



COMMERCE COMMISSION

Memorandum

To: Commerce Act Division Public Version
From: Anna Walton 11597
Anthony Stewart
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Classification: Public
Subject: Investigation Report - Semenoff Sand Supplies / Lakeside Business Park

OVERVIEW

1. In October 2008 the Commission received a complaint from [] concerned that an agreement between the two major sand suppliers in the region could result in price increases for sand to customers north of Whangarei.
2. Staff have investigated whether an agreement between Semenoff Sand Supplies Limited (Semenoff Sands) and Lakeside Business Park Limited (Lakeside) in relation to the sand resource located at Lakeside's Ruakaka¹ site is likely to contravene section 27 of the Commerce Act 1986 (the Act).
3. Staff have concluded that:
 - the relevant market is that for the extraction and supply of sand in the Northland region (from Helensville north);
 - the two largest sand suppliers in the market, Semenoff Sands and Lakeside, entered into an arrangement;
 - existing competition provides a competitive constraint on Semenoff Sands under the arrangement;
 - presently, potential competition also provides a degree of competitive constraint on Semenoff Sands under the arrangement; and
 - therefore the arrangement did not have the purpose, effect or likely effect of substantially lessening competition.
4. Accordingly, staff recommend that the Commission take no further action in this matter and close the investigation.

¹ Ruakaka is approximately 30 kilometres south of Whangarei near Marsden Point.

PARTIES

Parties to the Agreement

Stan Semenoff, Semenoff Sands and Envirosands Northland Limited

5. Semenoff Sands is the oldest existing supplier of sand in the Northland region. Stan Semenoff is its sole director.
6. In the past Semenoff Sands has supplied sand from a land-based resource at Uretiti; 40 kilometres south of Whangarei. In July 2009 Semenoff Sands moved its sand operation to Lakeside's site in Ruakaka, approximately seven kilometres north of Uretiti and closer to Whangarei. Since 20 July 2009, all sand sold by Semenoff Sands has been sourced from Lakeside's site in Ruakaka.
7. Mr Semenoff is also the sole director and shareholder of Envirosands Northland Limited (Envirosands Northland), which was incorporated on 10 December 2008. Envirosands Northland has assumed the supply of sand to the customers who were previously supplied by John Keith's Envirosands United Limited (Envirosands United). Under the agreement that is the subject of this investigation, Lakeside extracts and processes the washed sand on behalf of Envirosands Northland. Envirosands Northland then sells the washed sand to customers as well as extracting and selling windblown sand.
8. Mr Semenoff is also a director of:
 - Kaipara Water Transport Limited (KWT), which supplies sand; and
 - Stan Semenoff Transport Limited, which is a transportation company.

John Keith, Lakeside Business Park, and Envirosands United

9. John Keith is the sole director and shareholder of Lakeside. Lakeside owns land at Ruakaka, which Mr Keith has previously used for sand extraction and supply under the banners of Envirosands and Envirosands United. Mr Keith began supplying sand in the Northland in 2001 having found that the land he had bought for farming was too sandy to be used as such.
10. Mr Keith entered into the agreement in question with Mr Semenoff in late 2008. Presently, Lakeside is developing the land into a commercial subdivision. For the purposes of this report, Lakeside Business Park and the business that has operated under the banners 'Envirosands' and Envirosands United are referred to as Lakeside.

Other Relevant Parties

KWT

11. KWT is a sand supplier based in Dargaville that dredges sand from the Kaipara harbour.
12. KWT was formed in 2001. Maurice Eyles is the Managing Director and owns 50% of the company. Mr Semenoff owns 25% of the company and is also a director. Fletcher Concrete and Infrastructure Limited owns the remaining 25% of the company and is represented on the board by Marc Hainen, Chief Operating Officer, Firth Northern Branch, Firth Industries Limited (Firth).

Kaipara Limited

13. Kaipara Limited (Kaipara) owns an onshore sand plant based at Tomarata (Kaipara Tomarata). Tomarata is approximately 25 kilometres north-east of Wellsford and a one hour round trip from State Highway One.

McCallum Bros Limited

14. McCallum Bros Limited (McCallums) operates an offshore sand operation off the coast of Pakiri, near Tomarata. It purchased the rights to extract the sand in 2008 from the previous licence holders.

Firth

15. Firth is a wholly owned subsidiary of Fletcher Building Limited (Fletchers). Firth is a nationwide manufacturer of ready-mix concrete and other concrete products. Firth has five ready-mix concrete plants in the Northland region.

Winstone Aggregates Limited

16. Winstone Aggregates Limited (Winstones) is also a wholly owned subsidiary of Fletchers. Winstones is the largest aggregate company in New Zealand and has 26 quarries around the country; relevant to this investigation are Winstones operations at Helensville and Otaika in the Northland region.
17. Winstones Helensville, on the north-western fringe of Auckland, extracts and sells a range of aggregates including sand. Winstones Helensville extracts its sand from the Kaipara harbour and barges it to Helensville. Winstones Helensville now supplies Winstones Otaika with sand, which is approximately eight kilometres south of Whangarei. Winstones Otaika operates an aggregate quarry from which it supplies aggregate and the imported sand in the Northland region.

