will pose a barrier to potential bidders placing a competitive bid depends on the tender evaluation method adopted by Transit or the TLA.
133. The Price Quality Method (PQM) assesses the bids on price and non-price attributes, weighted 70% on price and 30% on non-price attributes. Non-price attributes include experience, track record, technical skills, management skills and methodology. The bidder that scores highest over both price and non-price attributes wins the contract. Under the PQM a bidder may offer the lowest price, but still fail to win the contract if it has scored relatively poorly on non-price attributes.
134. A bidder who is given an unfavourable rating for non-price attributes may be disadvantaged under this tender evaluation method. For example, a new entrant may have met the minimum non-price attribute standards, but have only limited experience in chip sealing. Under the PQM, this bidder may be required to bid at a significantly lower price than existing competitors in order to win a contract. This occurred in the tender for the [] resurfacing contract, where [] would have had to have priced [] below G J Beynon in order to win the contract.
135. The Lowest Price Conforming method (LPC) awards the contract to the lowest priced bidder. However, Transit and TLAs require that contractors register and pre-qualify in order to become eligible to bid for LPC tenders. In order to pre-qualify as an eligible bidder, a contractor must demonstrate that it is capable of carrying out the type of work for which it is bidding.
136. Under the LPC method, once a bidder has pre-qualified, it becomes eligible to compete on a 'lowest price wins' basis with current competitors.
137. At present Grey and Westland District Councils use the PQM method when tendering resurfacing contracts, and Transit and the Buller District Council use the LPC method.
138. Peter Connors of Transit advised the Commission that the track record requirement can be difficult for new entrants. This is particularly the case for Transit resurfacing contracts, where the pre-qualification standard is set higher than for TLA resurfacing contracts. Mr Connors advised the Commission that because Transit resurfacing projects are of a larger scale than TLA projects, Transit typically expects bidders to have successfully completed TLA contracts to demonstrate their ability to undertake resurfacing work of a significant scale.
139. An implication of this is that experienced bidders may be able roughly to assess the 'mark down' on less experienced potential bidders, and so lift their bids accordingly.

Establishing a Local Base or Transporting Equipment to the West Coast

140. In order to carry out a resurfacing contract on the West Coast, a successful bidder will face costs associated with either transporting its equipment and staff to the West Coast, or with setting up a permanent base in the region. Having a local presence can reduce the costs associated with servicing resurfacing contracts, such as the costs of board, travel, and cartage. In most cases these costs cannot be avoided completely on the West Coast due to the remoteness and vastness of the region.
141. Other costs that can be avoided by having a local base include higher costs that may occur when resurfacing crews are geographically isolated from their operational branch. For example, a resurfacing crew can be left idle when wet weather prevents resurfacing work from being carried out. In previous years, [] after wet weather delayed the completion of resurfacing work.⁹ If a contractor has a local branch, the resurfacing crew can be reallocated to other tasks, such as general contracting work during rainy weather.
142. Having an operational branch near the reseal site also helps the contractor to take advantage of small gaps in the bad weather, and therefore rely less on long spells of good weather to undertake work.
143. David Faulkner, Managing Director of Fulton Hogan, considered that in order to undertake a resurfacing job on the West Coast, a business would need access to three 7.5m trucks, two rollers, a loader, a sprayer, and a tanker. Mr Faulkner noted that all of these vehicles can be hired, with the exception of the bitumen sprayer. Mr Faulkner advised the Commission that it would cost [] to set up a greenfield operation on the West Coast. This would include land, plant, equipment, staff, and initial losses incurred in establishing the business.
144. Simon Everett, Managing director of Blacktop, advised the Commission that a minimum capital expenditure of [] would be required in order to compete for Transit and TLA resurfacing contracts.
145. The Commission considers that the cost of setting up a local base depends on the facilities and equipment at the base. For example, G J Beynon's multi-site operational base in Greymouth is equipped for various activities, including quarrying and aggregate crushing, asphalt production, chip sealing and asphalt laying. In contrast, Works' West Coast base is only equipped for providing maintenance and general contracting services.
146. The upfront cost of establishing a self-sufficient resurfacing unit (such as that operated by G J Beynon) is likely to be high relative to the costs associated with setting up a small local base (such as that operated by Works). However, parties that service resurfacing contracts without local access to a chip sealing and asphalt laying crew will be required to transport personnel and equipment from outside of the region to service the contract.

