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COMMERCE COMMISSION

Decision No. 376

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

Fletcher Challenge Steel Products Limited

and

Steel and Tube Holdings Limited

The Commission:	M J Belgrave (Chairman) M N Berry P R Rebstock
Summary of Proposed Acquisition:	The acquisition by Fletcher Challenge Steel Products Limited of up to 100% of the shares in Steel and Tube Holdings Limited.
Determination:	Pursuant to section 66(3)(b) of the Commerce Act 1986, the majority of the Division of the Commission declines to give clearance for the proposed acquisition.
Date of Determination:	4 November 1999

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TABLE OF CONTENTS

THE PROPOSAL 4

THE PROCEDURES 4

THE PARTIES 4

FLETCHER CHALLENGE STEEL PRODUCTS LIMITED (FLETCHER STEEL) 4
STEEL AND TUBE HOLDINGS LIMITED (STEEL AND TUBE) 5

OTHER RELEVANT PARTIES 5

KIWI STEEL LIMITED (KIWI STEEL) 5
ASMUSS STEEL AND WIRE (ASMUSS) 5
VULCAN STEEL LIMITED (VULCAN) 6
UNITED INDUSTRIES LIMITED (UNITED) 6
BHP NEW ZEALAND STEEL (NEW ZEALAND STEEL) 6
PACIFIC STEEL 6

BACKGROUND 6

STEEL INDUSTRY 6
NEW ZEALAND STEEL PRODUCTION 9
NEW ZEALAND STEEL DISTRIBUTION 9

THE RELEVANT MARKETS 10

INTRODUCTION 10
THE NATIONAL MARKET FOR THE DISTRIBUTION OF MERCHANT STEEL PRODUCTS 12
Product and Function Dimensions of the Market *12*
Geographic Extent of the Market *12*
THE NATIONAL MARKET FOR THE FABRICATION AND DISTRIBUTION OF REINFORCING STEEL 13
Product and Function Dimensions of the Market *14*
Geographic Extent of the Market *14*
THE NATIONAL MARKET FOR THE DISTRIBUTION AND PROCESSING OF STEEL PLATE 14
Product and Function Dimensions of the Market *14*
Geographic Extent of the Market *14*
THE NATIONAL MARKET FOR THE DISTRIBUTION AND PROCESSING OF STEEL COIL 15
Product and Function Dimensions of the Market *15*
Geographic Extent of the Market *15*
THE NATIONAL MARKET FOR THE MANUFACTURE AND DISTRIBUTION OF DOMESTIC ROOFING PRODUCTS 15
Product and Functional Dimensions of the Market *15*
Geographic Extent of the Market *16*
THE NATIONAL MARKET FOR THE MANUFACTURE AND DISTRIBUTION OF INDUSTRIAL ROOFING PRODUCTS 16
Product and Functional Dimensions of the Market *16*
Geographic Extent of the Market *16*
CONCLUSION ON MARKET DEFINITION 17

COMPETITION ANALYSIS 17

INTRODUCTION 17
The Dominance Test *18*
THE MARKETS FOR THE DISTRIBUTION OF MERCHANT STEEL PRODUCTS 19
Market Concentration *19*
Constraint from Existing Competition *20*
CONSTRAINT FROM MARKET ENTRY 21
BARRIERS TO ENTRY 21
Distribution Network *21*
Incumbent Response *22*
Cost of Establishing Brand Loyalty and Reputation *23*
Conclusion: Barriers to Entry *23*
ASSESSMENT OF THE CONSTRAINT BY POTENTIAL COMPETITION 23
Likelihood and Sustainability of Entry *24*
Extent of Entry *24*

Timeliness of Entry ... *25*
CONCLUSION ON CONSTRAINTS FROM POTENTIAL COMPETITORS ... 25
Countervailing Power of Buyers and Suppliers ... *25*
CONCLUSION ON THE NATIONAL MARKET FOR THE DISTRIBUTION OF MERCHANT STEEL PRODUCTS ... 26
THE NATIONAL MARKET FOR THE FABRICATION AND DISTRIBUTION OF REINFORCING STEEL ... 26
Market Share ... *26*
Constraint from Existing Competition ... *27*
Constraint from Potential Competition ... *27*
Countervailing Power of Buyers and Suppliers ... *28*
CONCLUSION ON THE NATIONAL MARKET FOR THE FABRICATION AND DISTRIBUTION OF REINFORCING STEEL ... 28
THE NATIONAL MARKET FOR THE DISTRIBUTION AND PROCESSING OF STEEL PLATE ... 29
Market Share ... *29*
Constraint from Existing Competition ... *29*
Constraint from Potential Competition ... *30*
CONCLUSION ON THE NATIONAL MARKET FOR THE DISTRIBUTION AND PROCESSING OF STEEL PLATE ... 30
THE NATIONAL MARKET FOR THE DISTRIBUTION AND PROCESSING OF STEEL COIL ... 31
Market Share ... *31*
Constraint from Existing Competition ... *31*
Constraint from Potential Competition ... *32*
The Countervailing Power of Buyers and Suppliers ... *32*
Conclusion on the Market for the Distribution and Processing of Steel Coil ... *32*
THE MARKET FOR THE MANUFACTURE AND DISTRIBUTION OF DOMESTIC ROOFING PRODUCTS ... 32
Market Share ... *32*
Constraint from Existing Competition ... *33*
Constraint from Potential Competitors ... *34*
The Countervailing Power of Buyers and Suppliers ... *34*
CONCLUSION ON THE NATIONAL MARKET FOR THE MANUFACTURE AND DISTRIBUTION OF DOMESTIC ROOFING PRODUCTS ... 34
THE MARKET FOR THE MANUFACTURE AND DISTRIBUTION OF INDUSTRIAL ROOFING PRODUCTS ... 35
Market Share ... *35*
Constraint from Existing Competition ... *35*
Constraint from Potential Competition ... *36*
The Countervailing Power of Buyers and Suppliers ... *36*
CONCLUSION ON THE MARKET FOR THE MANUFACTURE AND DISTRIBUTION OF INDUSTRIAL ROOFING PRODUCTS ... 36

