Public Version
ISSN NO. 0114-2720
12170

COMMERCE COMMISSION

Decision No. 696

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

TOMARATA SAND LIMITED

and

COASTAL RESOURCES LIMITED

The Commission:	Dr Mark Berry Sue Begg
Summary of Application:	The acquisition by Tomarata Sand Limited of the assets and business of Coastal Resources Limited relating to sand mining operations at Tomarata.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give a clearance to the proposed acquisition.
Date of Determination:	25 June 2010

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EXECUTIVE SUMMARY

E1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 13 April 2010. The Notice sought clearance by Tomarata Sand Limited (Tomarata Sand or the Applicant) to acquire the assets and business of Coastal Resources Limited (Coastal Resources) relating to its sand mining operations at Tomarata in Northland.

E2. Both the Applicant and Coastal Resources supply sand, which is predominately used as an ingredient in the manufacture of ready-mix concrete. The Applicant supplies its sand from a property at Ruakaka while Coastal Resources supplies its sand from a quarry near Tomarata. Both supply sand to customers in the Northland region.

E3. The Commission found that the cost of transportation is one of the most important factors in the supply of sand, as the ‘delivered’ price of sand can be up to twice the cost of the sand itself. Therefore, most customers prefer to source sand from their nearest supplier. This tends to limit the degree to which sand suppliers in different locations, such as Ruakaka, Tomarata, Dargaville or Helensville, actually compete with one another.

E4. However, the Commission found that, in Northland, it is feasible to source sand from different locations especially when the sand is able to be transported as part of a backload. In this respect, the Commission’s assessment indicated that sand from as far south as Helensville could be supplied in sufficient quantities to compete with the likes of the Applicant or Coastal Resources, who are located further north.

E5. Accordingly, the Commission considers the relevant market to be the market for the extraction and wholesale supply of sand in the Northland region (the Northland sand market).

E6. The proposed acquisition would, however, remove one of the few remaining sand suppliers in the Northland sand market.

E7. The Commission found that most customers in the Northland region are based around Whangarei. Until recently, there were two relatively large sand suppliers in the immediate vicinity of Whangarei: Lakeside Business Park Limited; and Semenoff Sands Limited. To this extent, there was little need for Whangarei-based customers to source sand from other suppliers in the market, such as those in Helensville.

E8. This is no longer the case and Coastal Resources is the next closest supplier to Whangarei. However, both Atlas Concrete Limited and Winstone Aggregates Limited at Helensville have significant spare capacity to supply the Northland sand market including those customers in Whangarei, if required. While the availability of backloads will vary, the Commission considers that there would be sufficient opportunity for customers in the market to obtain Helensville sand for a backload rate and that this would provide a competitive constraint on the combined entity.

E9. While each of the remaining competitors in the market would only provide a limited or minimal constraint, the Commission considers that when taken together, it is likely that customers in the market would have economically competitive alternatives to the combined entity.

E10. Accordingly, the Commission considers that, on balance, existing competition is likely to provide a sufficient competitive constraint on the combined entity, post-acquisition.

E11. This is important because the Commission is of the view that de novo entry is unlikely to occur within a one to two year timeframe to an extent that would be sufficient to constrain the combined entity.

E12. In addition to the constraint from existing competition, the Commission also considered that ready-mix manufacturers would have a degree of countervailing power which would serve to provide constraint to the combined entity through their ability to either self supply or by fostering the expansion of existing competitors.

E13. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any market.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 13 April 2010. The Notice sought clearance by Tomarata Sand Limited (Tomarata Sand or the Applicant) to acquire the assets and business of Coastal Resources Limited (Coastal Resources) relating to its sand mining operations at Tomarata in Northland.

PROCEDURE

2. 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. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 25 June 2010.

3. 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

4. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is 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 application. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.[2]

5. 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]

6. In determining whether there is a change along the spectrum which 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 of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

7. 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

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[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 Limited v Commerce Commission* (2004) 11 TCLR 347, 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.

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.

8. 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

9. 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).

10. 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 scenarios, in terms of:

   - existing competition;
   - potential competition; and
   - other competition factors, such as the countervailing market power of buyers or suppliers.

THE PARTIES

Tomarata Sand Limited

11. Tomarata Sand Limited is a recently formed company owned by Stan Semenoff. Mr Semenoff, through his various sand companies, has been supplying sand in the Northland area since the late 1970s and of the existing sand suppliers in the region, has been established the longest.

12. In the past, Mr Semenoff through his company Semenoff Sand Supplies Limited (Semenoff Sands) supplied sand from a land-based resource at Uretiti; 40 kilometres south of Whangarei. More recently, Mr Semenoff entered into an agreement with Lakeside Business Park Limited[5] (Lakeside) and now all sand extracted by Semenoff Sands is sourced from Lakeside's site in Ruakaka, approximately seven kilometres north of Uretiti.

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[5] Pursuant to section 27 of the Act, the Commission undertook an investigation into this agreement and concluded on 27 January 2010 that the agreement was unlikely to have had the effect of substantially lessening competition in a market.

13. Mr Semenoff is the current mayor of Whangarei and also a director of:

    - Kaipara Water Transport Limited (KWT) which also supplies sand; and
    - Stan Semenoff Transport Limited which is a transportation company.

Coastal Resources Limited

14. Coastal Resources operates an on-shore sand plant based at Tomarata. Tomarata is approximately 25 kilometres north-east of Wellsford or approximately a half hour drive from State Highway One.

15. Coastal Resources' parent company is Kaipara Limited. Kaipara Limited has a number of interests including commercial property around Beachlands, east of Auckland, as well as a number of aggregate quarries in various parts of New Zealand.

16. Coastal Resources has been supplying sand from the Tomarata site for many years. Up until 2005, Coastal Resources was a joint venture between Kaipara Limited and Holcim Limited, a concrete and aggregates company. The joint venture disbanded with Kaipara Limited taking over full ownership of the company although a [ ] supply agreement for sand was signed between Holcim and Coastal Resources. [ ].

OTHER INDUSTRY PARTIES

Kaipara Water Transport Limited

17. KWT is a sand supplier based in Dargaville which dredges sand from the Kaipara Harbour.

18. KWT has essentially three main shareholders. Maurice Eyles holds a 50% shareholding and, as Managing Director, is responsible for the day-to-day operations of the company. Mr Semenoff holds a 25% shareholding and Fletcher Concrete and Infrastructure Limited (KWT's major customer) holds the remaining 25% shareholding.

John Keith

19. John Keith has been supplying sand from his Ruakaka property for a number of years and he is the sole director of Lakeside. Through Lakeside, John Keith recently entered into an agreement with Mr Semenoff under which Lakeside extracts and processes sand for Mr Semenoff who then sells the sand to end-customers.

20. Separate to the agreement between Lakeside and Mr Semenoff, John Keith also supplies sand to Atlas Concrete Limited (Atlas). This sand is from a different section of John Keith's property and falls outside the above agreement.

Other sand suppliers

21. There are a number of other sand suppliers with a presence in the Northland region. These include:

    - McCallum Bros Limited (McCallum) which operates an offshore sand operation off the coast of Pakiri near Tomarata. At present, McCallum extracts the sand from the sea bed and transports the sand by barge down to Auckland for unloading;

- Winstone Aggregates Limited (Winstone) supplies sand from the Kaipara Harbour and unloads this sand at its Helensville site; and
- Atlas also extracts and supplies sand from the Kaipara Harbour which it unloads at its Mt Rex site, near Helensville.

Customers

22. Sand is a key component of ready-mix concrete and so the main customers of sand suppliers are concrete suppliers. The main concrete suppliers in the Northland area include:
    - Firth Industries Limited (Firth). Firth is an operating division of Fletcher Building Limited (Fletcher);
    - Atlas;
    - Allied Concrete Limited (Allied);
    - Virgin Concrete Limited (Virgin Concrete); and
    - Wharehine Construction Limited (Wharehine).

ASSOCIATION

23. A preliminary question the Commission must determine is whether the Applicant is associated with any other parties in the industry. Section 47(1) of the Act refers to an acquisition by a person, where person is defined as including two or more persons that are associated under section 47(2).
24. Sections 47(3) and (4) stipulate that two or more persons are associated if one, either directly or indirectly, is able to exert a substantial degree of influence over the activities of the other. The Commission is of the view that, in this context, a substantial degree of influence means being able to bring real pressure to bear on the decision making process of the other.
25. In coming to a view on association, the Commission must consider each case on its particular facts. Among the factors the Commission usually takes into account in determining association are the:
    - nature and extent of ownership links between the companies;
    - presence of overlapping directorships;
    - rights of one company to appoint directors of another; and
    - nature of other shareholder agreements and links between the companies concerned.
26. The Commission also considers the interaction between these various factors. For example, the Commission assesses the nature and extent of the communications between those persons, and the apparent influence of one person on the key strategic decisions of the other.[6] The question the

[6] *Commerce Commission Decision 388: New Zealand Seafood Investments Ltd / Basuto Investments Ltd*, 23 March 2000, Para's 16 – 24.

Commission has to answer is whether two enterprises can, for the purposes of commerce and competition, be regarded as one.[7]

27. As noted above Mr Semenoff is a director and 25% shareholder in KWT, a sand supplier based in Dargaville. He is one of three directors of the company. The other shareholders are Morrie Eyles (50%[8]) who takes care of day to day operations and Fletcher (25%) who is KWT's major customer. The Commission understands that Mr Semenoff also backloads sand from KWT in Dargaville to Fletcher's Firth operations in Whangarei.

28. The Commission canvassed industry participants in respect of the relationship between Mr Semenoff and the competitive constraint provided by KWT. Various industry parties advised that KWT was not prominent in the industry and that KWT tends not to compete to any great extent. Several parties suggested this was, in part, due to Mr Semenoff's shareholding in KWT.

29. Historically, approximately [ ] of sand extracted by KWT is supplied to Fletcher, either for the Firth plant in Dargaville or for the Firth plant in Whangarei. Mr Eyles, Managing Director, KWT advised the Commission that generally he is not approached by sand purchasers shopping around.

30. More recently, Virgin Concrete, a new concrete supplier (and therefore a potential new sand customer), entered the ready-mix industry and its entry was discussed at a KWT board meeting on 27 November 2008. [ ]

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31. [

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32. In April 2010, Virgin Concrete advised the Commission that there has been a change in its purchasing arrangements and it is now purchasing sand from Mr Semenoff. [

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33. However, the sand Mr Semenoff supplies to Virgin is sourced from KWT. [

], the Commission understands that Mr Semenoff is acquiring the KWT sand himself and then on-selling to Virgin Concrete.