Equipment and Staffing Requirements

147. In order to compete for a resurfacing contract, an operator needs access to trucks, mechanical rollers, a loader (tractor with shovel), a large bitumen sprayer, and at least one bitumen tanker (preferably two). While some of the

⁹ [].

equipment can be hired, bitumen sprayers of the size needed for these contracts are specialised machines, and a new one costs approximately \$500,000.

148. Additionally, in order to compete for these contracts, a contractor needs to have staff with expertise in large scale bitumen/asphalt sealing projects.
149. As noted above, Fulton Hogan advised the Commission that it would cost [] to set up a greenfield operation to service the West Coast contracts. This estimate provides an indication of the costs associated with meeting the equipment and staffing requirements to compete for contracts on the West Coast.

Access to Bitumen Supply

150. Bitumen is a core ingredient in the resurfacing process. Industry participants advised the Commission that Transit's resurfacing contracts on the West Coast typically require approximately 300,000 litres of bitumen, or 12 truck tanker loads (although this will vary depending on the size of the contract).¹⁰
151. In the past, Shell and BP have been the major suppliers of bitumen. Recently, road surfacing contractors such as Works and Oldfields have begun importing bitumen directly from overseas suppliers, rather than purchasing domestically from Shell or BP. Works (through its subsidiary BSL) and Oldfields are now suppliers of bitumen in the South Island.
152. Bitumen is shipped to the South Island through the Ports of Nelson, Lyttelton, and Timaru.

Conclusion on Requirements to Bid

153. While the requirements exist under both the factual and the counterfactual scenarios, they impact on market participants to greater or lesser extent. Some operators may find these requirements insurmountable, whereas others may overcome them more readily. The Commission has assessed the effect of the requirements outlined above in relation to each potential bidder identified. The impact of requirements on potential bidders is described below.

Impact of requirements on potential bidders

154. The Commission has assessed the impact of requirements on the following potential bidders:
- Fulton Hogan/GJ Beynon (Combined Entity);
 - Blacktop;
 - Ferguson;
 - Works Infrastructure;
 - Oldfields; and
 - Isaacs.

Combined Entity

155. The Commission considers that in the factual scenario Fulton Hogan would acquire G J Beynon and consolidate the land, assets and quarry of G J Beynon into its West Coast operations.

¹⁰ Jack Beynon of G J Beynon.

156. The combined entity has already met the requirements of competing for resurfacing contracts. As noted earlier, the two have won nearly all of the West Coast contracts in recent years.
157. G J Beynon has a reputation as being a high-quality resurfacing contractor on the West Coast, with an exceptional quality record. Industry participants advised the Commission that G J Beynon scores highly on non-price attributes because of its track record on the West Coast.¹¹
158. Similarly, Fulton Hogan also has a reputation as being a high quality resurfacing contractor on the West Coast, and scores highly on non-price attributes.¹²
159. Fulton Hogan and G J Beynon both have the necessary equipment and personnel in place to compete in the market for the provision of chip sealing and asphalt laying services on the West Coast.
160. Fulton Hogan is a nationwide roading contractor with a maintenance branch set up on the West Coast. It has traditionally bid for West Coast resurfacing contracts from outside the West Coast because its local branch is not equipped to provide resurfacing services. Fulton Hogan has managed to compete successfully for two out of the five resurfacing contracts on the West Coast despite facing the costs associated with transporting its resurfacing machinery and crew from outside of the region.
161. G J Beynon is a long-standing West Coast contractor with a locally-based surfacing division.
162. Fulton Hogan has a contract with Shell for the supply of bitumen. It is also an on-seller of bitumen and has bitumen supply tanks in Christchurch, Nelson, and Alexandra, from which it transports bitumen to the West Coast in tanker trucks. Despite regularly carrying out resurfacing work on the West Coast, Fulton Hogan has not considered it necessary to install a permanent bitumen supply tanker on the West Coast.
163. G J Beynon also sources its bitumen from Shell through the Port of Lyttelton, but has a supply tank on the West Coast. G J Beynon transports bitumen overland from the Port of Lyttelton to its supply tank on the West Coast.
164. The Commission considers that the combined entity would be well placed to compete for large scale resurfacing contracts on the West Coast under the factual. In particular, the combined entity would be an established road resurfacing operator on the West Coast that has met all the requirements to compete for Transit and TLA contracts, and has a very strong track record in competing for West Coast resurfacing contracts. For instance, between G J Beynon and Fulton Hogan, presently, they have four of the five road surfacing contracts on the West Coast, and in two previous years, they have had all five.