OVERALL CONCLUSION ... 36

DETERMINATION ON NOTICE OF CLEARANCE ... 37

DISSENTING OPINION OF M N BERRY ... 38

BASIC PRINCIPLES ... 38
MERCHANT STEEL PRODUCTS ... 39
STEEL PLATE ... 45
CONCLUDING REMARKS ... 46

THE PROPOSAL

Pursuant to section 66(1) of the Commerce Act 1986 (the Act), Fletcher Challenge Steel Products Limited (Fletcher Steel) gave notice to the Commission dated 6 October 1999 (the application), seeking clearance for it to acquire up to 100% of the shares in Steel and Tube Holdings Limited (Steel and Tube).

THE PROCEDURES

2 Section 66(3) of the Act requires the Commission either to clear or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. Two extensions of four working days and five working days were sought by the Commission and agreed to by Fletcher Steel. Accordingly, a decision on the application is required by 4 November 1999.

3 In the application, Fletcher Steel sought confidentiality for sensitive commercial information contained in the application and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the notice. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.

4 The Commission's determination is based on an investigation conducted by its staff.

5 In the course of their investigation of the proposed acquisition, Commission staff have discussed the application with a number of parties. These parties included roofing manufacturers and distributors, steel distributors and processors, large manufacturers, large construction companies and independent domestic manufacturers of steel products.

THE PARTIES

Fletcher Challenge Steel Products Limited (Fletcher Steel)

6 Fletcher Steel is a wholly owned subsidiary of Fletcher Challenge Industries Limited, which forms part of the Fletcher Challenge group of companies. Other wholly owned subsidiaries of Fletcher Challenge Industries Limited include Fletcher Construction Company Limited, Firth Industries Limited, Winstone Aggregates Limited, Fletcher Homes Limited, Pacific Steel Limited and CSP Pacific Limited. These companies are all part of the Fletcher Challenge Building division of Fletcher Challenge Limited. Fletcher Challenge Building is ranked as the fifth largest company in New Zealand in terms of revenue.[1]

7 Fletcher Steel is the parent company of a number of subsidiaries involved in the merchandising, processing and manufacture of a range of steel products. Dimond Industries is one trading arm that is involved in the manufacture and marketing of a range of roll-formed steel roofing and cladding products. Dimond Industries also markets a pressed metal tile for the roofing market, and manufactures and markets a range of gutter systems, ridging, barges, flashings and metal fascia.

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[1] "1998 Top 200 New Zealand Companies", Management December 1998, 74

8 Fletcher Easy Steel is another trading arm whose principal business is the distribution of long and flat steel products. It distributes merchant steel products and processed and unprocessed steel plate and coil products.

9 Fletcher Reinforcing is a trading arm involved in the fabrication of steel reinforcing bar products.

10 Fletcher Steel has a nationwide distribution network for its businesses.

Steel and Tube Holdings Limited (Steel and Tube)

11 Steel and Tube is the parent company of a number of subsidiaries involved in the merchandising, processing and manufacture of a range of steel products. It is a publicly listed company, which is ranked as the 52nd largest company in New Zealand in terms of annual revenue.[2] The majority shareholder of Steel and Tube is Tubemakers of New Zealand Limited (Tubemakers) which holds 50.01% of its issued share capital. Tubemakers is a wholly owned subsidiary of an Australian company, Broken Hill Proprietary Limited (BHP) which also owns BHP New Zealand Steel Limited. Tubemakers' 50.01% shareholding is currently being offered for sale by BHP.

12 Steel and Tube is involved in the manufacture and distribution of steel roofing products through its subsidiaries BHP Steel Building Products NZ Limited and Longrun Industries Limited.

13 It is involved in steel distribution and processing through its trading arm Steel and Tube, and "Nuts, Bolts & Screws", and through its subsidiaries Stewart Steel Limited, Metal Sales Limited, and Fastening Supplies Limited.

14 Steel and Tube is also involved in the reinforcing and fabrication of steel products through CP Reinforcing Limited.

15 Steel and Tube has a nationwide distribution network for its businesses.

OTHER RELEVANT PARTIES

Kiwi Steel Limited (Kiwi Steel)

16 Kiwi Steel is involved predominantly in the distribution of steel coil and steel plate. It has distribution outlets in Auckland and Christchurch, and has a representative in the Hawkes Bay. Kiwi Steel distributes steel on a nationwide basis.