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[7] *Commerce Commission Decision 278: Air New Zealand Ltd / Ansett Holdings Ltd/Bodas Pty Ltd,* 3 April 1996, especially paras 180 – 182.

[8] The Commission notes that Mr Eyle's 50% shareholding is split between himself and his son, Wayne Eyles.

34. The Commission is of the view that these circumstances suggest a close relationship between the actions of Mr Semenoff, Director, KWT and those of Mr Semenoff, Owner, Semenoff Sands and Tomarata Sand.

Assessment on Association

35. Having taken the relevant factors into account, it appears that Mr Semenoff is able to bring real pressure to bear on the decision making process at KWT. In addition, the Commission has found no evidence that KWT and Mr Semenoff's sand operations compete to any extent. Therefore, the Commission concludes that Mr Semenoff is likely to have a substantial degree of influence over KWT.

36. Accordingly, for the purposes of the present application, the Commission will proceed on the basis that the Applicant and KWT are associated parties.

PREVIOUS INVESTIGATION

37. In January 2010, the Commission completed an investigation into whether an agreement between Semenoff Sand Supplies Limited and Lakeside Business Park Limited was likely to contravene s27 of the Act (the Lakeside Investigation).

38. The Lakeside Investigation concluded that the arrangement did not have the purpose, effect or likely effect of substantially lessening competition. Primarily, this was because the Commission considered that a degree of competitive constraint remained in the relevant market.

39. In particular, the Commission emphasised the constraint offered by Coastal Resources and its quarry at Tomarata. The Commission considered that Coastal Resources offers a competitive constraint on other sand suppliers through:
    - its presence as an existing sand supplier in the market, such as its present supply to Wharehine; and
    - its ability to expand its presence in the market, given an incentive to do so.

40. The Lakeside Investigation also noted that any further consolidation in the industry would likely dampen the competitive constraint that existed in the industry. The present application is now considering this issue.

MARKET DEFINITION

41. The Act defines a market as:[9]

    > 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.

42. 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

[9] Section 3(1A) of the Act.

Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product Market

43. 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. The degree of demand-side substitutability is influenced by the extent of product differentiation.

44. 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.

45. 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.

46. Sand is primarily used as a fine aggregate in the production of ready-mix concrete and other cement based products used in construction. Sand can be mined from land and it can also be extracted from the seabed.

47. Land based sand operations dig sand out of the ground using a digger. The sand is then processed through a plant that removes impurities and screens it to ensure it is of a consistent grade. Land based sand operations produce washed and windblown[10] sand. Washed sand is washed to make it suitable for use in the manufacture of concrete. Windblown sand is suitable for a range of uses such as fill, and is processed to a lesser extent than washed sand.

48. Sand can also be extracted from the seabed using a suction pump (sea sand). The sand is then barged to a port for loading onto trucks for delivery to customers. The process of extracting the sand from the seabed removes the need for the washing process that land based sand requires.

49. Industry participants advised the Commission that land-extracted sand and sea sand are generally substitutable for one another. One of the key criteria for customers is the grade of sand, which refers to the fineness of the sand, rather than whether it is land or sea sand.

50. The Commission understands that sand is a relatively homogeneous product. Some suppliers try to differentiate their product on various non-price factors such as colour or grade. While this differentiation may be sufficient to limit demand substitution within a project, it will be insufficient to stop substitution between different projects. Therefore, the Commission considers such differentiation is not sufficient to affect the product market definition in this instance.

51. Also some suppliers provide speciality sand for places such as golf courses, equestrian arenas and playgrounds, for which they charge a premium. The Commission understands that the volume of such speciality sands is negligible compared to the level of sand used for ready-mix concrete and in the construction industry.

[10] Windblown sand is also referred to as unwashed sand.

Conclusion on Product Market

52. The Commission considers that for the purposes of examining the proposed acquisition, it is appropriate to include washed, windblown and sea sand within the same product market.

Functional Market

53. Sand is sourced in most instances from natural deposits from which it is extracted, processed and then sold to end-users. Accordingly, the relevant functional level of the market is that for the extraction and wholesale supply of sand.

Geographic Market

54. The Commission defines the geographical extent of a market to include all of the relevant, spatially dispersed sources of supply to which buyers can turn should the prices of local sources of supply be raised. For each good or service combination, the overlapping geographic areas in which the parties operate are identified. These form initial markets to which a SSNIP test is applied. Adjacent geographic regions are also considered for inclusion in the relevant geographic market, within which the hypothetical monopolist could profitably impose a SSNIP.

55. Industry participants advised the Commission that the Northland region is unusual due to its geography, population, location and transportation requirements. It is a long narrow peninsula with almost half its population based in rural areas. Road transport is the main means of moving freight.

56. A recent study highlighted how transport in the Northland region differs from other parts of the country. The study noted that aggregates (which include sand) generally need to be locally sourced and are only transported short distances, although it specifically noted that the Northland region was quite different with aggregates routinely transported over long distances.[11]

57. The Commission understands that the cost of transportation is one of the most important factors in the supply of sand. This is because the ‘delivered’ price for sand in Northland, which would include the sand and transport cost, can, in some cases, be more than twice the cost of the sand itself. Industry participants noted that most customers have a preference to source sand from their nearest supplier.

58. The Applicant submitted that the relevant market(s) for sand from Coastal Resources is predominantly defined by the Auckland market for sand and supplies. The Applicant estimated that [ ] of the sand Coastal Resources extracts is delivered to customers in the Auckland region with [ ] supplied to customers within the immediate geographical area of the Tomarata quarry.

59. Industry participants advised that there are a number of sand suppliers to the Auckland region, including Coastal Resources. The Applicant advised that [ ]. Accordingly, the Commission will not consider supply in the Auckland region any further.

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[11] See National Freight Demands Study, Richard Paling Consulting, September 2008.

60. The Applicant submitted that the relevant geographic market for sand in the Northland region extends from Kaitaia in the north to Helensville in the south. Other sand quarries and suppliers within this region are:

- Winstone, in Helensville;
- Atlas, in Helensville;
- Coastal Resources, near Tomarata;
- KWT, in Dargaville;
- John Keith, in Ruakaka; and
- McCallum, which extracts sand offshore from Tomarata.

61. The locations of these parties are indicated on the map in Appendix A. The Applicant submitted that the relevant market overlaps in the region between Whangarei and Auckland. This is because transportation costs are a significant factor in the price for sand such that it is generally going to be the case that the nearest supply point will be the cheapest. In this respect, Tomarata and Helensville-based suppliers of sand will not, generally, be competitive with Whangarei/Ruakaka sourced sand for Whangarei customers. Conversely, Whangarei/Ruakaka sand will not generally be competitive with Tomarata or Helensville sand in Auckland.

62. The Commission notes that apart from Atlas and Winstone, which are both located in Helensville, each of the above suppliers are based in different locations. In this respect, it is likely that no two sand suppliers are likely to be perfect substitutes for a given customer.

63. Each customer is likely to have a preference to buy from one supplier over another, because of the locations of the sand quarries relative to its own location. This suggests that a given sand supplier may possess a degree of market power – it can raise the price above marginal cost and still retain a substantial proportion of its customers – although its ability to do so would be limited by the presence of other sand suppliers offering close substitutes (which will depend on the proximity of competing sand suppliers and the extent of transport costs).

64. As a result, the most distant sand supplier might not, in a practical sense, be considered a suitable substitute for the local sand customer. However, market boundaries can be difficult to delineate in a geographically differentiated market: an overly narrowly defined market may exclude significant substitutes; on the other hand, an overly broad market may overlook the differing degrees of constraint offered by close and less close substitutes.

65. McCallum extracts sand from an offshore source with a dredge and barge and sends all its sand to Auckland. The option of McCallum supplying Whangarei was investigated in the Lakeside Investigation. In that instance, the Commission found that [

] Accordingly, the Commission considers that McCallum is not a feasible supply option for customers in Northland region.

66. When discussing the relationship between sand supply and transportation, industry participants emphasised the importance of backload/backhaul.

Backload is the return of the carrier to the original point or area from which it began. Typically backload transportation rates are offered at lower rates than the headhaul rates. Transportation companies wish to secure backload transportation wherever possible to ensure they do not incur the costs of trucks returning empty. Ideally, sand customers want to have their sand transported at backload rates wherever possible to reduce the cost of the transportation of sand.

67. A number of transportation companies advised the Commission that demand for all types of goods in the Northland region is relatively low which means that, in general, there are not large numbers of trucks transporting goods from Auckland to Whangarei. Therefore, there is limited opportunity to backload sand from Whangarei to Auckland. However, this is not the case in the other direction as there are significant amounts of goods being transported from Northland to the Auckland region. In addition, the recent economic downturn has meant that many transport companies are actively seeking out backloads from sand suppliers.

68. Industry participants such as [ ] advised that backload rates can be as low as [ ] of the headhaul rate. The Commission canvassed various industry parties to assess the most appropriate transportation rates. From the data received, the Commission considers [ ] cents per cubic metre of sand per kilometre (c/m^3/km) to be the average headhaul target rate[12]. Using this headhaul rate, the Commission calculated the backload rate of [ ] c/m^3/km (i.e. [ ] of headhaul rate). This figure is consistent with the examples of backload rates provided to the Commission by industry participants.

69. In addition, the Commission understands that the backload rate can be actually lower. For example, [ ]. The [ ] trucks are well suited to cart sand and [ ] indicated that it would transport Helensville-sourced sand to Whangarei for [ ]

Whangarei

70. The Applicant submitted that the competitiveness of the Whangarei (and north of Whangarei) regions will not be affected by the proposed acquisition. The Applicant also contended that Helensville sand sources are in the same market as both Coastal Resources and the Whangarei sand sources.

71. In order to assess these two propositions, the Commission constructed a simple distance model in conjunction with a Critical Loss Analysis[13].

72. For the distance model, the Commission used the following costs obtained from industry participants, namely:

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[12] [ ] indicated that the competitive price for headhaul rate had some flexibility and that it could go as low as [ ].

[13] The use of critical loss analysis was first suggested by Barry C. Harris and Joseph J. Simons, "Focusing Market Definition: How Much Substitution is Necessary?" Research in Law and Economics, v. 12, 1989, p.207-226. Since it was proposed, it has appeared in numerous White Papers presented to the antitrust agencies, numerous pre-trial affidavits, and expert testimony offered on behalf of antitrust defendants.

- [ ] per m^3 for sand;
- a headhaul rate of [ ] $c/m^3/km$;
- a backload rate of [ ] $c/m^3/km$; and
- a backload rate of [ ] per m^3 when used for the Helensville sourced sand.