Blacktop

165. Blacktop is a North Island-based road resurfacing contractor that has in recent years undertaken Transit and TLA resurfacing contracts in the South Island. Blacktop began competing for resurfacing contracts in the South Island after setting up Delta Corporation (Delta), a bitumen supply business with facilities located at the Port of Tauranga and the Port of Timaru. Delta was established in

¹¹ Westland District Council.

¹² Peter Conners, Transit New Zealand.

1999 as a joint venture between Blacktop, Island Asphalt, and Ashburton Contracting Limited (ACL).

166. According to Simon Everett, Managing Director of Blacktop, Delta was set up because Blacktop and Island Asphalt were unable to buy bitumen from the existing North Island suppliers at a competitive price. Delta bypasses New Zealand suppliers by purchasing bitumen directly from overseas suppliers.
167. Blacktop sends a resurfacing division to the South Island from its Auckland base during the summer months to carry out resurfacing contracts. In the past Blacktop has typically bid for contracts on the east coast of the South Island.
168. In 2006,
[
]. This was the first time Blacktop had bid for contracts on the West Coast.
169. [

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170. Blacktop is a pre-qualified resurfacing contractor for LPC contracts, and therefore has met the non-price attribute requirements necessary to compete for resurfacing contracts.
[

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171. However, once Blacktop has completed the 2006/07 Buller District Council Contract, it will have developed a track record on the West Coast, and will be better placed to compete on non-price attributes for PQM contracts in the future.
172. Blacktop is an established operator and already has the staff and equipment required to carry out resurfacing work on the West Coast. However, it does not have a branch on the West Coast, and, therefore, is required to incur the costs associated with transporting equipment and staff to the West Coast to carry out resurfacing work.
[

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173. Simon Everett noted that servicing the 2006/07 Buller District Council resurfacing contract will give Blacktop an idea of the costs associated with resurfacing on the West Coast out of its base in Timaru.
174. [

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175. However, Blacktop informed the Commission that
[

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176. The Commission recognises that, while Blacktop has demonstrated that it can bid competitively for resurfacing contracts on the West Coast,
[
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Ferguson

177. Ferguson is an established road maintenance and construction operator on the West Coast.

178. Ferguson first placed a bid for the 2006/07 Westland resurfacing contract, but failed on non-price terms because it was unable to demonstrate that it had the technical expertise necessary to undertake the sealing project.

179. [
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180. [
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181. Ferguson is principally involved in highway maintenance through the Southern and Central Transit contracts that it currently holds (the contracts expire in 2009). In fulfilling these maintenance contracts, Ferguson is sometimes required to do small amounts of sealing work. In the past, Ferguson has sub-contracted G J Beynon to do this work because Ferguson was not equipped to carry out sealing work.