Asmuss Steel and Wire (Asmuss)

17 Asmuss is a division of industrial company HJ Asmuss & Co Limited which has been in business for 75 years, although it has become a significant steel supplier only in the past ten years. Asmuss is involved in the nationwide distribution and processing of steel plate, steel merchant products and steel reinforcing. Asmuss has steel distribution outlets in Auckland, New Plymouth, Wellington (Steel Traders Limited) and Christchurch (Tudor Pipeline Supplies Limited).

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[2] Ibid at 76

Vulcan Steel Limited (Vulcan)

18 Vulcan, a privately owned company, is involved in the distribution and processing of steel coil, steel plate and steel merchant products. Vulcan distributes steel products nationally, with outlets in Auckland, Palmerston North, Nelson, Christchurch and Dunedin.

United Industries Limited (United)

19 United is the parent company of subsidiaries Metalcraft Industries Limited (Metalcraft), ReoFab Limited (Reofab) and Steel Plus Limited (Steel Plus). Metalcraft is involved in the manufacture and distribution of long run steel roofing products. Steel Plus is involved in the distribution of steel merchant products and Reofab in the fabrication and distribution of steel reinforcing rod.

20 Metalcraft operates a nationwide distribution network with outlets in Auckland, Hamilton, Palmerston North, Wellington and Christchurch. Steel Plus operates in the Auckland region and ReoFab operates in the northern part of the North Island **[ ]**.

BHP New Zealand Steel (New Zealand Steel)

21 New Zealand Steel manufactures flat rolled steel products at its steel mill situated at Glenbrook in South Auckland. It has a production capacity of 700,000 tonnes and in the year ending May 1999 produced [ ] tonnes of which [ ] was exported.

Pacific Steel

22 Pacific Steel, which is part of the Fletcher Challenge group of companies, manufactures steel billet which is further processed to produce ‘long’ steel products. This steel mill has a production capacity of 300,000 tonnes per annum. In the year to June 1999 Pacific Steel produced [ ] tonnes for the domestic market.

BACKGROUND

Steel Industry

23 Steel is a metal composed of iron plus various amounts of carbon as well as other elements such as chromium, nickel, molybdenum, zirconium, vanadium. Steel with different characteristics is produced by adjusting the chemical composition and adapting any of the different stages of the steel making process. Currently there are over 3000 catalogued steel grades available, which range from basic grades to sophisticated high-alloy for specialised applications.[3]

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[3] <http://www.worldsteel.org/steelmaking/intro/index.htm1>

24 Steel can be made by two different processes: the 'blast furnace' process and the 'electric arc furnace' steel making process. The blast furnace is the first step in producing steel from iron oxides, and large modern furnaces can produce 13,000 tons of steel per day. An electric arc furnace uses 'scrap steel' as an input, which is melted and refined to produce steel.

25 Crude steel is produced from the steel making process. Crude steel is then formed into semi finished or finished products, which are sold to processors and manufacturers. The semi finished products are steel slabs, billets and blooms. Steel slabs go through further processing to produce hot or cold rolled flat products such as plates, coils or sheets. Blooms and billets are processed to produce hot-rolled long products such as tube, structural mill and bars and rods. These products are known as finished products.

26 Steel is produced for a vast array of products. The largest markets for steel are construction and manufacturing. The manufacturing sector of the economy contributes about 18% to New Zealand's nominal GDP, whilst the construction sector contributes about 4%.[4] These two industries are important in the New Zealand economy. Steel is used in road, rail and bridge construction, food and beverage cans, concrete walls and pillars, furnishings, industrial machinery and in a vast array of other products.

27 The demand for steel is cyclical in nature and reflects major economic forces. Steel use increases when construction activity is increased, as investment is made in infrastructure and transport. An economic recession results in lower demand for steel because there is a lower level of investment in the economy.[5]

28 The largest consumption of steel is in the wealthiest countries of the world. Steel consumption of finished steel products in 1997 ranges from approximately 20 kilograms per person per year in Africa to around 340 kg in Europe, 420 kg in the United States and 635 kg in Japan. The largest consumers are in Asia,[6] where consumption is climbing rapidly due to investments in industry, transport, infrastructure, and construction.[7] In New Zealand steel consumption per person was 154 kg, whilst the figure for Australia was 323 kg per person.[8]

29 The apparent consumption of finished steel for some of the major countries is summarised in Table One below.

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[4] <http://www.treasury.govt.nz/pubs/nzdmo/efo_99/Economy.htm>
[5] <http://www.worldsteel.org/trends_indicators/20thcentury.htm1>
[6] Singapore 1200 kg/capita, Taiwan over 970 kg/capita and South Korea 830 kg/capita.
[7] <http://www.worldsteel.org/steelmaking/intro/index.htm1>
[8] International Iron and Steel Institute, *Steel Statistical Yearbook 1998* (International Iron and Steel Institute Association, Brussels, 1998) 202

Table One
Apparent Consumption of Finished Steel (million metric tonnes)

Country	**1997**	**1996**	**1995**	**1994**
China	108.5	105.5	97.8	105.4
United States	113.2	106.7	99.5	102.9
Japan	79.9	75.8	77.7	64.9
Russia	16.1	15.8	17.2	16.4
Germany	34.2	30.7	36.5	34.2
Australia	6.0	5.5	5.6	5.7
New Zealand	0.580	0.690	0.667	0.630

Source: *Steel Statistical Yearbook 1998*, International Institute Steel and Iron

30 The global steel industry produces over 750 million tons of crude steel each year, with the largest producing countries being China, Japan and the United States. Global steel production is summarised in Table Two below, whilst Table Three summarises the largest steel producing companies.