73. The Commission assessed this data to determine the degree of constraint that each geographical source of sand would have on a hypothetical monopolist in the Whangarei region. Figures 1, 2, 3 and 4 below show the relationship between price (vertical axis) and the percentage of backload rates (horizontal axis). The percentage of backload rates determines the cost of total supply given that a certain percentage of that supply is delivered as a backload. For example, if the backload rate is 20%, then the total cost of sand will be made up from 80% of the cost of sand delivered at full freight cost, plus the 20% cost of sand delivered at backload rates. [

Figure 1: Sand Supply to Whangarei Under SSNIP at Ruakaka

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74. Figure 1 indicates that the sand sources that offer any competitive constraint on Semenoff Sands (should a 10% SSNIP be imposed at Ruakaka[14]) in Whangarei are:

- KWT at a [ ] backload rate; and
- Coastal Resources at a backload rate above [ ].

[14] [

]

75. This analysis suggests that Helensville sand is unlikely to compete with a 10% price rise at Ruakaka, under the assumed freight conditions, [ ].

76. The Commission understands that [ ] Figure 2 below shows these [ ] under a SSNIP.[15]

77. Figure 2 indicates that all alternative sources of sand are competitive for these [ ] utilising backload freight rates where appropriate and available. [

Figure 2: Sand Supply to Whangarei, [], Under SSNIP at Ruakaka

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78. In the Lakeside Investigation, the Commission noted that there was sand supply coming from Winstone Helensville to Virgin Concrete (near Whangarei) utilising backhaul on chip liners previously bringing woodchip from Northland to Auckland. [ ]

79. [ ]

80. With that in mind, the Commission modelled a scenario of price conditions where all the competing sand sources lower their prices to [ ] in response to a

[15] [ ].

SSNIP at Ruakaka.[16] The results are illustrated in Figure 3 below. The assumptions about freight costs hold from the first scenario.

81. In this scenario, Helensville supply is an option for sand users in Whangarei when faced by a SSNIP (even at the lower SSNIP of 5%) at Ruakaka, albeit at very high backload percentages. This is represented in Figure 3. The cut-off point for sand prices at Helensville where they can compete in the Whangarei region given a 10% SSNIP on the price of sand is [ ]. [

Figure 3: Sand Supply to Whangarei Under SSNIP at Ruakaka

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82. The Commission found evidence that transportation companies in the region would be both willing and physically able to provide regular backloads from Helensville to Whangarei. For example, [ ] advised that backloads are available anytime from Helensville to Whangarei. Accordingly, the Commission considers that backload rates in the order of [ ] seem reasonably likely, putting sand sourced from Helensville into direct competition with Whangarei-based sand suppliers.

83. As Helensville is further away from Whangarei than Tomarata, Tomarata would have a lower backload percentage to be feasible. Therefore, the Commission considers Tomarata may potentially be part of a Whangarei sand market.

84. However, the Commission was unable to find any consistent evidence of transport companies offering regular backloads from Tomarata to Whangarei. Several suggested that Tomarata was too far from the main highway for backloading to be a viable option. In addition, any truck offering a backload to Tomarata on a return trip from Auckland would likely have to travel empty from Auckland to Tomarata and this would be factored into any backload rate charged. These factors bring into doubt the feasibility of Tomarata as a source of sand for the Whangarei region.

[16] The SSNIP prices were calculated on a base price of [ ].

85. In the Commission's view, an alternative supply does not need to fully replace a hypothetical monopolist to be a constraint on any price increase; it merely has to be able to offer enough supply to render any price increase unprofitable. The percentage that must be taken from any supplier to render a price increase unprofitable depends on both the size of the price increase and the margin above variable cost that the supplier gets per unit sold. This percentage is calculated using a Critical Loss Analysis and is called the Critical Diversion Ratio (CDR).

86. The CDR, as the name implies, is the amount of a good that must be diverted to another seller in the market to make a price rise unprofitable. The conventional method for calculating a CDR is to divide the SSNIP percentage by the sum of the SSNIP percentage and the margin above the variable cost (as a percentage of price).[17]

87. This calculation requires the assumption of a linear demand relationship. The Commission considers this assumption to be realistic within the small price range of a SSNIP.

88. Table 1 shows the CDRs with different contributing margins and SSNIP percentages, given the assumption of linear demand.

Table 1: Critical Diversion Ratios

Margin	CDR from a 10% Price Increase[18]	CDR from a 5% Price Increase[19]
10%	[ ]	[ ]
20%	[ ]	[ ]
30%	[ ]	[ ]
40%	[ ]	[ ]
50%	[ ]	[ ]
60%	[ ]	[ ]
70%	[ ]	[ ]
80%	[ ]	[ ]
90%	[ ]	[ ]

Source: Commission estimates.

89. Industry participants, including [ ], suggested that the appropriate contributing margin in the sand industry is approximately [ ] (for land based extraction). If the above table is used and the margin is [ ] then the CDR range is between [ ] for a 10% price increase in the price of sand, which translates to a [ ] increase on the price of delivered sand and [ ] for a

[17] CDR = s /(s + m); Where the "m" is "Unit Contribution Margin Ratio" which is equal to the margin above the variable cost of production divided by the price of the good, and s is the SSNIP (5% - 10%).

[18] The 10% price increase on sand represents a [ ] increase (on average) on the delivered price, given the freight component on the delivered price of sand.

[19] The 5% price increase on sand represents a [ ] increase (on average) on the delivered price, given the freight component on the delivered price of sand.

5% SSNIP on sand, which translates to a [ ] increase on the price of delivered sand.

90. In this respect, if the combined entity were to increase its prices by 5%-10%, any advantages from this price increase would be negated if it lost between [ ] of its sales.

91. Accordingly, the Commission considers that the actual amount of sand that must be obtained from an alternative supply to make the SSNIP unprofitable for Semenoff Sands at Ruakaka is approximately [ ] of its total volumes, or approximately [ ], when compared to the 2009/10 year.

92. The Commission notes alternative sand sources would offer enough of a constraint to render a SSNIP unprofitable, given that [ ] of the Semenoff customers are contestable, due to [ ].

93. The Commission also notes that if the Applicant, post acquisition, were to price discriminate, only raising the price on the lower priced customers, that these volumes would be contestable if the sand suppliers at Helensville were to price as they did for the supply to Virgin Concrete [ ]. This scenario was modelled in Figure 3 above. The Commission considers, as detailed above, that the very high backload rates required to facilitate this sand supply are readily available and sustainable.

Tomarata

94. Coastal Resources supplies over half of its volumes to customers in the general vicinity of its Tomarata quarry. As such, the Commission assessed the supply options for customers in the general Tomarata area.

95. The vast majority of Coastal Resources supply within the general vicinity of Tomarata goes to Wharehine. Figure 4 below shows the alternative supply options that Wharehine would likely have when faced with a 5%-10% SSNIP at the Tomarata sand quarry. For the distance model, the Commission has used the same price and cost assumptions as above, namely:

- [ ] m^3 for sand;
- a headhaul rate of [ ] c/m^3/km; and
- a backload rate of [ ] c/m^3/km.

96. The results are weighted by actual volumes used in the 2009/10 year at Wharehine's three sites.[

Figure 4: Sand Supply to Wharehine Under SSNIP at Tomarata

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97. Figure 4 shows that, at similar backload rates, Ruakaka and Helensville sourced sand is a competitive alternative for Wharehine when faced by a SSNIP at the Tomarata sand quarry.[20]

98. The Commission notes that [ ]

99. As detailed above, the Commission considers there is sufficient evidence of backloads being available from Helensville northwards. In particular, backloads to Wellsford are likely as Wellsford is located on the main trunk route.

100. From the evidence gathered by the Commission it was calculated that the Tomarata quarry has a [ ] than Semenoff Sands and therefore has a [ ]. Wharehine contributes approximately [ ] of the total volume currently demanded from the Tomarata quarry. Therefore, if Wharehine were to divert between [ ][21] of its total volumes to a Helensville sand supplier it would be able to make a 5%-10% price increase unprofitable.

101. Therefore, the Commission considers the Helensville sand supplies are in the same market as the Tomarata sand supply in so much as the Helensville sand supplies can offer a competitive alternative supply to the customers in the vicinity of the Tomarata quarry.

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[20] The distance weighted average 10% SSNIP price for delivered sand is [ ], which assumes a weighted average freight cost of [ ] from Tomarata. Wharehine advised that its weighted average freight costs from Tomarata is currently [ ] with no backloads and, as such, a SSNIP at Tomarata may in fact be as high as [ ]. Therefore backloaded sand from Ruakaka and Helensville may provide an even greater constraint than illustrated above.

[21] [ ].

102. Given this analysis, the Commission considers it likely that sufficient quantities of sand could be supplied from Dargaville, Tomarata or Helensville suppliers. Nevertheless, the ability to obtain backloads varies between these different locations.

103. Therefore, the Commission will take into account variations in competitive intensity throughout the Northland region as part of its competition assessment.

Conclusion on Geographic Market

104. Accordingly, the Commission considers the geographic market for the supply of sand to be the Northland region. For the purposes of this investigation the Commission has defined the Northland region as the area north of Silverdale on the east coast and Helensville on the west coast.

Conclusion on Market Definition

105. The Commission concludes that, based on the current facts and for the purposes of this analysis, the relevant market is that for the extraction and wholesale supply of sand in the Northland region (the Northland sand market).

COUNTERFACTUAL AND FACTUAL

106. In reaching a conclusion as to whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a comparative judgment by considering the likely outcomes between two future hypothetical situations: one with the acquisition, the factual; and one without the acquisition, the counterfactual.[22] The Commission then views the impact of the acquisition on competition in a market as the prospective difference in the extent of competition between these two scenarios.

Factual

107. The Applicant submitted that his rationale for the proposed acquisition was to gain access to sand to enable him to supply sand competitively into the Auckland region. At the same time, Coastal Resources is looking to divest itself of its Tomarata sand operations.

108. Historically, Mr Semenoff, through his various sand companies, has not supplied sand as far south as Auckland. The reason for this is that the distance to Auckland from either the Ureiti property, or more recently the Ruakaka property, meant that it was uneconomic to transport the sand.

109. However, Mr Semenoff, through Stan Semenoff Transport Limited, has a network of trucks operating throughout the upper North Island, carting a variety of goods for various companies in various industries, with Auckland being a primary destination. Mr Semenoff advised that it would be efficient for him to use his fleet of trucks to supply sand to certain customers in the Auckland region if he had a sand source closer to these customers.

110. In particular, [

[22] *Air New Zealand & Qantas Airways Ltd v Commerce Commission* (2004) 11 TCLR 347, Para 42.