182. Recently, Ferguson has acquired chip sealing equipment
[
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183. Mackley Ferguson, Manager of Ferguson, informed the Commission that
[

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184. [

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185. [

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186. Ferguson is located in Hokitika on the West Coast. Consequently, it will not face the costs associated with establishing a local base. Brett Beagley of Works Infrastructure advised the Commission that,

[

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187. Ferguson has recently demonstrated its ability to meet TLA quality requirements (in meeting the quality requirements to compete for the 2006/07 Grey District Council resurfacing contract). However, the Commission notes that it was unsuccessful in its bid.

188. [

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189. The Commission recognises that Ferguson has invested in the equipment required to compete for resurfacing contracts, and has []. These actions demonstrate Ferguson's intention to continue bidding for large scale resurfacing contracts on the West Coast.

190. [

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Works Infrastructure (Works)

191. Works has bid for West Coast resurfacing contracts on a number of occasions in previous years, although in many cases []. Works has not won a resurfacing contract on the West Coast since 2001.

[

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192. [

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193. Brett Beagley informed the Commission that

[

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194. Despite this,
[
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195. Brett Beagley noted that Works recently won a five year slurry sealing contract¹³ on the West Coast with Transit, and that having this contract means that Works has more personnel and equipment based in the area. [
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196. Works is a pre-qualified resurfacing contractor, and therefore has met the non-price attribute requirements necessary to compete for resurfacing contracts.
[
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197. Works is a large national operator and already has the staff and equipment required to carry out resurfacing work. However, although Works has the necessary resources it may not have capacity to use its resources on the West Coast.
198. Works has road maintenance contracting branches located in Greymouth and Westport, but does not have a resurfacing division on the West Coast. In the past Works has undertaken resurfacing contracts on the West Coast from its Dunedin, Nelson and Invercargill branches. Brett Beagley of Works informed the Commission that in the past the costs faced by Works in transporting equipment and staff to the West Coast for resurfacing contracts have been no different to those faced by Fulton Hogan.
199. [
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200. The Commission considers it likely that Works will continue to compete for large-scale resurfacing contracts on the West Coast. Works has met the requirements to compete for Transit and TLA contracts.
201. [
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Oldfields

202. Oldfields is a North Island road sealing contractor that has recently set up an operational branch in Nelson. In Nelson, Oldfields is sub-contracted to carry out resurfacing work for Heb over the next five years as part of Heb's

¹³ Slurry is a low cost form of asphalt that is used to fill in potholes and indentations in the road.

maintenance contract. Oldfields also has asphaltting contracts in Nelson and Tasman.

203. Oldfields placed a bid for the 2005/06 Buller District Council resurfacing contract and priced within [] of the winning bid. []
204. In 2006, Oldfields bid for the Northern West Coast Transit resurfacing contract and the Buller District Council resurfacing contract. Oldfield's bid price for the Transit contract was [] than Fulton Hogan's winning bid of []. However, its bid price for the Buller contract was [].
205. Andrew Murphy informed the Commission that []
- []
206. []
- []
207. Oldfields is an established and pre-qualified resurfacing contractor, and therefore has met the non-price attribute requirements necessary to compete for resurfacing contracts. If it establishes its second resurfacing crew, it would have sufficient staff and the equipment required to carry out resurfacing work on the West Coast.
208. As Oldfields does not have a branch on the West Coast, it must incur the costs associated with transporting equipment and staff to the area to carry out resurfacing work. []
- []
209. []
- []
210. Oldfields purchases bitumen from Shell out of the Fulton Hogan supply tank at the Port of Nelson and transports the bitumen in a tanker to its own 50,000 litre storage tank in Nelson. Andrew Murphy of Oldfields advised the Commission that Fulton Hogan charges Oldfields a port handling fee that is twice as high as what Oldfields pays elsewhere.
211. Mr Murphy said that if Oldfields were to bid for the resurfacing contracts in Westland, it would source its bitumen directly from Shell in Christchurch and tanker it over to the West Coast.

212. The Commission considers that the competitive constraint provided by Oldfields would depend on its willingness to compete for contracts on the West Coast. Oldfields indicated to the Commission that it would typically []].