Atlas Concrete Limited

18. Atlas Concrete Limited (Atlas) supplies ready-mix concrete, pre-cast concrete, and aggregate. Atlas has several branches in the Northland region. Atlas Helensville dredges sand in the Kaipara harbour.

Allied Concrete Limited

19. Allied Concrete Limited (Allied) operates 45 ready-mix plants around New Zealand. As a ready-mix producer, it is a purchaser of sand. Of relevance to this investigation are Allied's plants in Ruakaka, Whangarei, Waipapa (near Kerikeri) and Doubtless Bay.

INDUSTRY BACKGROUND

20. 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.
21. 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 windblown² 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.
22. 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.

² Windblown sand is also referred to as unwashed sand.

23. Industry participants advised Commission staff 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.
24. Another key criterion for customers is the cost of transportation. Sand is a low value bulk aggregate that is expensive to transport due to its bulk relative to its value.
25. Sand customers can store sand to some degree and use transportation companies to replenish their stock piles and most customers do not have contracts for the supply of sand in the Northland region. Most customers, such as ready-mix companies, prefer to use one sand supplier as small differences in quality between sand sources can impact the overall mix of inputs required to make concrete. Nevertheless, customers can and do switch between sand suppliers.

MARKET DEFINITION

26. The Act defines a market as:

... 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.³

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

Product

28. Commission staff are of the view that sand is a relatively homogeneous product. Some suppliers try to differentiate their product on various non-price factors such as colour, although this differentiation is not sufficient to affect the product market definition in this instance. For example, some suppliers provide specialty sand for such places as golf courses for which they charge a premium. Staff understand 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. Commission staff are of the view that washed, windblown and sea sand all fall within the same product market.

Functional Level

29. 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 supply of sand.

Geographic Extent

30. 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

³ Commerce Act 1986, s 3(1).

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.

31. Industry participants advised Commission staff 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.
32. 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) need to be locally sourced and in New Zealand are only transported short distances, although it specifically noted that the Northland region was quite different with aggregates routinely transported over long distances.⁴
33. Industry participants advised Commission staff 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 actual sand. Industry participants noted that most customers have a preference to source sand from their nearest supplier.
34. Lakeside and Semenoff Sands have both supplied sand in the Northland region. Their respective quarries are located in relatively close proximity to one another; Semenoff Sands at Uretiti; and Lakeside at Ruakaka.⁵ Figure 1 indicates their approximate location. Given their proximity to one another, the transportation component that customers face would have been relatively similar for sand from either of these quarries and, as such, staff consider that they are close substitutes for one another.
35. Semenoff Sands 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 Helensville;
 - Atlas Helensville;
 - Kaipara Tomarata;
 - KWT, in Dargaville; and
 - McCallums, which extracts sand offshore from Tomarata.

⁴ See National Freight Demands Study, Richard Paling Consulting, September 2008.

⁵ In July 2009 Semenoff Sands ceased extracting sand from the Uretiti site and moved its washing plant to Lakeside's property at Ruakaka.

FIGURE 1: Location of Sand Quarries and Select Customers in Northland

Source: www.wises.co.nz

36. Most customers in the Northland region are located around the region's main centre, Whangarei. However, a number of other customers are located further afield. Represented in Figure 1 are:
- Firth Kaitaia;
 - Mangonui Ready-mix;
 - Firth Puketona; and
 - Firth Russell.
37. When discussing the relationship between sand supply and transportation, industry participants emphasised the importance of backhauling. Backhauling is the return of the carrier to the original point or area from which it began. Typically backhaul transportation rates are offered at lower rates than the headhaul rates. Transportation companies wish to secure backhaul 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.
38. Several industry participants advised that there is a significant volume of goods travelling between Auckland and Whangarei such that the prospect for regular transport north to Whangarei was relatively good. In addition, the recent economic downturn has meant that many transport companies are actively seeking out backloads from sand suppliers.

Helensville

39. Winstones has primarily been supplying its Helensville sand into the Auckland region. Winstones Helensville's sand is [

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40. Winstones concluded that it is economically viable for it to deliver sand from Winstones Helensville to Winstones Otaika⁶, near Whangarei and began doing so in September 2008. It supplies itself as well as third parties. For example, [

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41. Winstones Helensville advised Commission staff that it [

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42. Commission staff are of the view that a customer in Whangarei, for example, if faced with the imposition of a SSNIP by Semenoff Sands, would find supply from Helensville to be a realistic substitute. In this respect, staff consider that the sand supplied from Helensville is likely to fall within the geographic boundary of the relevant market.