]

111. The Applicant also advised that he intends to maintain Tomarata's current customer base. This includes retaining Coastal Resources two main customers: Wharehine, based in the Tomarata area; and Holcim, based in Auckland.

112. [

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113. Accordingly, in the factual scenario, the Applicant would operate the Tomarata sand quarry, extracting and supplying sand to customers in both the Northland and Auckland regions.

Counterfactual

114. Various industry participants advised the Commission that the existing operators of the Tomarata quarry have, for the past few years, been looking at selling the business.

115. [ ] Coastal Resources advised that it has been considering its options for some time as it no longer considers that sand extraction and supply in the region is a core business for it. Coastal Resources advised that it has discussed the potential sale of the business with [

]

116. At present, Coastal Resources holds two resource consents for sand extraction in the region; one relates to off-shore extraction and one relates to on-shore extraction.

117. The on-shore consent relates to sand extraction at Tomarata and is the consent relevant to the present application. As noted above, Coastal Resources was in a joint venture relationship with Holcim in respect to the Tomararta sand quarry. Essentially, Coastal Resources was responsible for the sand extraction and Holcim was the end-user of the sand. Approximately five years ago this joint venture disbanded although a [ ] supply agreement for sand was put in place between Holcim and Coastal Resources.

118. [

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119. [

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120. While Coastal Resources holds the off-shore consent, it sold a licence to use the consent to McCallum in 2008 (in addition to all the necessary equipment including its barge).

121. At the time McCallum acquired the off-shore licence, [ ]

122. [ ]

123. [ ]

124. [ ].

125. [ ].

126. [ ]

127. [ ]

Assessment of the counterfactual

128. The Commission understands that a number of parties have had an interest, or expressed an interest in acquiring the sand operations of Coastal Resources. At this point in time, the Applicant's proposal is the only offer that has eventuated.

129. Coastal Resources advised that it is facing no commercial imperative to sell the business. Although sand volumes are down [ ] in recent times, as a result of the general downturn in the region, Coastal Resources advised that the real value in the operation was its resource consent.

130. It recently renewed the relevant consents for the next 20 years or so. Even though it has existing consents, Coastal Resources advised that the renewal process took approximately 12 months. In its view, this [

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131. In this respect, Coastal Resources advised that [

]. To this extent, the Commission considers that the Tomarata quarry has the necessary consents, equipment and capacity to be able to continue to extract and supply sand in the region for the foreseeable future.

132. Therefore, absent the proposed acquisition, the Commission considers that it is likely that Coastal Resources, under its present ownership structure or through a third party, would continue to extract and supply sand in the region and that the entity would be independent of Mr Semenoff, or one of his companies.

COMPETITION ASSESSMENT

Existing Competition

133. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).

134. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.

135. The Commission considers that a business acquisition is unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:

- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected persons or associated persons) has less than in order of 40% share; or
- the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.

Treatment of Market Shares

136. As discussed above, the Commission views Mr Semenoff and KWT as one head in the market for the purposes of the present application.

137. The Commission notes that certain industry participants that extract sand (either themselves or via associated parties) may also use sand as an aggregate in the manufacture of ready-mix concrete or other construction products. In this respect, there is a degree of vertical integration in this industry. In most

instances, the Commission excludes this "self-supply" from its assessment of the relevant market because that supply is typically not contestable. For example, a company is generally unlikely to forgo supply to itself in order to supply an existing or potential competitor in another part of the supply chain.

138. However, the Commission understands that when there is capacity in excess of what is required for self-supply, certain existing sand competitors have supplied sand into the relevant market. Therefore, while the Commission has excluded sand used by competitors for self-supply from the market shares below, it has also noted the available capacity which would be contestable.

139. The market shares for the Northland Sand Market are set out in Table 2 below.

Table 2: Estimated market shares for the Northland Sand Market for the 2009/2010 year.

Parties	Volume (m^3)	Market Share	Estimated annual capacity (m^3)
Semenoff Sands	[ ]	[ ]	[ ]
KWT	[ ]	[ ]	[ ][23]
The Applicant	*[ ]*	*[ ]*	*[ ]*
Coastal Resources	[ ]	[ ]	[ ]
Combined Entity	*[ ]*	*[ ]*	*[ ]*
John Keith	[ ]	[ ]	[ ]
Winstone	[ ]	[ ]	[ ]
Atlas	[ ]	[ ]	[ ]
Total	**[ ]**	**100%**	**[ ]**

Source: Industry participants, Commission estimates

140. All industry participants interviewed, advised the Commission that currently, demand in the market is low, with sales significantly down on previous years. For example, the Commission understands that until recently annual sales in the market were in the order of [ ]. Industry participants were unsure when demand would be likely to return to these levels although most considered that the worst of the recession in the region was over.

141. Sand suppliers advised that it can be difficult to estimate their annual capacity. Most resource consents permit suppliers to extract a maximum amount over a significant period of time. Further, given the state of demand in the region, most suppliers indicated that they had significant spare capacity. Table 2 indicates that [ ] is capacity constrained to any significant extent.

142. Post-acquisition, Table 2 indicates that the Applicant would increase its market share in terms of volume from [ ] and the three-firm concentration would be [ ]. This is outside the Commission's safe harbour guidelines.

143. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order

[23] Excludes self supply to Fletcher, as the Commission considers that Fletcher is unlikely to forgo its existing supply from KWT.

to understand the impact of the proposed acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

Competitors

Coastal Resources

144. Various industry participants advised that the ability of Coastal Resources to supply sand, and therefore the competitive constraint it offers, is influenced by its location. The quarry at Tomarata is approximately 25 kilometres north-east of Wellsford.

145. In this respect, it is at a competitive disadvantage to other sand suppliers in the market. For example, sand from Ruakaka is a much better option for customers in Whangarei than it is for customers near Tomarata just as sand from Helensville is a much better option for customers in Auckland than it is for customers near Tomarata. However, Tomarata is much better suited than Ruakaka or Helensville to supply sand to customers in the surrounding Rodney District, such as those at Wellsford.

146. [ ] of sand supplied by Coastal Resources currently goes to customers in the Auckland region, although historically this figure was around [ ]. Supply to the Auckland region is not significantly impacted by the proposed acquisition and is not considered further.

147. However, [ ] would suggest that Coastal Resources would have spare capacity to supply additional volumes in the Northland market.

Capacity Constraints

148. Coastal Resources recently had its resource consents for the Tomarata quarry renewed for an additional 20 plus years or approximately 2,000,000 m^3, whichever expires first. This averages to over 100,000 m^3 per year. Coastal Resources is currently extracting significantly below this volume (Table 4).

Table 4: Coastal Resources annual extraction quantities

Year	Quantities of sand (m^3)
2006/07	[ ]
2007/08	[ ]
2008/09	[ ]
2009/10	[ ]

Source: Coastal Resources

149. To this extent, whether or not [ ] it has significant capacity to expand its present supply. Although the total possible extraction from Coastal Resources is capped, it has sufficient excess capacity to supply the industry for the foreseeable future.

150. Therefore, the Commission is of the view that Coastal Resources has significant excess capacity such that it could substantially increase its existing supply to the Northland market.

<u>Supply to Northland customers</u>

151. Coastal Resource's main customer in the Northland market is Wharehine. At present, Wharehine purchase approximately [ ]. For Wharehine, Coastal Resource's Tomarata quarry is ideally located as a source of sand supply. Wharehine acquires the sand and then transports it to its ready-mix plants at Mangawhai, Wellsford and Matakana. These plants are all located within a relatively small radius of Tomarata.

152. Although Coastal Resources is the closest sand quarry to Wharehine's various plants, Wharehine also acquires [ ] of its sand requirements from Mr Semenoff. [ ].

153. Wharehine advised the Commission that it [ ]

154. In this respect, for the custom of Wharehine, Coastal Resources and Mr Semenoff are in direct competition with one another. This competition would be lost in the factual scenario.

155. Wharehine advised that the rates at which it is able to obtain sand from Mr Semenoff on a backload are [ ].

156. Wharehine advised that it has investigated the possibility of acquiring sand from other sand suppliers. As with many other customers, the key determinative for Wharehine is the cost of transportation. In respect of KWT, it considered that the physical distance to its locations from Dargaville excluded KWT from being a potential supplier to it. Further, there was almost no potential for any backloads on this route.

157. In respect of Auckland-based sand suppliers, such as those located at Helensville, again it considers that the cost of transportation makes this option [ ] than its two existing sand suppliers. [ ].

158. [ ].

159. Wharehine has never previously sourced sand from the Auckland region in any significant quantities. Wharehine advised that it would have the ability to source sand from Auckland such that it had no concerns about running out of sand (for instance, if it decided not to source from the combined entity); however, the key issue for Wharehine would be how much [] it would have to pay to get this sand delivered.

160. Wharehine advised that transportation costs in the industry are relatively well known by all those involved. For example, it is relatively easy for Wharehine and Mr Semenoff to calculate the cost of transporting sand a certain distance.

161. To this extent, if the proposed acquisition were to proceed, Wharehine considered that [

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162. [

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163. [

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164. While this might be the case if Wharehine switched to sourcing its entire sand requirements from Helensville, the Commission notes that Wharehine has to source only a proportion of its sand requirements from Helensville to impose a competitive constraint on the combined entity.

<u>Supply to Whangarei and the Far North</u>

165. Coastal Resources advised that, historically, it has not supplied sand to customers north of Ruakaka as [

]

166. Up until recently, Whangarei-based sand customers could choose between John Keith at Ruakaka and Mr Semenoff at Uretiti and had no real reason to seek alternative suppliers from further afield. Accordingly, given that sand from Tomarata is considered more expensive and that there were two competitors located around Ruakaka, Coastal Resources does not appear to have, historically, offered a strong level of competitive constraint on sand suppliers located in the immediate Whangarei area.

167. This is typically the case with any geographically differentiated market. With few sources of supply and with a spread of customers, each supplier in the market has a transport-cost-based advantage in supplying some customers but not others. To this extent there is unevenness in the competition for different customers in the Northland Sand Market.

168. The Commission notes that, prior to the arrangement between John Keith and the Applicant, there was no real commercial imperative for Whangarei-based customers to seek alternate suppliers, given the strong head-to-head competition between John Keith and the Applicant.

169. In addition, as the Lakeside Investigation concluded, the Commission is of the view that Coastal Resources offers a degree of competitive constraint on other sand suppliers through:

- its presence as an existing sand supplier in the market, such as its present supply to Wharehine; and
- its ability to expand its presence in the market, given an incentive to do so.

170. Industry participants such as [ ] advised that, while they have not previously used Coastal Resources for their sand supply, Tomarata sand is their next best alternative to their existing supplier. Tomarata is significantly closer than the next commercial sand supplier(s), which are situated at Helensville.