Isaacs

213. Isaacs is a road sealing contractor based in Christchurch. Isaacs is an established operator performing resurfacing contracts in the greater Canterbury region.
214. Isaacs is a pre-qualified resurfacing contractor, and therefore has met the non-price attribute requirements necessary to compete for resurfacing contracts. It is an established operator and has the staff and equipment required to carry out resurfacing work. Isaacs does not have a branch on the West Coast, and would therefore have to bear the costs associated with transporting equipment and staff to the West Coast to carry out resurfacing work.

215. []

- []
216. Grant Bonniface suggested that []

217. []

- []
218. []

Conclusion on Potential Bidders

219. The Commission has assessed the ability of potential bidders to satisfy the conditions required to bid successfully for the Transit and TLA resurfacing contracts on the West Coast and therefore, their respective ability to provide effective competition to the merged entity in the factual scenario.
220. The Commission recognises that the degree of competitive constraint provided by each of the potential bidders is dependent on their ability and willingness to compete for contracts. The Commission considers that each of the potential bidders assessed would likely face higher costs than the combined entity for resurfacing contracts on the West Coast.
221. Of the potential bidders assessed, the Commission considers that, in the factual scenario, []

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222. The Commission considers that, in the factual scenario,
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223. In the past,
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224. [

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225. Because of
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226. The Commission concludes that in the factual scenario, the combined entity would be a strong bidder with an incumbent advantage in almost all of the West Coast regions.
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Countervailing Power

227. In some circumstances the potential for the combined entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition.

228. The major customers of resurfacing services on the West Coast are Transit, Buller District Council, Grey District Council, and the Westland District Council.

229. The Applicant submitted that post-acquisition, the countervailing power of Transit in particular, and to a lesser extent the TLAs, would continue to provide a degree of constraint on the combined entity.

Transit

230. Transit is a national purchaser of road construction and resurfacing services, and is therefore well placed to monitor contract pricing and input costs related to resurfacing contracts.

231. Transit has a methodology for estimating the likely price of a contract. The price estimation methodology has been put in place to ensure that Transit personnel are aware of pricing trends, and in particular of changes in the underlying costs of road surfacing over time.

232. Transit's Central Office distributes costing and pricing information to its regional branches (as well as to TLAs) on a monthly basis, which each office then feeds into the price estimates. As a result of this process, Transit

employees are well placed to assess the competitiveness of bids for contracts being administered.

233. Using the methodology described above, Transit typically estimates the price of a contract before it is sent out. In cases where the bids received are priced significantly higher than expected, Transit can reject bids or explore the reasons behind the high prices.
234. Peter Connors, Operations Manager for the Southern Zone of Transit advised the Commission that it has various ways of exerting countervailing power when tendering resurfacing contracts. These methods are described below.

Redesigning Tenders

235. Peter Connors advised the Commission that it designs resurfacing contracts in such a way that promotes competition. For example, a contract can be designed to suit the largest number of potential bidders, or to encourage bids from small parties or new entrants. This may be done by:
- Varying the timing of the tender – timing the tender in such a way that will suit, and therefore attract, the maximum number of bidders. For example, Transit can issue its request for tender early in the year, before the potential bidders have committed their resources to other contracts. Alternatively, if necessary Transit can delay tenders until there is more competition in the market.
 - Varying the length of contracts – varying the duration of the contract depending on the preference of potential bidders. For example, bidders may prefer the security of longer term contracts, particularly where significant sunk costs are involved in servicing the contract.
 - Grouping resurfacing contracts together / or splitting them apart - Peter Connors noted that typically a region of comparable size to the West Coast would be covered by a single reseal contract, in order to attract bids from large South Island firms. However, Transit has in recent years issued two separate contracts on the West Coast in order to protect G J Beynon. Transit thought that G J Beynon would be better positioned to compete with large South Island operators if the region were split into two separate contracts.
 - Grouping resurfacing contracts with maintenance contracts (creating ‘Hybrid Contracts’) - Transit frequently amalgamates its maintenance contracts with its resurfacing contracts in order to attract more competitive bids.