Table Two
The Major Steel Producing Countries
(Million metric tons crude steel production)

Country	**1998**	**1997**	**1996**	**1995**
China	114.3	108.9	101.2	95.4
United States	97.7	98.5	95.5	95.2
Japan	93.5	104.5	98.8	101.6
Germany	44.7	45.0	39.8	42.1
Russia	42.5	48.4	49.3	51.6
Australia	8.8	8.8	8.4	8.5
New Zealand	0.800	0.758	0.808	0.842

Source: *Steel Statistical Yearbook 1998*, International Institute of Steel and Iron

Table Three
The Largest Steel Producing Companies
(million metric tons crude steel output)

Company	**1998**	**Country**
POSCO	25.6	South Korea
Nippon Steel	25.1	Japan
Arbed	20.1	Luxembourg
Usinor	18.9	France
LNIM	17.1	Great Britain
British Steel	16.3	Great Britain
Thyssen Krupp	14.8	Germany
Riva	14.5	Italy
NKK	11.5	Japan

Source: *Steel Statistical Yearbook 1998*, International Institute of Steel and Iron

31 The global steel production industry is characterised by strong competition, and a feature of the industry is excess capacity. The industry faces increasing global concentration of client industries, technological change and pressure on steel prices. Globally, domestic producers of steel face competition from imports. In 1997 world trade in steel as a percentage of world steel production was 37.3 percent.[9]

New Zealand Steel Production

32 There are two producers of steel in New Zealand, New Zealand Steel and Pacific Steel. New Zealand Steel produces ‘flat’ steel products, slabs, which are formed into plate and coil, and ‘long’ steel products, which are formed into merchant steel. Pacific Steel produces ‘long’ steel products, blooms and billets which are formed into reinforcing and merchant products.

33 Seventy two percent of the steel produced in New Zealand is by the ‘blast furnace’ process; the remaining 28 percent of steel is produced by the ‘electric arc’ process.[10]

New Zealand Steel Distribution

34 The two domestic producers of steel, New Zealand Steel and Pacific Steel, have their steel mills in the Auckland region. Pacific Steel uses a combination of rail and road operations to transport steel from the mill to consumers.

35 Pacific Steel has a $29 per tonne standard rate for transportation of steel to the main North Island centres, and a $42 per tonne standard rate for deliveries to the main South Island centres. For delivery to locations other than those specified above, or for direct delivery to a destination other than the customer’s store, an additional $25 per tonne is charged.

36 The majority of the imported steel product comes into the ports of Auckland and Lyttelton and is distributed from there. The transportation cost is a function of the

[9] Ibid at 117
[10] <http://www.worldsteel.org/trends_indicators/figures_6.htm1>

distance travelled, and based upon information provided to the Commission, can range from 3% to 9% of the total per tonne delivered cost.

37 Historically, multi-branch distribution structures developed because of the regulated transport industry, which required New Zealand Railways to carry freight over 150km. Rail transport was relatively inefficient and infrequent, which resulted in a network of regional branches offering major product lines. The transport industry was deregulated and this has resulted in efficiencies and the provision of better service. Steel can now be delivered quickly and relatively cheaply.

38 The presence of multiple steel distribution branches around New Zealand has created an expectation from steel purchasers that demand can be satisfied on a 'just in time' basis. A large number of sales at these regional locations are small 'daily sales', where consumers expect to purchase steel the day they require it.

39 However, Queenstown is an example of a location where there are no distribution outlets and where there is a demand for steel from the construction industry. Purchasers have to plan their steel purchasers and allow for transportation. They cannot rely on 'just in time' purchasing.

40 In steel processing, particularly coil processing, new machinery costs are relatively high, which results in centrally located processing centres. The processed steel is then distributed to the purchaser.

41 Distribution of steel in New Zealand is therefore characterised by two distinct network systems. The two largest firms, Fletcher Steel and Steel and Tube, each have dispersed processing and distribution networks across a range of goegraphic locations. Newer, smaller operators have centralised their processing and distribution functions, and rely on transportation options to carry goods to consumers.

THE RELEVANT MARKETS

Introduction

42 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.

43 Section 3(1A) of the Act provides that:

> "the term 'market' is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them."

44 Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*[11] and in the Commission's *Business Acquisition Guidelines* ("the Guidelines").[12] A brief discussion of the methodology follows.

45 Markets are defined in relation to product type, geographical extent, and functional level. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, in response to a change in relative prices of the products concerned. A market is the smallest area in which all such substitution possibilities are encompassed. It is in this area that a hypothetical monopoly supplier could exert market power.

46 A properly defined market will include products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension). A market defined in these terms is one within which a hypothetical profit-maximising sole supplier of a product could impose at least a small yet significant and non-transitory increase in price (the *"ssnip"* test), assuming other terms of sale remain unchanged. It will also include those suppliers currently in production who are likely, in the event of such a *ssnip*, to shift promptly to offer a suitable alternative product, or offer their product to alternative acquirers.