Dargaville and Tomarata

43. The other active sand suppliers in the Northland region are KWT and Kaipara Tomarata. Staff are of the view that, given that Helensville is considered to be within the boundaries of the relevant market, it is likely that sand suppliers based at Dargaville and Tomarata would also fall with the boundaries, given their location is even closer to Whangarei.

East Coast Offshore Extraction

44. Currently, McCallums extracts sea sand from off the east coast of Northland near Tomarata. This sand is then barged down to Auckland Harbour where it is supplied into the Auckland region. [

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45. Semenoff Sands advised that, historically, sea sand extracted from the east coast was unloaded at the old Whangarei port and McCallums, or any other sea sand consent holder, could do this. McCallums [

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- [];
- [];

]

⁶ Winstones Otaika is an aggregate quarry that has space to stockpile sand and existing infrastructure in place to load and unload aggregates.

46. As such, McCallums [

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47. Therefore, staff are of the view that due to [

], the geographic boundary on the east coast of the market is likely to be drawn at the water's edge and therefore exclude off-shore operations on this coast.

Conclusion on Geographic Market

48. Accordingly, Commission staff consider the geographical boundaries for the supply of sand to be the Northland region. For the purposes of this investigation the Northland region has been defined by Commission staff as the area north of Silverdale on the east coast (excluding off-shore operations on this coast) and Helensville on the west coast.

Conclusion on Market Definition

49. Staff conclude that, based on the current facts and for the purposes of this investigation, the relevant market is that for the extraction and supply of sand in the Northland region (the Northland sand market).

SECTION 27

50. Section 27(1) of the Act provides:

No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.

51. To determine the degree to which competition in the market has been lessened, the Courts have applied a counterfactual test. This test involves the identification and assessment of the effect of a provision of an agreement on competition in the relevant market (the factual) in comparison with the state of competition that would have existed without the provision (the counterfactual).⁷

52. Staff have investigated whether there was a contract, arrangement or understanding (an agreement) between Semenoff Sands and Lakeside, and whether that agreement had the purpose, or effect or likely effect of substantially lessening competition in the Northland Sand Market.

Contract Arrangement or Understanding (Agreement)

53. To be a contract the test to apply is whether the particular transaction would be enforceable at law.⁸

54. To constitute an arrangement there must be the following:

- a meeting of minds;⁹ and
- the meeting of minds must have given rise to an agreed course of conduct with a clear expectation as to that future conduct.¹⁰

⁷ *Air New Zealand v Commerce Commission* (2004) 11 TCLR 347 at para 42.

⁸ *Hughes v Western Australian Cricket Association (Inc) & Ors* (1986) ATPR 48-020 at 48-040.

⁹ *New Zealand Apple & Pear Marketing Board v Apple Fields Limited* (1991) 1 NZLR 257, 261.

¹⁰ *Commerce Commission v Giltrap City Ltd* (2004) 1 NZLR 608, 613 para 17.

- 55. It is not sufficient that there is an expectation about future conduct, there must be the ‘intentional’ creation of an expectation as to future action.¹¹
- 56. Essentially the same tests apply to establishing an understanding as to an arrangement. However, it is acknowledged by the courts that an understanding is less formal than an arrangement and may be easier to prove.¹²

The Agreement

57. Lakeside and Semenoff Sands advised Commission staff that they have entered into an agreement for the sale and purchase of sand that gives Semenoff Sands the exclusive right to explore, extract, process, load and haul the sand resource at the properties of Lakeside at Ruakaka.¹³

58. The written agreement contains the following terms:

- 2. []
- []
- 2.1 []
- []
- 2.2 []
- []
- 4. []
- 4.1 []
- []
- 7. []
- 7.1 []
- []
- 7.2 []
- []

59. Semenoff Sands is obliged to purchase [] sand at a specified price each year. Under the agreement, Lakeside has agreed not to supply sand to any other party provided Semenoff Sands purchases this [] amount. Semenoff Sands created a new entity, Envirosands Northland, to give effect to the agreement.

60. The parties advised Commission staff that the agreement [

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¹¹ *ACCC v CC (NSW) Pty Ltd* (1999) 165 ALR 468 (FCA). At page 500 the court noted that a mere expectation is not enough.

¹² *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Limited*, *ibid*, at page 662 and *TPC v TNT Management PTY Ltd* (1985) ATPR 40-512 at 46-098.

¹³ The Sand Agreement, Thomson Wilson Solicitors, Whangarei, Ref D0811004.