171. The Commission is of the view that, while up until now Coastal Resources has not competed strongly with other sand suppliers in the market, in the counterfactual scenario, Coastal Resources would be a viable existing competitor with significant excess capacity to which sand customers could switch given an incentive to do so by the combined entity.

172. Accordingly, the Commission considers that Coastal Resources would impose an important competitive constraint on the Applicant and that this constraint would be removed in the factual scenario.

John Keith

173. John Keith, through his various companies, has been supplying sand in the Northland area for the past decade. Up until the recent agreement between Lakeside and Mr Semenoff, John Keith was one of the main suppliers of sand in the Northland Sand Market. The agreement was the subject of the Commission's recent s27 investigation discussed above. The agreement, effectively removed John Keith as an independent supplier of sand in the market.

<u>Atlas arrangement</u>

174. Atlas advised that it also has an arrangement with John Keith for the supply of sand, which has been in place for some time. [ ].

175. John Keith advised that, although there is an exclusive agreement between himself (via his company Lakeside) and Stan Semenoff, the exclusivity relates to property specifically defined in the agreement. In this respect, John Keith (but not Lakeside) supplies Atlas from a separate block of his land. As noted in the table above, this totals approximately [ ] per annum. [ ].

176. John Keith advised that the agreement did not specifically stop him from supplying Atlas, or any other customer. However, the Commission notes that John Keith is not active in the promotion of this sand asset nor has he received any inquiries about its potential use as a sand source.

177. John Keith advised the Commission a number of times that he intends to cease being a sand supplier and become a property developer as the value of the Ruakaka property has become such that it is uneconomic to remain a sand supplier from that location. As noted in the Lakeside Investigation, John Keith

entered into the arrangement with Stan Semenoff to protect his business development from a decline in the demand of sand and give the development a minimum level of financial security in terms of cashflow.

178. The Commission notes that John Keith may have some capacity to increase the amount of sand that he presently supplies to Atlas and that this could also be supplied to a third party. However, the Commission also understands that John Keith chose to enter the arrangement with Mr Semenoff in order to focus on his property development business.

179. The Commission is of the view that it is unlikely John Keith would, soon after signing an agreement with Stan Semenoff to extract a significant amount of sand from his property, return to becoming an active and independent sand supplier in the market. This would seem inconsistent with John Keith's rationale for entering into the agreement in the first place.

180. While the Commission acknowledges that John Keith does offer a degree of competitive constraint in the market, through his ability to continue to supply sand to Atlas, the Commission can not give this constraint any significant weight. The agreement between John Keith and Mr Semenoff is a clear indication that John Keith is intending to extricate himself from the sand supply business in the long term.

181. Accordingly, the Commission considers that John Keith would only provide a minimal competitive constraint on the combined entity.

KWT

182. As noted above, the Commission is of the view that Mr Semenoff is able to bring real pressure to bear on the decision making process at KWT, and therefore, the Commission has proceeded on the basis that the Applicant and KWT are associated parties. As such KWT is likely to provide little competitive constraint in either the factual or the counterfactual scenario.

183. [ ].

184. The Commission has [ ] considered the competitive constraint an independent KWT would offer in the factual.

185. Given its location, KWT is best placed to compete for customers in the Dargaville region. Its ability to compete in the rest of the Northland area would be dependent on obtaining low cost transportation through backloads to the main sand customers, primarily located around Whangarei.

186. KWT's ability to act as a vigorous competitor is limited to some degree by its capacity. [ ].

187. In respect of capacity constraints, Mr Eyles advised that, to date, this has not been an issue for KWT. Demand in the region is such that it has never been at full capacity, let alone extracting anywhere near its resource consent cap. In addition, the recent recession has reduced the number of backloads from Dargaville to Whangarei, limiting the extent to which KWT could economically transport any extra volume it did extract.

188. Mr Eyles advised that, historically, [ ] of its sales had been to Firth and that this supply was the main focus of the business. [

]

189. The Commission notes that, more recently, Mr Semenoff began acquiring KWT sand and then on-selling this sand to Virgin Concrete. To this extent, some of KWT's excess capacity is now being utilised[24].

190. Table 3 indicates the current demand for KWT's sand and any excess capacity.

Table 3: Estimates of KWT's current supply

Customer	**Quantities of sand (m^3 per year)**
Firth	[ ]
Virgin Concrete (via Mr Semenoff)	[ ]
Excess capacity	*[ ]*
Total	**[ ]**[25]

Source: Industry participants

191. The Commission considers that, even if it was not associated with Mr Semenoff, KWT is unlikely to provide a strong competitive constraint on other sand suppliers in the market. This is due to its Dargaville location and a lack of customers in the immediate vicinity. KWT is primarily focused on supplying one of its shareholders, Firth, [
]. Moreover, KWT does not have a history of actively seeking new customers, and prior to supplying Virgin via Mr Semenoff, had not supplied any of the other ready-mix customers. In addition, even if there was additional demand in the market, KWT is capacity constrained which places an uppermost limit on its ability to expand.

192. Accordingly, the Commission considers that an independent KWT would only provide a minimal competitive constraint on the combined entity.

Casual Sand Suppliers

193. The Applicant submitted that there are a number of small scale, casual sand suppliers in the market and that these suppliers would continue to provide a competitive constraint on the combined entity.

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[24] [
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[25] This is calculated on Coastal Resources [
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194. Further, the Applicant submitted that it is relatively easy for this to occur because land-based sand mining does not always require a formal consent. For example, sand extraction under 5000 m^3 does not generally require specific resource consent.

195. The Commission has considered whether any small sand operations do (or could) extract and supply sand into the market and whether this would provide any degree of competitive constraint on the combined entity.

196. Hoppers Development Limited (Hoppers) is a property developer, with a presence in the Northland area. Hoppers has, at times, sold unwashed sand to third parties as part of its property developments. Presently, it is in the process of a canal housing development at Marsden Cove which would, potentially, require the extraction of approximately [ ] of sand over time. The Commission notes that this is not an insignificant volume of sand.

197. The Applicant contends that such sales are at the expense of existing sand suppliers such as itself and that these type of sales would continue to act as a constraint on the combined entity.

198. Hoppers advised that, at present, it has been able to supply sand to some extent as its relevant resource consent allows for the extraction of sand from the property and its disposal elsewhere and may continue to make, 'one-off' sales of sand as it reaches different stages of its developments. [ ].

199. [ ], purchased approximately [ ] of unwashed sand from Hoppers but considered this to be a 'one-off' purchase. [ ] advised that this scenario happens in the industry from time-to-time but it was difficult to rely on and was not typical.

200. All main sand customers stressed to the Commission that consistency of supply is an important consideration when selecting a sand supplier. Ready-mix concrete manufacturers account for the vast majority of the sand purchased in the market. These manufacturers advised that because concrete is certified to a particular standard, the quality of all the aggregates used in the mix, including sand, need to be consistent.

201. Accordingly, ready-mix manufacturers are cautious about using sand from casual suppliers or accepting 'one-off' supplies of sand. Further, they tend not to use two types of sand when making a particular batch of concrete because this could affect the consistency of the concrete.

202. In addition, demand can be quite lumpy and often fluctuates significantly from month-to-month. This means that, at times, customers ramp up their demand over a relatively short period and any delays in sourcing sand impacts on the entire construction project. Therefore, security of supply is an important consideration when sourcing sand. In this respect, there is a reluctance to purchase quantities of sand from ad hoc suppliers, such as Hoppers.

203. Accordingly, it is difficult for the Commission to give this type of sand supply any significant weight. In particular, it does not offer existing customers any degree of consistency, which is one of the main criteria for sand customers.

204. In addition, most of the main customers in the region purchase in excess of the 5000 m^3 figure mentioned above. In addition to concerns of consistency, there are also concerns about capacity of casual sand suppliers to supply the substantial quantities required by many of the main customers.

205. The Applicant advised that it has recently acquired significant quantities of sand from a number of third parties and that any other entity would be free to do something similar. For example, in 2006 Mr Semenoff extracted [ ] of sand from [ ] and, in 2008, Mr Semenoff extracted [ ][26]. The Commission notes that these are not insignificant amounts of sand.

206. Hoppers advised that, in respect of sand, its long term goal is the extraction of sand from the property. Hoppers noted that as a developer it has certain flexibility in relation to how it extracts the sand. It advised this could occur in a variety of ways, namely:

- independently disposing of the sand itself;
- contracting an existing sand supplier to extract the sand; or
- approaching an end-user to purchase a substantial amount of sand from it.

207. Hoppers advised that it has considered all its options and all were conceivable, although it has not advanced any of them, at this point in time. Nevertheless, any sand extraction is dependent on the status of the property development.

208. The Applicant submitted that these are examples of the abundance of sand in the area and that this would continue to act as a constraint on sand suppliers in the area, post-acquisition.

209. However, the Commission notes that sand from the properties listed above are examples of an existing supplier acquiring additional sand, rather than new supply. Importantly, Mr Semenoff was responsible for washing this sand, which he has the relevant consents to do, before supplying it to his existing customers.

210. To this extent, the Commission considers that this sand is unlikely to have been sold into the market without the involvement of Mr Semenoff and his relationships with existing sand customers. It is only Mr Semenoff that has the necessary washing facilities and contacts to supply this sand.

211. To offer a competitive constraint on the combined entity, a competitor must be able to both extract sufficient quantities of sand and also supply that sand to customers. The Commission acknowledges that, at times, sand has been supplied into the market from casual sand suppliers, although this has been on an ad hoc basis. However, it is difficult for the Commission to predict the amount of such supply in either the factual or counterfactual scenarios. In addition, there is a real reluctance by the main sand customers to source from this type of supplier.

212. Therefore, in comparison to the amount of sand supplied by existing competitors, sand supply from casual suppliers appears to be at the margins. Accordingly, the Commission considers that casual sand suppliers would provide a minimal competitive constraint on the combined entity.

[26] In these instances, Mr Semenoff paid a royalty to the land owners for the use of the sand.

Helensville Sand

213. The Applicant advised that there are significant sand resources available at Helensville. Both Winstone and Atlas operate off-shore sand mining barges that dredge sand in the Kaipara Harbour before returning to unload the sand at Helensville. To this extent, both Winstone and Atlas have significant excess capacity to extract sand from the Kaipara Harbour and could supply this sand to the Northland area.

214. In addition, the Applicant submitted there would be nothing stopping a Northland-based sand customer approaching either Winstone or Atlas to obtain sand. In this respect, the Applicant argued that Helensville-based sand suppliers currently act as a constraint on Mr Semenoff's various sand interests and would continue to do so, if the acquisition were to proceed.