Rejecting bids

236. Transit can reject bids, and re-tender a resurfacing contract at a later date. Alternatively, in order to foster entry from smaller operators, Transit could reduce the size of the contract if it wished.

Encouraging new entrants

237. Peter Connors advised the Commission that Transit is aware that it must have a choice of providers in order to be able to exert any countervailing power over bidders for its contracts. He stated that Transit can spur the entry of new firms into the resurfacing market by tendering smaller, one-off (entry level) surfacing projects that give smaller contractors a chance to gain experience in surfacing.

238. Once the smaller contractors have gained some experience in surfacing, Transit can pre-qualify the small contractors as accredited resurfacing contractors and then encourage them to tender for the annual resurfacing contracts. Peter Connors noted that a similar strategy was used to encourage Ferguson to compete for maintenance contracts on the West Coast.

Negotiating with the winning bidder

239. Where there is only one bid received for a contract, Transit may attempt to renegotiate a price with the bidder in order to get a better price. This may involve meeting with the bidder to discuss any risks that the bidder has factored into its pricing of the contract.
240. If Transit considers that risk to be overstated, it may offer to change the contract in order to reduce the risk, in return for a reduction in the price. For example, the bidder might be averse to the risk of delays in obtaining resource consents, which might result in the bidder failing to meet the deadline for completion of the work, and deem the bidder liable for liquidated damages. Transit may not think this risk exists, so may relax the liquidated damages clause in return for the bidder reducing its price.
241. Peter Connors advised the Commission that Transit would consider redesigning the West Coast contracts in the following ways if Fulton Hogan were to acquire G J Beynon:
- tendering a single contract for the West Coast (rather than separate Northern and Southern resurfacing contracts);
 - tendering for longer term contracts; and
 - combining reseal contracts with maintenance contracts to form 'hybrid contracts'.
242. Transit intends to take into account the size and capabilities of potential bidders before changing the design of the contracts. For example, if there were no longer a local operator competing for resurfacing contracts on the West Coast, Transit would consider redesigning the contracts in such a way as to attract competitive bids from operators outside of the West Coast.
243. However, Transit is aware that Ferguson has purchased resurfacing equipment and is now bidding for resurfacing contracts on the West Coast. Transit intends to take Ferguson into consideration before changing the design of the contracts. Peter Connors noted that Transit would uphold its current contract design if a local operator such as Ferguson expressed interest in competing for resurfacing work on the West Coast.
244. Industry participants advised the Commission that Transit could tailor contracts to suit particular bidders. For example,
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245. Similarly,
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246. [

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247. Transit has tendered hybrid contracts in other areas of the South Island, in order to attract more competitive bids. Works has just won a hybrid contract in Canterbury, where it was competing with Fulton Hogan.

[

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248. The Commission considers that in the factual scenario, Transit would retain the ability to design its tenders in such a way as to encourage bids from smaller operators in the West Coast region. It would also have the ability to attract bids from other large South Island-based sealing operators by combining contracts if it desired. The strategy it adopts would depend on the available capacity of the various operators. Such ability is likely to provide a degree of constraint on the combined entity.

TLAs

249. Buller, Grey and Westland District Councils are the other major purchasers of road resurfacing services on the West Coast. The countervailing power of the TLAs is dependent on them having a choice of providers.

250. In 2006 the Buller, Grey and Westland District Councils

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251. Two of the District Councils, Grey and Westland advised the Commission that they considered that the acquisition of G J Beynon by Fulton Hogan would encourage other parties to bid for resurfacing contracts on the West Coast.

252. The Commission considers it likely that the Buller, Grey and Westland District Councils would have a choice of providers under the factual scenario, although their bids may not always be competitive.