Rationale for the agreement

61. Mr Keith advised that there were a number of reasons for entering into the agreement with Semenoff Sands. Mr Keith advised that, until recently, the sand supply business had been operating relatively profitably. However, approximately three years ago, Lakeside's Ruakaka property was reassessed by the local council and the rates increased significantly as a consequence.
62. When faced with this rates bill, Mr Keith advised that he had to re-evaluate the business model for the property. As a result of the rate increase, Mr Keith considered whether the property might provide a better return from an alternative activity. Subsequently, Mr Keith made a decision to develop the land as a commercial subdivision.
63. In order to develop the property, the underlying sand had to be either moved or extracted. Because of this, Mr Keith continued to extract and sell sand which provided some cash flow for the development as well as pay the council rates.
64. However, Mr Keith's move into property development coincided with the economic recession. Mr Keith considered that this had two important impacts on his plans. First, the demand for commercial property was low and secondly, the amount of construction was also down, affecting the demand for sand.
65. As a consequence, Mr Keith advised Commission staff that the main reason for entering into the agreement was to protect Lakeside from the decline in the demand for sand and give it a minimum level of security in terms of cash flow.
66. From 2004, Mr Keith was involved in a joint partnership with United Carriers. United Carriers provided the transport aspect of the sand business. It also handled all the administrative functions of the operation leaving Mr Keith to concentrate on the sand extraction process. Mr Keith advised Commission staff that [].
67. United Carriers was acquired by Toll Holdings Limited (Toll) and the joint venture was terminated between July and August 2008, which left Mr Keith in sole charge of the administration and logistics functions of the business. Entering into the agreement with Semenoff Sands also meant that Mr Keith would no longer have to deal with the administrative and logistics functions of the business.
68. Mr Semenoff explained to Commission staff that his reason for entering into the agreement with Lakeside []. Mr Semenoff explained that he had been extracting sand from the Uretiti site for a number of years under a lease arrangement. Mr Semenoff stated that although he [].
69. Mr Semenoff said the opportunity to obtain sand from Lakeside's property came up and []. Mr Semenoff also told Commission staff that, absent the agreement, he would still be extracting sand from the Uretiti site. Failing that, Mr Semenoff said he has 40 year licence from the Department of Conservation to extract sand from another Uretiti site, but that he would need to obtain the relevant resource consents before the sand could be extracted.

Assessment of the agreement

70. Staff are of the view that there is contract, arrangement or understanding (an agreement) between Semenoff Sands and Lakeside, and that through this agreement, Semenoff Sands holds the exclusive right to sell the sand extracted from Mr Keith's Ruakaka property. In addition, Semenoff Sands continues to hold the rights to extracting sand from the Uretiti site. Furthermore, Mr Keith has agreed not to compete with Mr Semenoff while the agreement is in place.
71. Accordingly, under the agreement between Lakeside and Semenoff Sands (i.e. the factual scenario), Lakeside has ceased being an independent supplier of sand in the Northland Sand Market.

Date of execution of contract.

72. Commission staff note that, as of December 2009, the written agreement had not been formally executed. Nevertheless, both parties advised that the agreement had been functioning in accordance with the general terms of the contract dated December 2008.¹⁴
73. In addition, Mr Keith and Mr Semenoff sent a notice to all Mr Keith's regular sand customers stating that, as of 1 November 2008, Mr Semenoff's new company, Envirosands Northland, would be taking over from 'Envirosands'.
74. Staff are of the view that there has been an agreement between Lakeside and Semenoff Sands since at least November 2008, when the parties advised their customers of the agreement.

Developments since December 2008

75. At the time of the original agreement in December 2008, Semenoff Sands was operating a sand quarry at Uretiti. Although not the land owner, Semenoff Sands has the right to extract sand from this property and was supplying approximately [] m³ per annum.¹⁵
76. Subsequent to the agreement with Lakeside, Semenoff Sands reduced the rate of extraction from Uretiti to the point that that quarry is now closed. In addition, Semenoff Sands' plant has now been moved to Lakeside's Ruakaka property where it is used in the processing of windblown sand. Lakeside's plant is still in operation (operated by Mr Keith) and is used for washing sand, which is then on-sold to Semenoff Sands (as part of the agreement). In this respect, two sand extraction operations and processing plants are in operation on Lakeside's property.

Counterfactual

77. In assessing the counterfactual, the Commission must consider what is likely to have occurred in the absence of the agreement between Lakeside and Semenoff Sands.
78. Mr Keith advised Commission staff that entering into a contract with Semenoff Sands was just one of the possibilities he considered in relation to the extraction and supply of

¹⁴ Both parties noted that there has been some minor amendments and drafting clarifications to the contract, since December 2008 but that these did not change any substantive clauses.

¹⁵ For consistency, this report refers to sand in cubic metres. Where industry participants have supplied information in tonnes, the figures have been converted to cubic metres at the conversion rate used by the individual sand plants that the sand has been sourced from.

the sand from his property. Other than Semenoff Sands, Mr Keith advised he considered the following possibilities:

- [];
- []; and
- [].