215. Atlas and Winstone advised the Commission that they have significant spare capacity in relation to their ability to extract sand from the Kaipara Harbour. However, both stressed that the primary destination for this sand is to customers in the Auckland area.

216. Nevertheless, the Commission understands that, in certain circumstances, both Winstone and Atlas have previously supplied sand to the Northland area. For example, the Applicant noted that, recently, Winstone has been storing Helensville sand at its depot at Otaika, which is just south of Whangarei. It has then been supplying customers in the Whangarei area with this sand. Also, Atlas has, at times, supplied its Brynderwyn concrete plant with sand from Atlas Helensville.

<u>Atlas Helensville</u>

217. Atlas advised the Commission that its Helensville sand operation at Mt Rex is primarily to supply sand for its concrete plants in the Auckland region and that, historically, [ ] of its sand is sold to customers north of Helensville.

218. [ ] advised the Commission that it has bought [ ] of Atlas sand in the past, although the cost of transportation from Helensville meant that the cost of this sand was [ ] compared to its other suppliers. Further, [ ] advised it preferred not to mix off-shore sand (i.e. Helensville sand) with the other types of sand it purchases because it can impact on the consistency of its concrete.

219. The Commission understands that Atlas has, historically, supplied some of its plants in the region with sand from its Mt Rex facility, such as its Brynderwyn plant.

220. For Atlas, any increase in self supply would likely be at the expense of its existing sand suppliers in the Northland sand market. At present, Atlas' Ruakaka plant is supplied sand by John Keith, independent of the arrangement between Mr Semenoff and Lakeside.

221. Atlas advised that it is more economic to source from John Keith than itself, given the cost of transporting sand north from Helensville. The Commission considers that Atlas' decision to source sand from John Keith at Ruakaka, rather than source its own sand from Mt Rex, indicates the importance of transportation costs when acquiring sand. Atlas is ideally situated to acquire sand from John Keith as Atlas' Ruakaka operation is essentially located next

door to John Keith's property and because of this, the transportation costs are minimal.

222. Atlas advised that it pays John Keith [ ] for delivered sand, whereas it would cost [ ] to have sand delivered from Mt Rex. To this extent, the Commission considers that Atlas' Mt Rex sand does not appear to be an [ ] alternative for Atlas' Ruakaka plant.

223. It follows that this would also be the case for other potential sand customers in the Ruakaka region. However, the Commission notes that not all customers are located at Ruakaka (or next to a sand quarry) and so their economic options for sand suppliers, including potentially Atlas from Helensvile, could be different. Moreover, given the cartage rates of which the Commission has been advised, it is conceivable that other sand customers, if incentivised, could secure lower priced backload cartage rates (and therefore a lower delivered price) than what Atlas could obtain.

<u>Winstone Helensville</u>

224. The Commission understands that, in 2008, Winstone investigated the possibility of supplying Helensville sand to its operation at Otaika. At the time, Winstone Otaika was acquiring sand from Mr Semenoff (through his various sand companies) and then using sand for its own purposes, as well as supplying small quantities of sand to local customers.[27]

225. At the time, Winstone found that there was sufficient low cost backload transportation available from third party transport companies to make sourcing sand from Winstone Helensville, and then supplying it to Winstone Otaika, a viable alternative to supply by Mr Semenoff. In addition, Winstone then expanded this supply to include Virgin Concrete, who, at the time, was a newly-established ready-mix supplier based in Whangarei.

226. In this regard, the strongest evidence that Helensville-based sand suppliers have, in the past, offered a degree of competitive constraint on sand suppliers in the Northland market was the supply from Winstone to Virgin Concrete. Virgin Concrete made a commercial decision to source sand from Winstone rather than the closest sand supplier to its location, which was Mr Semenoff.

227. [ ], in mid-2009, Virgin Concrete re-assessed its options for sand supply [ ].

228. Virgin Concrete advised that it was able to [ ]

[27] Notably, none of these small customers include ready-mix customers.

229. Virgin Concrete advised that [

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230. The Commission has been advised that Virgin Concrete paid Winstone [ ] for sand delivered from Helensville, and that it is currently paying Mr Semenoff [ ] for sand delivered from KWT. This amounts to [

].

231. In this respect, the Commission considers that for Virgin Concrete, at least, Helensville sand via Winstone is, and would continue to be, a substitute for sand from Mr Semenoff through his various sand companies.

232. However, Winstone advised that its previous pricing was based on being able to obtain consistent backloads from Helensville to Otaika (and therefore Whangarei). [

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233. In mid-2009, Fletcher announced that the Kumeu plant was to close and this occurred in July 2009. [

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234. In assessing the competition implications of the present application, the Commission has found little evidence of any significant quantities of sand being supplied to customers in the Northland area from a Helensville-based sand supplier. However, if a sand supplier or a customer was incentivised to source backloads from Helensville, this could change the current level of competitive constraint.

<u>Ability to obtain Backloads</u>

235. All industry participants interviewed advised the Commission that it is difficult to predict the level of backloads. For example, [ ] advised that backloads are very hard to measure and quantify because they are dependent on a number of variables including:

- aggregate sale locations;
- trucking logistics;
- the type and grade of sand at the respective quarries; and
- storage requirements.

236. Nevertheless, industry participants advised that backloads do occur in the market from time to time. However, a key issue for a potential acquirer based in Northland of Helensville sand is being able to regularly obtain a backload at a competitive rate.

237. In this respect, the Commission found evidence that transportation companies in the region would be both willing and physically able to provide regular backloads from Whangarei to Helensville. Further, the Commission understands that these companies would be able to backload sand from Helensville to Whangarei for [ ]. In the Commission's view, sand purchased then carted under this rate would make Helensville sand price competitive with Mr Semenoff's various sand companies.

238. For example, [ ] advised that it currently carts significant volumes of [ ]. These trucks then return north to the home base of Whangarei. [ ] advised that, in its view, there is ample opportunity for it to regularly backload substantial amounts of sand from Helensville on behalf of sand customers in the Northland market, if required.

239. Further, [

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240. While the availability of backloads will fluctuate with the dynamics of various industries, the Commission considers that the competitive and comprehensive nature of the transport industry in the region is likely to provide sufficient opportunity to backload sand from Helensville and therefore provide a competitive constraint on the combined entity.

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241. [

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242. [

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243. [

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244. [

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245. [ ]

246. [ ]

247. [ ]

<u>Conclusion on Constraint from Helensville Sand</u>

248. Accordingly, the Commission considers that if the combined entity attempted to impose a significant price increase, it is likely that Helensville-based sand suppliers would be an economic and feasible alternative for some customers in the Northland area. In this respect, the ability for the combined entity to sustain a price increase would be constrained to some extent.

249. Therefore, the Commission considers that Helensville-based sand suppliers would be likely to provide a degree of competitive constraint on Mr Semenoff's various sand companies should the acquisition proceed.

Conclusion of Existing Competition

250. The proposed acquisition would remove from the market one of the few remaining competing sand quarries with significant capacity in the Northland region.

251. The arrangement between John Keith and Mr Semenoff is an indication that John Keith is intending to extricate himself from the sand supply business. An independent KWT would be constrained to some extent by capacity concerns. Casual sand suppliers only appear to be able to supply sand at the margins as they can not offer larger customers any surety or consistency of supply.

252. Further, due to its distance from Whangarei, Helensville-based suppliers have, historically, not tended to supply significant amounts of sand to the Northland market.

253. However, the Commission notes that, until recently, there were two relatively large sand suppliers in the immediate vicinity of Whangarei: Lakeside; and Semenoff Sands. To this extent, there was little need for Whangarei-based customers to source sand from other suppliers in the market, such as those in Helensville.

254. Both Atlas and Winstone at Helensville have significant spare capacity to supply the market, if required. While the availability of backloads will vary, the Commission considers that there would be sufficient opportunity for customers to obtain Helensville sand for a backload rate and that this would provide a competitive constraint on the combined entity.

255. While each of the individual competitors listed above would only provide a limited or minimal constraint, the Commission considers that when taken together, it is likely that customers in the market would have economically competitive alternatives to the combined entity.

256. Accordingly, the Commission considers that, on balance, existing competition is likely to provide a sufficient competitive constraint on the combined entity, post-acquisition.

POTENTIAL COMPETITION

257. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any impediments they might encounter should they try.

258. The Applicant has submitted that the barriers to entry into the market are relatively low, citing the limitless availability of sand, the modest capital requirement and the possibility of using existing resource consents.

Requirements for Entry

259. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of market conditions that impede entry.

260. Industry participants advised the Commission that sand extraction under 5000 m^3 does not generally require specific resource consent. However, large ready-mix customers generally require more than 5000 m^3 per year. Their demand can also be lumpy, requiring a ramping up of supply over a short time period. As such, there may be concerns in relation to a smaller supplier being able to offer the same security of supply, which is viewed by sand customers as an important factor in the choice of sand supplier. Therefore, in the same manner as casual suppliers only offer a minimal constraint, a sand extraction operation under 5000 m^3 is unlikely to be large enough to provide any degree of ongoing competitive constraint.

261. In this respect, the Commission has assessed the key requirements for entry for the supply of sand over 5000 m^3. These include:

- access to suitable sand deposits;
- the relevant consents required to extract sand;
- equipment to process the sand;
- access to a transportation network; and
- customers.

Access to suitable sand deposits

262. Sand suitable for construction and project work can be extracted from land-based sand deposits or it can be dredged offshore from the sea bed. The Commission considers de novo land-based entry into the Northland market to be more likely than offshore entry due to:

- [ ]; and
- the additional difficulties in securing the requisite consents for offshore extraction. This is evidenced in recent years by Atlas (Mt Rex), McCallum and Winstone all facing considerable expense, delay and vocal opposition in relation to their applications for renewed offshore sand consents.

263. Land-based sand deposits can be obtained by purchasing suitable land (as Lakeside did) or by entering into an arrangement with the land owner for extraction (for example, Stan Semenoff's arrangement with Lakeside).

264. Industry participants and local body officials advised that Northland contains substantial sand resources, although much of this sand is on the west coast or in the Far North district, and is therefore a significant distance from the Northland main customer base of Whangarei.