47 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products proceeds through a series of vertical functional levels, so the functional levels affected by the application have to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the "manufacturing market", while that between wholesalers and retailers is usually known as the "wholesaling market".

48 The nature of the markets at issue in this proposed acquisition are complex, and may be considered in a variety of ways. Nonetheless the Commission has adopted a pragmatic approach to the issue of market definition, given the information provided by Fletcher Steel, and other industry sources. The Commission recognises that there may be arguments to support wider (or narrower) market definitions. However, for the purposes of analysing this proposal, the Commission considers that the market definitions discussed below are the most appropriate upon which to base an analysis of the competition and competitive effects of the proposed merger.

49 On the basis of the application, and investigation of the proposal, the Commission considers that the potential areas of aggregation in the case of this application would be in the following markets:

- the national market for the distribution of merchant steel products;
- the national market for the distribution and fabrication of reinforcing steel;
- the national market for the distribution and processing of steel plate;
- the national market for the distribution and processing of steel coil;

[11] (1991) 4 TCLR 473.
[12] Commerce Commission, *Business Acquisition Guidelines*, 1999, 11-16.

- the national market for the manufacture and distribution of residential roofing products; and
- the national market for the manufacture and distribution of industrial roofing products.

The National Market for the Distribution of Merchant Steel Products

50 Merchant steel products generally encompass products consisting of steel bars, angles, flats, square and rectangular hollow sections, pipes, structural sections, special steels and stainless steels. These merchant products are imported into New Zealand by domestic distributors and manufacturers. Merchant steel products are also supplied by two domestic producers, BHP NZ Steel and Pacific Steel.

51 Merchant steel products are sold to a variety of end users including fabricators, building merchants, builders, the construction industry and manufacturers.

Product and Function Dimensions of the Market

52 Fletcher Steel submits that merchant product is generally a more extensively transformed product than other steel products, and many users would be reluctant to fabricate merchant products from either coil or plate steel for their own use.

53 As there is no processing of merchant steel products, Fletcher Steel submits that the functional level in this case is that of distribution only.

54 The Commission's investigations of the proposal have found that the applicant's product and functional definitions of merchant steel products are accurate, and reflect the fact that there are unlikely to be substitute products available. It is also noted that the definitions are generally agreed to by other market participants.

55 For the purposes of analysing this proposal, it is considered appropriate to define the market as that for the distribution of merchant steel products.

Geographic Extent of the Market

56 Fletcher Steel submits that the appropriate geographic extent of the market is national. Fletcher Steel contends that, in addition to a national distribution network conducted by itself and Steel and Tube, a number of other steel distributors conduct business outside their specific location.

57 Fletcher Steel submits that many customers purchase merchant products on a national basis, and that there is evidence that customers with a presence in one region can, and do, access suppliers from across New Zealand.

58 The Commission received a number of submissions from purchasers of steel products, stating that they only purchased locally from within their respective regions. These purchasers are generally small-scale provincial operators, typically involved in the engineering and manufacturing sectors. The operators submitted that, as they purchased steel in relatively small amounts, the cost of freighting steel from neighbouring districts was likely to be prohibitive.

59 These same purchasers also made reference to the fact that many of them do not hold stock, and purchase their requirements on a "just in time" basis. In addition to the cost of freight, the purchasers also expressed a concern that alternative suppliers did not

carry the wide range of products stocked by Fletcher Steel and Steel and Tube, thereby causing delays in accessing a particular product when required.

60 While Fletcher Steel and Steel and Tube have dispersed networks, there are examples of smaller operators where centralisation of distribution has occurred due to modern transportation and logistics. The relative sizes of these smaller operators as against the merger parties suggests that the number of outlets is dictated, in part, by the scale of the operation. That is, the larger merger parties are both supported by an extensive, regional network of branches, with smaller distributors operating a centralised distribution network.

61 The business activities of Asmuss Steel, and the entry of other distributors such as Kiwi Steel and Vulcan Steel, are examples of national distribution being effected from centralised locations. These companies, all based in Auckland, distribute varying ranges of steel products to customers throughout New Zealand. In selected areas, these operators will have a warehouse or depot to store their respective products, though it may not include any processing equipment. In such cases, the processing will be contracted to a steel processor.

62 The Commission notes that Vulcan Steel, of Auckland, is currently constructing a distribution facility in Palmerston North that will principally serve the lower North Island. [ ] The Commission also notes that Asmuss, also of Auckland, has depot facilities in Wanganui, and a subsidiary company operating in Christchurch.

63 The Commission's investigations of the proposal have therefore found that on the demand side of the merchant steel products market, there is evidence of purchases being made on a national basis, as well as the smaller customers purchasing only from within their own immediate locality. On the supply side, the Commission's investigation confirms that distribution of steel products is made by large operators through a dispersed network and, in part, distribution is also made by smaller operators through a relatively centralised network.

64 The conflicting information regarding the supply of merchant products has provided some difficulty in accurately assessing the geographical boundaries of the market. However, given the information provided to the Commission, it is currently unlikely that a distributor in any region could profitably impose a *ssnip*.

65 For the purposes of analysing this proposal, the Commission concludes that the relevant geographic market for the distribution of merchant steel products is national.