79. Mr Keith advised that, post the acquisition of United Carriers by Toll, there were a number of changes. For example, [

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80. Mr Keith also approached [

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81. Mr Keith advised that he also considered [

]. Further, in his view, given the declining demand in the region, it would not be possible to gain any degree of certainty from [].

82. In this respect, Mr Keith advised that only through the agreement with Semenoff Sands, [

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83. Mr Keith requires [] hence the agreement between Lakeside and Semenoff Sands for the extraction of [] tonnes. At present, [

]. In addition, as part of the agreement, Lakeside has continued to physically extract some of the sand which is on-sold to Semenoff Sands.

84. Staff are of the view that absent the arrangement, Mr Keith would have the incentive to continue to extract sand from the property. In addition, Mr Keith has the necessary resources to physically extract and process the sand himself, as he still does this as part of the agreement with Semenoff Sands. Accordingly, staff are of the view that, absent the agreement between Lakeside and Semenoff Sands, Mr Keith would have both the incentive and the ability to continue to supply sand in the Northland Sand Market, either by himself or with a joint venture partner.

COMPETITION IN THE NORTHLAND SAND MARKET

85. The competitors in the Northland sand market are:

- Lakeside's operation at Ruakaka;
- Semenoff Sand's operation at Uretiti and Ruakaka;
- Kaipara Tomarata;
- KWT at Dargaville;

- Winstones Helensville; and
- Atlas Helensville.

86. Table 1 shows the estimated market shares for the competitors in the Northland sand market by both volume and value.

TABLE 1: Estimated Northland Sand Market Shares for 2007/08 and 2008/09

Sand Supplier	2008/2009				2007/2008			
	Total value	% value	Total volume m ³	% volume	Total value	% value	Total volume m ³	% Volume
Semenoff Sands	\$[]	[]%	[]	[]%	\$[]	[]%	[]	[]%
Lakeside	\$[]	[]%	[]	[]%	\$[]	[]%	[]	[]%
KWT	\$[]	[]%	[]	[]%	\$[]	[]%	[]	[]%
Kaipara Tomarata	\$[]	[]%	[]	[]%	\$[]	[]%	[]	[]%
Winstones Helensville	\$[]	[]%	[]	[]%	\$[]	[]%	[]	[]%
Atlas Helensville	\$[]	[]%	[]	[]%	\$[]	[]%	[]	[]%
Total market	\$[]	100%	[]	100%	\$[]	100%	[]	100%

Source: Industry participants, Commission estimates

87. Table 1 shows that the total market is valued at approximately \$[] and in the 2008/2009 year the total volume of sand sold in the market was approximately [] m³. It also shows that:

- the parties to the agreement are the two largest sand suppliers in the market;
- all other competitors in the market are [];
- Winstones Helensville, as a recent entrant to the market, [];
- Atlas Helensville is [].

Competitors in the market

Lakeside

88. Lakeside has had a market share of []% by volume and []% by value in the past two financial years. Prior to the agreement []

[]. The remaining sales were significantly smaller quantities to a range of smaller ready-mix companies, transportation companies¹⁶ and other construction related companies.

89. When Mr Keith entered the market in 2001, he targeted one of the largest customers at the time, Allied, and after securing Allied¹⁷ as a customer, he then built up a customer base from there. Staff note that most of Lakeside's customers were previously supplied by Semenoff Sands. Mr Semenoff estimates that Mr Keith's sand operation took []% of Semenoff Sands' sand sales when it started up.

¹⁶ Certain transport companies on-sell sand to end-customers.

¹⁷ Allied's previous supplier lost its resource consent and exited the industry.

90. However, prior to the arrangement being put into place, it appears that competition in the industry was not vigorous. For example, Mr Semenoff told staff that the Northland region was relatively small and that everyone knows who the key sand customers are. []
91. Lakeside's location at Ruakaka, less than ten kilometres south of Whangarei and close to Semenoff Sands, and type of sand supplied from Lakeside's property, sand suitable to use in the production of ready-mix concrete, means that Lakeside was the competitor best placed to compete with Semenoff Sands.

Semenoff Sands

92. Prior to the agreement with Lakeside, Semenoff Sands, being located close to the market's greatest concentration of customers, was the oldest and largest competitor in the market with a []% share of the market by volume and value. Under the agreement, Semenoff Sands market share has moved to approximately []¹⁸.
93. Semenoff Sands' customers include a wide range of customers both large and small and from both the Whangarei areas and further afield. In particular, [] is its largest customer, purchasing approximately [] m³ per annum of sand from Semenoff Sands.
94. Under the agreement with Lakeside, Semenoff Sands must purchase a minimum of [] m³ per annum¹⁹ from Lakeside, which has a market value of approximately \$[]. Semenoff Sands has no maximum extraction limit from the Lakeside property other than the total amount of sand that needs to be extracted to complete the development. Mr Semenoff told Commission staff that []. Therefore, Semenoff Sands is not capacity constrained either with or without the agreement.