265. However, the Commission is aware of a number of possible sites for sand extraction:

- The Gordon family's property at Uretiti: Stan Semenoff previously extracted sand from this site until he moved his operations to Ruakaka. The Applicant identified escalating costs and a break down in the commercial relationship as the contributing factors to him ceasing operations at this property. The Gordon Family advised the Commission that [ ].
- John Keith's property at Ruakaka: As previously noted, John Keith's actions indicate his disinterest in reentering the sand business. Nevertheless, John Keith could conceivably enter into an arrangement with a new entrant for that entrant to extract sand from his Ruakaka property. However, given he has entered into a contract with Stan Semenoff for extracting sand on the John Keith adjacent property, the Commission considers that John Keith is less likely to be incentivised to facilitate new entry.
- Fishlock's property at Tomarata: Coastal Resources previously held a temporary permit to extract sand from the property of Margaret and Len Fishlock at Tomarata. Coastal Resources advised that [ ]. In this respect, the Commission considers it unlikely that this property would be used for sand extraction.
- Hoppers property development at Marsden Cove: Hoppers advised that it has a significant amount of sand to extract over the course of its proposed 15-20 year development. It advised that, at present, if it was adequately incentivised, it could bring forward some of its proposed extraction and look to dispose of the sand to a third party to generate some additional income as demand for property in the region was not high. However, Hoppers advised that it would only seriously consider doing this if it was able to secure a commitment [

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Relevant consents required to extract sand

266. The resource consents required for sand extraction depend on the specific circumstances of the individual proposal. The most significant consenting issues tend to be in relation to the extraction process, noise, traffic, dust, water extraction and disposal, and visual and amenity value impacts. Some of these issues can be alleviated by the consent applicant internalising the impacts. For example, if the consent applicant owns a 'buffer zone' of land around the extraction site this may minimise potential noise and visual pollution problems.

267. The time taken for the full consent process is also contingent on the specific circumstances, with much of the time variation relating to the required notification and potential for appeals. Non-notified resource consents may be granted if it can be shown that the activities do not significantly impact on other parties. This could be the case, for example, if the land is already zoned for commercial use, or if there are no close neighbours.

268. Limited notification or public notification may be required if the proposal could impact on other parties, and such notification opens the possibility of submissions and appeals. Limited notification restricts those who can submit on the application to a list of identifiable affected parties. Public notification is more likely to be required for coastal sites or offshore extraction, and the open-nature of the submission and appeal process for such consents can significantly lengthen the time required to gain a consent.

269. The Commission has been advised by the relevant local bodies that the resource consent process can be completed within three to six months; however under appeal this might extend to one to two years. For example, Wharehine advised that it recently received resource consent of an aggregate quarry after [ ]

270. Where consents have been notified, there is also the potential for interested parties to challenge council decisions by appealing to the Environment Court. Experience in the industry shows that appeals to the Environment Court can add significant financial costs and time delays. For example, McCallum applied to renew its (offshore) sand extraction permits in 2003 and following the consent process, the case was appealed to the Environment Court (by McCallum) and to the High Court (by the Auckland Regional Council and others) – with the High Court's final decision being made in 2009.

271. The Commission considers that the possibility of consents being appealed adds significant uncertainty and cost for entry into sand extraction, thus making entry more difficult.

Equipment to process the sand

272. The major equipment required for processing sand are a digger and a sand washing plant. The Applicant submitted that the likely cost of setting up a sand mining operation would be between $200,000 and $250,000. Coastal Resources is proposing to sell its second-hand extraction equipment as part of the proposed acquisition for [ ]. Sand washing plants are generally portable and therefore can be set up within a matter of weeks. This is evidenced by the fact that

Semenoff Sands was able to relocate its operation from Uretiti to Ruakaka within a short timeframe.

273. Therefore, the Commission considers that equipment is not a significant barrier in relation to entry into the sand mining business.

Access to a transportation network

274. As previously discussed, transportation is a key component of the final delivered price of sand and, as such, entry requires a source of sand close to a main customer base and/or near main transport links.

275. In respect of transport, the Applicant identified access to an efficient transportation network as a key component of the sand business. The Commission has previously identified at least eight transport companies that are active in the transportation of bulk goods in the Northland region and has noted the strong competition between transport companies seeking to maximise loads. As such, the Commission considers that access to transport, does not appear to be a significant issue.

276. The Commission notes, however, that the availability and regularity of backload transportation rates can be critical in terms of sand operations being able to supply at a competitive rate. The availability of backloads appears somewhat variable as it is dependant on transport companies' ability to optimise a range of factors, as well as the economic conditions in a range of other industries (for example, forestry and dairy).

Customers

277. As previously noted, concrete customers make up the majority of demand for sand. In addition, concrete customers' demand tends to be regular. Securing at least one major concrete customer would appear to be an important step for a new entrant.

278. The Commission has found some evidence of customers switching sand suppliers or sand supplies, namely:

- Allied switched to Lakeside when Lakeside first entered the market;
- Atlas switched from self-supply to John Keith [ ];
- Virgin Concrete switched from Winstone to Mr Semenoff in 2010. Mr Semenoff is currently reselling KWT sand to Virgin Concrete; and
- [ ]

279. On the other hand, there are some costs involved in switching sand suppliers. Each sand source has its own individual qualities and concrete mixes need to be adjusted in order to maximise cement yields (the more expensive component of concrete). For many concrete firms, switching sand suppliers would also be an 'all or nothing' decision because, for quality and consistency reasons, a single source of sand is generally preferred.

280. The Commission understands that currently, there are limited long-term supply contracts in the industry.

The LET Test

281. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:

- likely in commercial terms;
- sufficient in extent to cause market participants to react in a significant manner; and
- timely, that is, feasible within two years from the point at which market power is first exercised.

282. The most recent example of full-scale entry into the market was that of John Keith, who entered the market in 2001.

283. Industry participants advised the Commission of a substantial reduction in the demand for concrete since a peak of economic activity in 2008. The Commission also found that the industry is not confident that demand will quickly bounce back to previous levels, despite some evidence of infrastructure spending (for example roads) and recent moderate growth in the number of building permits issued.

284. The Commission considers that the current excess capacity in the sand market also reduces the likelihood of entry. The Commission understands that all market participants are operating significantly below full capacity. For example, [ ]

285. One of the factors the Commission takes into account in assessing potential competition is the extent to which incumbent competitors have the potential to act to discourage new entry. Various parties advised the Commission that Mr Semenoff is an influential person in Northland, and note that he is the current Mayor of Whangarei. The Commission considers that the ability of Mr Semenoff to respond aggressively to a new entrant, and the excess capacity at both Ruakaka and Tomarata is likely to be a deterrent to new entry.

286. The Commission identified McCallum as one possible entrant into the market. McCallum dredge sand off the Rodney District's coast and barges it into the Port of Auckland. [ ]

287. In relation to the extent of possible entry, while economies of scale do not appear to be a significant driver of the sand extraction industry, it is likely that any new dedicated entrant would need to enter with a capacity of at least [ ]. Below this level it is unlikely that entry would be commercially viable. The figure of [ ] is evidenced by:

- John Keith supplying his only customer, Atlas, around [ ];
- KWT supplying on average [ ]; and
- Coastal Resources currently supplying approximately [ ].

The Commission is of the view that entry of this extent would be likely to provide constraint to the combined entity.

288. Smaller scale entry is conceivable in conjunction with land development or construction projects. However, as previously discussed, the Commission considers that such sand suppliers would not be suitable for concrete customers, who require regular and consistent supply, and as such would not be sufficient to constrain the combined entity.

289. The ability for an entrant to enter in a timely manner is crucial as to whether an incumbent sand supplier may be constrained. In this instance, the Commission considers that issues relating to the gaining of resource consents and, in particular, the possibility of Environment Court appeals, mean that entry within a two year timeframe is uncertain.

Conclusion of potential competition

290. The Commission is of the view that potential competition is unlikely to occur within a one to two year timeframe to an extent that would be sufficient to constrain the combined entity.

COUNTERVAILING POWER

291. 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.

292. For example, the combined entity may be constrained if purchasers were able to exert a substantial influence on the price, quality or terms of supply of the good or service. A purchaser would be able to credibly exert such countervailing power if it were a large entity in relation to a supplier, well informed about alternative sources, ready and able to switch, and able to foster new supply (or self supply).

293. The Applicant submitted that the main acquirers of sand in the area are generally substantial businesses who have strong bargaining positions in relation to Mr Semenoff. In its view, these customers are unlikely to tie themselves to one supplier as this limits their bargaining position. Further, customers are generally free to switch suppliers.

294. [ ] This customer was free to switch as there was no formal contract in place, and so even though Mr Semenoff had been supplying this customer for a very long time, he was given less than a month's notice that [ ] would no longer be requiring his sand.[28] In Mr Semenoff's view, this illustrates that all the bargaining power rests in the hands of the customer.

295. The Commission canvassed with industry participants whether, post acquisition, any of the main sand customers in the Northland area would be able to maintain downward pressure on sand prices, and therefore act as a constraint on the combined entity.

Commercial Size and Strength

296. The Commission notes that many of the main ready-mix manufacturers in the region: Fletcher's (via Firth); Allied; and Atlas are large companies with

[28] [ ].

operations located throughout New Zealand. In this respect, the Commission notes that their business operations are substantially larger than the commercial operations of Mr Semenoff which include both his sand businesses and his trucking operation.

297. Moreover, as noted previously, ready-mix manufacturers account for a substantial proportion of Mr Semenoff's business. To this extent, the Commission considers that the loss of the custom of just one major ready-mix manufacturer would likely be significant enough to make an increase in the price of sand unprofitable. This would suggest that ready-mix manufacturers may have the commercial size and strength to impart some countervailing power.

298. However, Mr Semenoff himself advised the Commission that selling sand, particularly in the Northland area is a relationship business. To this extent, he has grown Semenoff Sands by establishing over time, numerous contacts in the region. Mr Semenoff considered this to be one of his commercial advantages and that a lack of commercial contacts was one of the factors that restricted Lakeside's sand operations leading to its eventual exit from the market via the arrangement between Semenoff Sand and Lakeside.

299. All industry parties noted that Mr Semenoff is a well-known and influential personality in the Northland area, in addition to being the current Mayor of Whangarei.

300. [ ]

301. Additionally, [ ]

302. The Commission is of the view that while many of the main sand customers in the market are much larger than Mr Semenoff, Mr Semenoff has certain commercial advantages in the region.

Alternative sources and transportation costs

303. The main customers in the market each purchase various aggregates including sand, and in many cases they also supply sand themselves. Therefore, they have a significant understanding of the cost of extracting sand as well as the cost of transporting sand.

304. Some suppliers consider their extraction methods more efficient than others. For example, John Keith designed his own processing plant for sand, [ ]. However, Mr

Semenoff [ ] considered his extraction method was efficient, which is why he moved his processing plant to Ruakaka after he exited the Uretiti property.

305. In this respect, the Commission understands that the price of sand ex-gate is relatively consistent between the various sand suppliers in the region. This is often the case with relatively homogenous products like sand. In addition, all industry participants are well aware of the relative cost of transportation, particularly the head haul rates.