The National Market for the Fabrication and Distribution of Reinforcing Steel

66 Reinforcing steel encompasses the fabrication and distribution of steel rods and associated consumables for use in concrete reinforcement. Reinforcing steel can be purchased as "deformed" bar or "plain" bar. Deformed bar is commonly used and has a "ribbed" pattern on the external surface. Fabrication involves the cutting and bending of reinforcing rod, and the manufacture of reinforcing mesh.

67 The majority of reinforcing steel used in New Zealand is produced domestically by Pacific Steel, the remaining product is imported. Reinforcing is sold for use in domestic and industrial construction and to retailers and building merchants for resale to smaller builders and private construction.

Product and Function Dimensions of the Market

68 Reinforcing steel is used for the specific function of concrete reinforcement in a variety of building projects. In the New Zealand construction industry there exists a reinforcing bar code, developed to provide for a particular earthquake resistance. The nature of reinforcing steel is such that it is not substitutable for any other product.

69 The fabrication of reinforcing steel involves bending and cutting reinforcing rod to standard sizes, or to particular specifications as advised by the customer. The cutting of rod can therefore be seen as an integral part of the distribution process.

70 Based on the information available, the Commission concludes that there is a separate market for the fabrication and distribution of reinforcing steel.

Geographic Extent of the Market

71 Fletcher Steel submits that the appropriate geographic market for reinforcing steel is a national market.

72 The Commission's investigation have found that, in addition to the national operations of Fletcher Steel and Steel and Tube, a number of smaller regional operators process and distribute steel reinforcing. These parties source the reinforcing steel either locally from Pacific Steel, or through imports.

73 For the reasons canvassed above in the discussion of merchant steel products, the Commission considers that a *ssnip* applied in any regional area is likely to cause sufficient customers to source reinforcing steel from elsewhere. The Commission concludes that the relevant geographic market for the fabrication and distribution of reinforcing steel is a national market.

The National Market for the Distribution and Processing of Steel Plate

74 Plate is generally a more "heavy duty" steel product. The majority of the product is produced domestically by New Zealand Steel. Some product is imported. Plate is generally sold in cut and uncut forms to a variety of end users including civil construction, heavy engineering businesses and a range of manufacturers.

Product and Function Dimensions of the Market

75 The Commission's investigation found that users of steel plate products are unlikely to substitute any other product. Steel plate has a specific "heavier" use than coil or other steel product, as evidenced by its use in construction and heavy engineering.

Geographic Extent of the Market

76 The distribution and processing of steel plate products is considered to be similar to that of reinforcing steel. There does not appear to be anything specific about plate products that requires a different view of the distribution process or geographic market.

77 Accordingly, for the reasons outlined above in the geographic analysis (at paragraphs 56 to 65), the geographic market for the processing and distribution of steel plate products is considered to be national in extent.

The National Market for the Distribution and Processing of Steel Coil

78 Steel coil refers to coil either sold complete in coil form, or cut into panels or strips. Plate product can either be purchased direct from the major domestic producer, New Zealand Steel, or purchased from an international producer. The Commission understands that New Zealand Steel has a one tonne minimum order, and overseas producers generally have a 50 tonne minimum order.

79 Steel coil is predominantly used in roofing and manufacturing (such as household appliances) in New Zealand.

Product and Function Dimensions of the Market

80 On the basis of information provided to the Commission by industry participants, steel coil is generally not substitutable for any other steel product. As with a number of other steel products, coil is cut and dispatched according to customer specifications. The processing can therefore be seen as overlapping the distribution process, such that the two should be considered together.

81 The Commission considers that the appropriate market is that for the distribution and processing of steel coil.

Geographic Extent of the Market

82 For the reasons given above, in relation to the geographic market for other steel products, the Commission considers that the appropriate geographic market is a national one.

The National Market for the Manufacture and Distribution of Domestic Roofing Products

Product and Functional Dimensions of the Market

83 There are a number of roofing products available for domestic roofing requirements. These include concrete tiles, rollformed steel products, metal tiles, shingles, and in some cases, rubber membrane products.

84 Fletcher Steel, Steel and Tube, and others, source steel for use in the manufacture of rollformed roofing products from distributors of coil, including related companies, and directly from New Zealand Steel, and imports. This rollformed product is then sold to roofers.

85 Fletcher Steel submits that a single roofing market, combining both domestic and industrial roofing products, is the appropriate market for considering the likely competitive effects of this proposal. Fletcher Steel submits that the use of all the various mainstream roofing products across both the domestic and industrial segments, albeit in differing proportions, supports its view.

86 The Commission received conflicting evidence as to whether domestic and industrial roofing may properly be considered as one market. Many industry parties considered that the two should be considered separately, submitting that many domestic roofing products, such as tiles and shingles, were not considered for use in an industrial roofing project. Further, industry parties commented that domestic roofing manufacturers and

distributors, such as Monier and AHI Roofing, were not active in the industrial roofing market.

87 Industry sources also stated that the industrial market was extremely price sensitive, whilst the domestic roofing market was less so. In the domestic roofing market, competitive factors such as fashion, aesthetics and cost are also relevant.

88 The Commission recognises that there are some arguments that support a broader market, such as that for roofing products. However, there are also arguments to support defining markets specifically to either domestic or industrial roofing. For the purposes of this application, the Commission proposes to adopt "narrow" market definitions with respect to roofing products. In doing so it is noted that if there are no dominance concerns arising out of these narrow markets, there are unlikely to be any dominance concerns within the wider market.