253. TLAs have various ways of exerting countervailing power when tendering West Coast resurfacing contracts. The methods employed by the TLAs are similar to those used by Transit. Rob Daniels of Westland District Council advised the Commission that Westland District Council redesigns tenders where necessary to stimulate competition, rejects bids, and times tenders to maximise the number of bidders.

254. Dave Evans of the Grey District Council noted that Grey District Council can re-tender if prices received are too high. Alternatively, they can carry work over to the next period.

255. TLAs can also tender contracts earlier in the season before potential bidders have committed their resources to other contracts.

[

] In particular,

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Conclusion on Countervailing Power

256. The Commission notes that the smaller size of the TLA contracts could be too small to attract bids from larger operators from outside of the West Coast region. To this extent, the Commission considers that while having a degree of countervailing power through their ability to redesign their contracts, it is likely to be less than that of Transit, which has larger contracts.

Conclusion on the Road Resurfacing Market

257. The Commission concludes that:

- the merged entity would likely be constrained to some extent by a number of potential bidders;
- Transit has a degree of countervailing power through its ability to alter the terms of its large contracts in order to promote competition; and
- TLAs also have a degree of countervailing power; albeit to a lesser extent than Transit.

258. Accordingly, the Commission considers that the proposed acquisition is unlikely to give rise to a substantial lessening of competition in the market for the provision of resurfacing services on the West Coast of the South Island.

General Paving Services Market

259. There are a large number of competitors capable of carrying out general paving work on the West Coast. These include general contractors, builders, and landscapers, as well as sealing contractors such as Oldfields, Ferguson, Coastal Contractors, and Westroads.

260. Given the number of participants in this market, the Commission considers that the proposed acquisition would give rise to minimal aggregation, such that the acquisition is unlikely to give rise to a substantial lessening of competition. Therefore, the Commission does not intend to consider this market further.

OVERALL CONCLUSION

261. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the markets for:

- the provision of resurfacing services on the West Coast of the South Island; and
- the provision of general paving services on the West Coast of the South Island.

262. The Commission considers that under the factual scenario, G J Beynon would be acquired by Fulton Hogan, and that the combined entity would compete against other potential bidders for resurfacing contracts, and in the provision of general paving services on the West Coast.
263. The Commission considers that under the counterfactual, G J Beynon would be acquired by another potential bidder, which would compete against Fulton Hogan, and the other potential bidders for resurfacing contracts and in the provision of general paving services.
264. The Commission considers that the acquisition of G J Beynon by Fulton Hogan is likely to encourage potential bidders to bid more frequently, and perhaps more competitively, for resurfacing contracts on the West Coast. The Commission acknowledges that the potential bidders have not, to date, been regular bidders for resurfacing contracts on the West Coast. However, the Commission considers that the aggregate effect of the potential bidders identified will act to constrain, to some degree, the combined entity in the market for the provision of resurfacing surfaces on the West Coast.
265. The Commission considers that the requirements for entry into the market – in terms of being able to bid - for the provision of resurfacing services on the West Coast of the South Island vary between firms. However, the Commission is of the view that there are sufficient potential bidders for whom the barriers to entry or expansion are not excessive. In addition, the Commission considers that the acquisition will not significantly impact on the countervailing power of Transit and the TLAs.
266. On balance, the Commission considers that:
- the merged entity would likely be constrained to some degree by a number of potential bidders;
 - Transit has a degree of countervailing power through its ability to alter the terms of its contracts in order to promote competition; and
 - TLAs also have a degree of countervailing power, albeit to a lesser extent than Transit.
267. The Commission concludes that, on balance, the proposed acquisition is unlikely to give rise to a substantial lessening of competition in either of the markets for:
- the provision of resurfacing services on the West Coast of the South Island, and
 - the provision of general paving services on the West Coast of the South Island.

DETERMINATION ON NOTICE OF CLEARANCE

268. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition by Fulton Hogan of the assets, quarry, and land of G J Beynon.

Dated this 19th day of December 2006

David Caygill
Deputy Chair