306. To this extent, the Commission understands that both customers and suppliers are generally well informed about the appropriate cost of sand and the relative cost of alternative sources, particularly from Helensville-based suppliers and those further afield.

307. Further, the Commission notes that many ready-mix customers would be able to select an alternative supplier to the combined entity (using regular backloads) which could be used to exert influence in their dealings with the combined entity.

Ability to Switch

308. All industry participants interviewed advised that supply contracts are relatively rare in this industry. For example, the only supply contract of any significance was the [ ] supply agreement between Coastal Resources and Holcim for supply to Auckland [ ][29]

309. To this extent, the Commission understands that none of the main customers in the market are tied to sand supply contracts, either in the short term or long term.

310. Nevertheless, industry participants advised that switching is relatively rare, particularly for ready-mix customers because, as differentiated products, each supplier's sand is slightly different. As a result, routinely changing suppliers could affect the quality of the end product (e.g. ready-mix concrete). To this extent, customers do not tend to use two types of sand in any one batch of ready-mix.

311. However, as noted previously, while for many customers each supplier's sand may not be a perfect substitute for another supplier's, the differentiation is not sufficient to exclude different suppliers from the market. Customers can use different varieties of sand and the Commission has found examples of customers switching between sand suppliers from time to time.

312. Therefore, the Commission considers that existing sand customers would be ready and able to switch to an alternative sand supplier in the factual. In addition, as discussed above, there are a number of viable existing sand suppliers, including Atlas and Winstone at Helensville.

Ability to foster new entry and threat of self-supply

313. The ability for ready-mix manufacturers to foster new supply or to self-supply varies between firms.

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[29] This contract was the result of the disbanding of the company that was jointly owned by Coastal Resources and Holcim.

314. Several of the main ready-mix manufacturers, such as [ ] advised that they had no ability to supply their own sand needs. For example, [ ] advised that although they operate various aggregate quarries around New Zealand, they both prefer to source sand from third party providers. [ ]

315. However, Firth and Atlas are already involved in the supply of sand. For instance, Firth already has the ability to self-supply through its association with KWT and Atlas has its own sand supply in Helensville, from which it has previously sourced sand.

316. In respect of the Northland market, Firth currently sources from both KWT and from Mr Semenoff through his various sand companies. Firth advised that it could, to some extent, [ ] if Mr Semenoff tried to increase prices, post-acquisition. Another alternative would be to source from Winstone in Helensville. Accordingly, the Commission considers that some customers may have the ability to self-supply, in the event that the combined entity attempted to increase prices.

317. In certain circumstances, a customer might exert a degree of countervailing power by encouraging or facilitating new entry. For example, by agreeing to source their sand from a new supplier.

318. As noted above, customers are generally free to switch to a new sand supplier. Industry participants advised that this is because customers have not tended to enter into long term supply contracts.

319. The only evidence over the last 10 years of entry in the Northland market was by John Keith. John Keith advised that his entry into the market was only achieved after he obtained a commitment from one major customer, Allied. In order to get this commitment, John Keith had to guarantee to Allied certain standards in quality, consistency and reliability. John Keith advised that he was then able to build up his sand operation on the basis of this one main customer.

320. Industry participants advised that a new entrant would be able to replicate John Keith's entry if it was able to secure a commitment from a main customer. Given the alternatives discussed in the existing competition section, it is unclear whether a customer when faced with a significant price increase in the factual would look to facilitate new entry as opposed to sourcing from an existing supplier.

321. Nevertheless, the Commission notes that it would likely only require one main ready-mix customer to facilitate the entry of a new competitor in order for that entrant to establish itself in the Northland market and therefore provide a competitive constraint on the combined entity.

322. Hoppers advised that it has the necessary consents to extract and dispose of a substantial amount of sand from its property which is something it intends to do over the next 15-20 years. Hoppers advised that it has considered the potential commercial opportunities of such sand disposal and it would be amenable to working with a significant sand customer to extract this sand.

323. The Commission is of the view that if the combined entity attempted to impose a significant price increase, some ready-mix customers would have some ability to maintain downward pressure on sand prices. They could do this through either self supply or by fostering the expansion of existing competitors.

324. While each customer's competitive options and therefore, their ability to constrain the combined entity varies, the Commission notes that it would only take the loss of one of the main ready-mix customer to negate a price increase by the combined entity.

Conclusion on Countervailing Power

325. The Commission concludes that ready-mix manufacturers would have a degree of countervailing power which would serve to provide constraint to the combined entity through their ability to either self supply or by fostering the expansion of existing competitors.

OVERALL CONCLUSION

326. The Commission has considered the probable nature and extent of competition that would exist, subsequent to the proposed acquisition, in the market for the extraction and wholesale supply of sand in the Northland region (the Northland sand market).

327. Absent the proposed acquisition, the Commission considers that it is likely that Coastal Resources would continue independently to Mr Semenoff, or one of his companies.

328. The proposed acquisition would remove one of the few remaining competing sand quarries in the Northland market.

329. The Commission found that most customers in the Northland region are based around Whangarei. Until recently, there were two relatively large sand suppliers in the immediate vicinity of Whangarei: Lakeside; and Semenoff Sands. To this extent, there was little need for Whangarei-based customers to source sand from other suppliers in the market, such as those in Helensville.

330. This is no longer the case and Coastal Resources is the next closest supplier to Whangarei. However, both Atlas and Winstone at Helensville have significant spare capacity to supply the Northland sand market including those in Whangarei, if required. While the availability of backloads will vary, the Commission considers that there would be sufficient opportunity for customers to obtain Helensville sand for a backload rate and that this would provide a competitive constraint on the combined entity.

331. While each of the remaining competitors in the market would only provide a limited or minimal constraint, the Commission considers that when taken together, it is likely that customers in the market would have economically competitive alternatives to the combined entity.

332. [

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333. Accordingly, the Commission considers that, on balance, existing competition is likely to provide a sufficient competitive constraint on the combined entity, post-acquisition.

334. This is important because the Commission is of the view that de novo entry is unlikely to occur within a one to two year timeframe to an extent that would be sufficient to constrain the combined entity.

335. In addition to the constraint from existing competition, the Commission also concludes that ready-mix manufacturers would have a degree of countervailing power which would serve to provide constraint to the combined entity through their ability to either self supply or by fostering the expansion of existing competitors.

336. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any market.

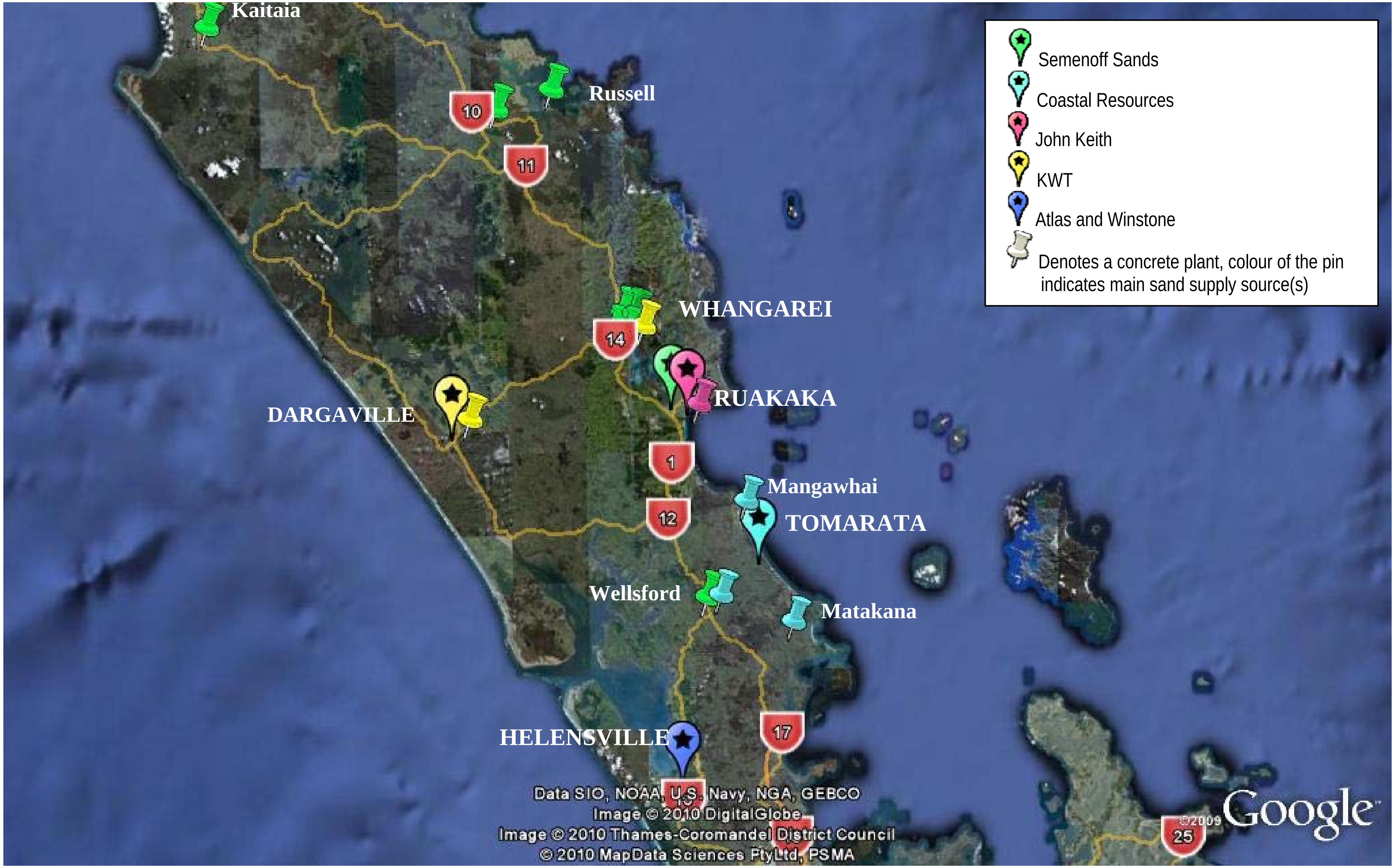
DETERMINATION ON NOTICE OF CLEARANCE

337. Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for Tomarata Sand Limited to acquire the assets and business of Coastal Resources Limited relating to sand mining operations at Tomarata.

Dated this 25th day of June 2010

Dr Mark Berry
Chair

APPENDIX A: MAP OF SAND SUPPLIERS AND MAJOR CONCRETE CUSTOMERS IN NORTHLAND



Note: Locations are indicative only