Geographic Extent of the Market

89 Information provided to the Commission confirms that many customers purchase on a national basis.

90 In addition to Fletcher Steel and Steel and Tube, there is a number of other national operators, including Monier and AHI Roofing. In addition to these operators there are a significant number of regional roofing distributors, operating on an inter-regional basis and serving a wider geographic area than their immediate localities.

91 The functional level at issue here is the distribution level, and not the supply and installation of roofing for final consumers. Therefore, the lead times in this market appear to be such that product can be sourced from a wide geographic area. The information provided to the Commission suggests that transport costs are not high relative to the delivered product, and would not be sufficient to sustain a *ssnip* in a narrow geographic area.

92 Accordingly, the appropriate geographic market for the manufacture and distribution of domestic roofing products is considered to be national in extent.

The National Market for the Manufacture and Distribution of Industrial Roofing Products

Product and Functional Dimensions of the Market

93 Fletcher Steel submits that industrial roofing products include the same products as those supplied for domestic roofing requirements, although it recognises that tile options are likely to be weaker substitutes than in domestic roofing.

94 As with the discussion of domestic roofing, the Commission recognises that it is possible for a broader roofing market to be considered. However, for the purposes of analysing the competitive impact of the current proposal, the Commission proposes to define an industrial roofing products market.

Geographic Extent of the Market

95 For the reasons outlined above in the geographic analysis of the domestic roofing market, a national market is considered appropriate.

Conclusion on Market Definition

96 On the basis of the analysis above, and on the information available, the Commission considers that the relevant markets for the purpose of analysing the competition issues arising from the proposed merger are the following:

- the national market for the distribution of merchant steel products;
- the national market for the distribution and fabrication of reinforcing steel;
- the national market for the distribution and processing of steel plate products;
- the national market for the distribution and processing of steel coil products;
- the national market for the manufacture and distribution of domestic roofing products; and
- The national market for the manufacture and distribution of industrial roofing products.

COMPETITION ANALYSIS

Introduction

97 The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of **dominance**.

98 Competition in a market is a broad concept. It is defined in section 3(1) of the Commerce Act as meaning "workable or effective competition". In referring to this definition the Court of Appeal said:[13]

> "That encompasses a market framework which participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency."

99 Section 3(9) of the Commerce Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has … a dominant position in a market if that person as a supplier … of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is … in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
> (b) The extent to which that person is … constrained by the conduct of competitors or potential competitors in that market:
> (c) The extent to which that person is … constrained by the conduct of suppliers or acquirers of goods or services in that market."

[13] *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 564-565

The Dominance Test

100 Section 47(1) of the Commerce Act prohibits certain business acquisitions:

> "No person shall acquire assets of a business or shares if, as a result of the acquisition, -
>
> (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
>
> (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

101 The test for dominance has been considered by the High Court. McGechan J stated:[14]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

102 Both McGechan J and the Court of Appeal, which approved this test,[15] stated that a lower standard than "a high degree of market control" was unacceptable.[16] The Commission has acknowledged this test:[17]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction."

103 The Commission's *Business Acquisitions Guidelines* state:

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor {or} customer reaction."
>
> …
>
> "A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability." (p21)

104 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined.

105 The Commission applies the dominance test in the following competition analysis.

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[14] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)
[15] *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)
[16] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC) and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)
[17] *Business Acquisition Guidelines*, Section 7

The Markets for the Distribution of Merchant Steel Products

Market Concentration

106 An examination of concentration in a market often provides a useful first indication of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.

107 The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act -

> "In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
>
> > the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
> >
> > the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share." (p 17)

108 These safe harbours recognise that both absolute levels of market share and the distribution of market shares between the merged firm and its rivals is relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state that:

> "Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of shares, fall within these safe harbours."

109 Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through market entry, also typically need to be considered and assessed.

110 Fletcher Steel provided market share estimates for the markets affected by this proposal. The Commission has sought to confirm much of the data provided following reference to other industry parties. The information provided by industry sources resulted in market estimates similar to those provided by Fletcher Steel.

111 Table Four provides the estimated market shares in the market for the distribution of merchant steel products.

Table Four
Estimated Market Shares in the National Market for
The Distribution of Merchant Steel Products

Company/trading name	**Estimated Market share**
Fletcher Steel	[ ]%
Steel and Tube	[ ]%
Merged Entity	**[ ]%**
Kiwi Steel	[ ]%
Vulcan Steel	[ ]%
Asmuss Steel	[ ]%
Steel Plus/Reofab Ltd	[ ]%
Other	[ ]%
Direct Imports	[ ]%
Independent Imports	[ ]%
Total	**100%**

112 On the basis of the above figures, the merged entity's estimated market share of the merchant steel market is over 60%. [ ] is the only competitor with an estimated market share of 15% or greater in this market.

113 From this data, it would appear that the combined entity's market share would fall outside the Commission's "safe harbours". However, as stated earlier, the fact that a proposed acquisition may lead to a market share falling outside these "safe harbours" does not necessarily mean that it will be likely to result in the acquisition or strengthening of a dominant position in a market. Additional factors must also be considered before a conclusion on dominance is reached. These other factors are discussed below in paragraphs 114-161.