KWT

95. After the combined Semenoff Sands / Lakeside entity, KWT is the next largest supplier of sand with a market share by volume of between []%. As well as being a shareholder, Firth is KWT's []
96. While KWT is best placed to compete in the Dargaville region, its location means that its ability to compete in the rest of the Northland market is dependent on low cost backload transport rates being available from Dargaville to get the sand to the most populated area, Whangarei, and to the main transport routes.
97. Industry participants advised the Commission that KWT tends not to compete to any great extent. In addition, []

¹⁸ The Commission's Mergers and Acquisitions Guidelines provide safe harbour guidance for business acquisitions. The Commission is of the view that an acquisition is unlikely to substantially lessen competition where the three firm concentration ratio is below 70% and the market share of the combined entity is less than 40%; or the three firm concentration ratio is above 70% and the market share of the combined entity is less than 20%.

¹⁹ Converted from tonnes to m³ at 1.3 as per contract.

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

]. This leaves KWT with [] m³ per annum spare capacity, based on 2008/2009 volumes, which is approximately []% of the market. [

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99. Commission staff have also considered whether the shareholding and directorships of KWT affect its ability to provide a competitive constraint in this market. As stated earlier, Stan Semenov holds a 25% shareholding in KWT and is one of three directors of the company.
100. The Commission considers that companies that are part of the same corporate grouping, or that have similar strong relationships, cannot be relied upon to provide an effective competitive constraint on one another. Fletchers' representative on the KWT board, Marc Hainen, advised Commission staff that the types of issues discussed by the KWT board include [

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101. However, in December 2008 a new concrete supplier, Virgin Concrete, started operating from Whangarei. Firth provided the Commission with a file note setting out details of a KWT board meeting held on 27 November 2008. The file note prepared by Marc Hainen, states:

[

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[

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102. When Commission staff contacted [

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103. This file note and [] illustrates that Mr Semenov's behaviour as a Director of KWT is strongly influenced by his association with Semenov Sands.

104. Without needing to explore the relationship further, the combination of the [] degree to which KWT has been competing in the past, its [] capacity and its links to Mr Semenov indicate that, KWT is unlikely to provide effective competitive constraint on Semenov Sands in the future.

Kaipara Tomarata

105. Kaipara Tomarata has a market share of approximately []% in the Northland sand market. This accounts for approximately []% of its total sales.²⁰

106. [

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107. Kaipara Tomarata has consent to extract a further [] m³ in total from its site. This is sufficient for Kaipara Tomarata to continue to supply all its customers with sand for more than [] years, at the current rate of supply. In the event that Semenoff Sands raised prices in the market, Kaipara Tomarata could increase its supply of sand into the market. Although the total possible extraction of Kaipara Tomarata is capped by its resource consent, Kaipara Tomarata has [] capacity to supply the Northland Sand Market with additional sand in the medium term.

108. Presently, Kaipara Tomarata sells its sand ex-gate only. Transportation remains a key factor for Kaipara Tomarata due to its distance from the main road and being in a region with a low population density. [

].

109. When combined with the cost of sand from Kaipara Tomarata, the backload rate would be [] the average delivered price paid by Semenoff Sands Whangarei-based customers and the non-backload rate is [] that Semenoff Sands charges its Whangarei based customers.

110. [

]

111. Staff note that presently, Kaipara Tomarata is wishing to sell its sand operation [

] However, if the business were to be purchased by an independent third party, then it is likely Kaipara Tomarata would have the capacity and ability to expand its operations.

112. Staff consider that if Kaipara Tomarata is sold to an independent third party, and in the event that Semenoff Sands attempted to raise prices significantly, the owner of Kaipara Tomarata would have the ability to expand the present operation. Staff are also of the view that absent a sale, Kaipara Tomarata would have both the incentive and ability to expand.

Winstones Helensville

113. The market share table above shows Winstones Helensville had a [] by volume and value in the Northland Sand Market in the 2008/2009 year and [

²⁰ Kaipara Tomarata supplies a number of customers south of Helensville/Silverdale and therefore, these customers have been excluded from the relevant market.

]. At present, Winstones Helensville supplies sand primarily to the Auckland region.

114. [

] Winstones advised that there has been a downturn in construction in Auckland, which has reduced the demand for sand in that region. Accordingly, the amount of sand extracted by Winstones Helensville [].

115. [] Winstones investigated the possibility of supplying Winstones Otaika (just south of Whangarei) with sand. Winstones Otaika retails sand from its yard to small volume customers and was previously supplied by Semenoff Sands. Winstones found that [

] to make supplying sand from Winstones Helensville to Winstones Otaika a viable alternative to sourcing sand from Semenoff Sands. Consequently, Winstones Helensville began supplying Winstones Otaika in []. Because of its existing aggregates business, Winstones Otaika already had existing loading infrastructure and excess storage capacity (to stockpile the sand) which afforded it economies of scope.

116. After Winstones Otaika began sourcing sand from Helensville it started [

]. Virgin Concrete switched to Winstones for its sand supply [

].

117. Winstones Helensville advised staff that if demand in Auckland increased to the point where it was above [

]. Winstones Helensville's resource consent allows it to extract [] m³ of sand per annum²¹ giving it significant capacity to expand.

118. [

]. This indicates that Winstones Otaika has []. However, staff note that, presently, Winstones' operation is largely self-supply.

119. Accordingly, staff are of the view that the overall market share of Winstones sand supply in the Northland sand market is low, [

].

Atlas Helensville

120. Atlas Helensville (whose main business is the supply of ready-mix) is located in the same geographical area as Winstones Helensville so it follows that it also falls within the relevant sand market. However, Atlas Helensville advised staff that [

]. Atlas advised Commission staff that [

²¹ Internally Winstones has decided []

]

Conclusion on Competition in the Northland Sand Market

121. The current competitors in the Northland Sand Market are Semenoff Sands, KWT, Kaipara Tomarata, Winstones Helensville and Atlas Helensville and prior to the agreement, Lakeside provided the strongest degree of competitive constraint on Semenoff Sands.
122. Staff consider that because of Semenoff's ownership of 25% of the shares of KWT and its place on the board of directors, KWT is likely to provide very limited constraint on Semenoff Sands. Likewise, Atlas, []].
123. Staff conclude that some degree of competitive constraint is likely to be provided by Kaipara Tomarata through its ability to expand and to a lesser extent, Winstones Helensville.

Potential Competition

124. In assessing whether an agreement is likely to lead to a substantial lessening of competition in the market the Commission considers potential competition and the degree of constraint, if any, it would be likely to pose on the parties to the agreement.
125. Semenoff Sands submitted that barriers to entering the market are low and provided recent examples of developers and construction companies selling sand. However, upon investigation of these claims, staff found that the examples provided by Semenoff Sands related to the ad hoc supply of small quantities of windblown sand. Staff note that the majority of the sand sold in the Northland sand market is used in the production of ready-mix concrete and that windblown sand is unsuitable for this purpose. While the product market identified for the purposes of this investigation is a broader market for sand, staff consider that if entry occurs only at the fringes of the market then that entry might not be sufficient to provide effective competitive constraint. Accordingly, staff have considered the requirements for entry in relation to supplying sand to ready-mix concrete customers as this is the core business under consideration.

Requirements for Entry

126. Industry participants informed staff that the key requirements for entry for the supply of sand over 5000 m³²² are:
- access to land with suitable sand deposits;
 - equipment to process the sand;
 - customers;
 - transport; and
 - the relevant consents required to extract sand.
127. There are several ways of obtaining access to suitable sand; either by purchasing suitable land as Lakeside did or by obtaining a licence from the land owner to extract sand as Semenoff Sands did in respect of its Uretiti operation. Staff were advised by

²² Sand extraction under 5000 m³ does not require resource consent; however, a sand extraction operation of this size is unlikely to be large enough to provide any degree of ongoing competitive constraint.

industry participants as well as local body officials, that the Northland region contains vast volumes of sand resource of a type suitable for use in ready-mix concrete.

128. The major equipment required for the processing of sand for supply are a digger and sand washing plant. Staff enquiries have established that second-hand diggers and sand washing plants are both available for purchase at a combined cost of around \$100,000. Sand washing plants tend to be 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.
129. Within the Northland sand market, the majority of customers tend to be localised around the Whangarei area. However, because ready-mix concrete must be poured within 90 minutes of being mixed, there are small ready-mix plants spread throughout the Northland region including in the remote and sparsely populated Far North District. Access to customers in the market could be facilitated by either situating a sand plant close to customers or in a location that allows for the optimisation of transport logistics to secure low cost backloads to areas where customers are based.
130. As discussed in the section on market definition, key to the economic transportation of sand is the ability to secure a backhaul. This is particularly important for transportation to more remote areas of the Northland region and also for sand suppliers located some distance from Whangarei. Commission staff identified at least eight transportation companies that are active in the transportation of bulk goods in the Northland region. These businesses differ significantly in scale and are based in a variety of locations throughout Northland, including in the Far North. Bulk goods that are commonly transported around the Northland region include a range of aggregates, palm kernel, wood chip and landscaping supplies. [] advised Commission staff that the transportation of sand is only a small proportion of bulk transport in Northland; however, [] explained that sand is an important product for bulk transporters because it is a product that needs to be supplied year round.
131. There are a number of different transportation models operating for sand. Presently, Kaipara Tomarata's sand is for sale ex-gate only, which means that it is up to customers to arrange transportation. [] operates on a supply and deliver basis, where it purchases sand from the sand supplier and on-sells it to the customer with transportation included. A third model staff identified is where the sand plant offers a bundled packaged of sand and transportation, as was the case in the joint venture between John Keith and United Carriers.
132. The availability of backhaul transportation between different locations in Northland is somewhat fluid as it is dependant on transport companies' ability to optimise a range of factors. While Commission staff did not seek to identify whether guaranteed backload transport would be available between any potential sand resource and possible customers, staff note that the competition between transport companies to maximise loads appears strong, particularly in a time of economic downturn.
133. The type of resource consents required for a sand operation will depend on the type of operation and land zoning. Resource consents from district councils allow the holder to carry out an activity that would otherwise contravene a rule in a district plan. Regional council resource consents relate to activities that would have an effect on the environment.
134. Obtaining resource consents is the most problematic of the requirements for entry as both offshore and onshore sand mining activities tend to raise environmental issues and

are therefore routinely contested. To this extent, in some cases, gaining required consents can take a considerable period of time to obtain.

135. During the investigation, staff consulted several local body councils in respect of the granting of resource consents. They advised that consents for seabed sand extraction require consents only from the regional council. However, these consents are likely to be challenging to obtain, are likely to be appealed to the Environment Court and take more than two years to obtain.
136. Consents for land based sand operations in the Northland area would require consents from both regional and district councils. The timeframes and costs to obtain resource consents are highly dependant on whether the council requires the consents to be notified. Whether an application for resource consent requires notification turns on the extent to which other parties are likely to be affected by the proposed land use. For example, Council staff explained that consent for a sand operation in an inland rural area would be more likely to be granted without notification than a consent for a coastal or built up area.
137. Starting at the most achievable level, Council staff estimated that non-notified consents could be obtained in three to six months and that the cost of the regional and district council consents combined would be in the range of \$3000 to \$6000.
138. Notified consents are more problematic. Commission staff enquires' found that the length of time and the cost of notified consents depends largely on the extent to which objections are raised and appeals are lodged. If objections and appeals were received at every stage possible, it is likely that the consents would take longer than two years to obtain. This is however, the worst case scenario. Council staff advised that in the previous 12 months three or four notified resource consents had been granted for quarrying activities other than sand, and that these consents were not appealed and such consents would typically take three to six months. Council staff were of the view that consents that were appealed could be granted within 12-18 months in situations where parties were open to negotiation.
139. Accordingly, gaining a resource consent and the length of time and cost involved is likely to be highly dependant on where the land for which the consent sought is situated.
140. Historically, sand customers have tended not to switch suppliers; however, staff note that when Lakeside entered it was successful in securing a large acquirer of sand, Allied (which it gained through the exit of another sand supplier), as well as gaining around []% of Semenoff Sands' customers. It appears that, to date, fixed term supply agreements for sand have been uncommon in the market.
141. 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. Commission staff were widely informed during their inquiries that Mr Semenoff is an influential person in Northland, and note that he is the current Mayor of Whangarei. [].
142. Commission staff were advised by [] that early in 2009 Semenoff Sands was seeking to []

]

143. One potential incumbent response to a new entrant could be for Semenoff Sands to look to cement existing relationships with fixed term contracts. Where a new entrant required notified resource consents, Semenoff Sands would be likely to be aware of the business being set up in advance of it being up and running. This would allow a window of time where Semenoff Sands could seek to enter into fixed term supply arrangements with existing customers, thus limiting the amount of business available to a new entrant.
144. However, staff consider that, currently, with the presence of other players in the market, while a long-term contracting strategy would make entry more difficult, it is unlikely that Semenoff Sands would be successful in implementing such a strategy. Having said this, staff note that as a result of the arrangement that is the subject of this investigation, Semenoff now has a significant market share. And while, at present, there appears to be a degree of competitive constraint in the market, particularly from Kaipara Tomarata, any further consolidation in the market is likely to dampen that constraint, particularly in respect of new entry.

Conclusion on Potential Competition

145. Commission staff have evaluated the conditions of entry and conclude that based on the current market structure, on balance, there is a sufficient prospect of new entry to provide a degree of constraint on Semenoff Sands.

OVERALL CONCLUSION

146. Staff conclude that:

- there has been an agreement between Lakeside and Semenoff Sands in respect of sand extraction and supply since at least November 2008;
- the relevant market definition for the purposes of this investigation is that for the extraction and supply of sand in the Northland;
- existing competition from Kaipara Tomarata and to a lesser extent Winstones Helensville is likely to provide competitive constraint on Semenoff Sands; and
- the potential for new entry into the market presently provides some additional degree of competitive constraint on Semenoff Sands.

147. Therefore it is unlikely that the agreement has the purpose, or has or is likely to have had the effect of substantially lessening competition in the Northland Sand Market.

Recommendation

148. Accordingly, staff recommend that no further action be taken, the parties be advised accordingly and the investigation be closed.