Constraint from Existing Competition

114 In the market for the distribution of merchant steel products the merged entity would have a market share of approximately [ ]. Asmuss Steel has approximately [ ] market share, whilst Vulcan Steel has a market share of approximately [ ]. Fletcher Steel submits that both these competitors, and other smaller operators, provide an effective constraint such that market power cannot be exercised by the merged entity.

115 The Commission understands that Asmuss Steel entered the merchant steel products market in 1990, and Vulcan Steel began its operations in 1996. Both parties have advised the Commission that, following entry, they attained a market share in the order of [ ]%. The Commission understands that this market share has not increased significantly in recent years. The pattern of entry indicates small scale market entry followed by a modest expansion of market share and corresponding price competition in related areas. Such entry is often associated with "niche" or "fringe" operators.

116 The assessment of the smaller operators as "fringe" operators is supported by the finding, noted earlier, that many end users of merchant steel products are not aware of the presence of operators other than the merger parties.

117 To the extent that scale advantages exist now for the merger parties, these are likely to be accentuated post-acquisition. The ability of the smaller operators to effectively compete currently against the merger parties is therefore likely to be lessened following the proposed acquisition.

118 Given the current market circumstances, the Commission concludes that the competition provided by current competitors is not sufficient to effectively constrain the merged entity in this case. Rather, competition in the market for the distribution of merchant steel products is likely to continue in the manner currently in evidence. This evidence suggests that the market is likely to continue to be characterised by small market shares shared by "fringe" distributors operating at a level that does not impose a significant constraint of sufficient extent upon the merger parties.

Constraint from Market Entry

119 A business acquisition is unlikely to result in any person acquiring or strengthening a dominant position in a market if behaviour in that market continues to be subject to significant constraints from the threat of market entry.

120 The Commission accepts that potential competition can act as a constraint on business activity. An assessment of the nature and extent of that constraint is an integral part of the Commission's assessment of competition and market dominance.

Barriers to Entry

121 Entry conditions, including the nature and height of any entry barriers, must be determined before the threat of new entry, which might constrain the conduct of the merged entity, can be properly evaluated.

122 Fletcher Steel submits that barriers to entry into the market for the distribution of merchant steel products are low. Fletcher Steel submits that entry involves a small capital outlay, the purchase of relatively inexpensive equipment, and no specific technical or labour knowledge. Fletcher Steel submits further that access to supplies, either from domestic producers or from overseas providers, does not pose any significant concerns, such that it acts as a barrier to entry into the market.

123 Following discussions with, and submissions from, a number of industry sources, the Commission has reviewed the relevant entry conditions below.

Distribution Network

124 A significant feature of this proposed acquisition is the extensive networks currently operated by the merger parties. Both Fletcher Steel and Steel and Tube have operations in a number of provincial areas of New Zealand, providing for immediate service delivery in some cases. The scale and reach of the merger parties' distribution network was considered by many industry sources as needing to be replicated by a potential entrant, and therefore represents a significant entry barrier. Indeed, the *Business Acquisition Guidelines* acknowledge the lack of access to distribution networks as a barrier to entry.

125 Alternatively, Fletcher Steel and a number of other industry parties (including other small operators) considered that a physical network of branches was not necessary to effectively compete at a national level. These parties pointed to the availability of a

number of transportation options, and submitted that a centralised distribution network is the modern model for distribution of steel products.

126 The Commission recognises that centralised distribution affords one method of distributing steel products to end users. Nonetheless, the scale and scope of the service centres operated by the merger parties is reflected in the estimated market shares of the merger parties, and the relatively modest market shares of other operators. It appears that a significant advantage is gained in this market if an operator is able to effectively service clients quickly. However, there remains a question as to why competitors have not competed across a wide range of products, and with a wider distribution network system.

127 An entrant would recognise that it would need to meet consumer expectations of frequency and level of service in order to compete effectively. This would require the establishment of an extensive distribution system, at considerable cost to an entrant. Further, the maintenance and continuation of the network requires ongoing financial and logistical support. The efficiencies of maintaining a distribution network are a reflection of the attainment of market share, and subsequent expansion of market share. In the event that market share is lost, the costs of maintaining that distribution network are still required to be borne by the operator. Such factors represent costs which the Commission considers are likely to raise the intial barrier of establishing a network to a level whereby entry at such a scale is unlikely.

128 The Commission concludes that entry would be required on a large scale to provide a real constraint. The Commission considers that this is likely to require entry across a wide product range, and over a wider geographic area than those currently operated by smaller distribution operators. This is likely to be achieved through the establishment and maintenance of a distribution network similar in scale and scope to those operated by the merger parties.

Incumbent Response

129 In order to provide effective competition, a potential entrant must be prepared to enter and secure a viable position in the market against the likely responses from incumbents.

130 An incumbent response might be greatest to the first threat of large scale entry, in order to eject that entry from the market and signal to other prospective entrants that further attempts to enter will be met by a similar response. It might be a particularly strong response if the incumbent believes that it has to make the investment only once, for example, if it has only one entrant to eject, with no other threat of entry imminent. If such a response were successful, it might make further attempts at entry much less likely.

131 The Commission believes it is relevant to consider previous entry into the merchant steel products market. On the basis of the information provided in Table Four above, the Commission notes that Vulcan Steel, with [ ]% and Asmuss Steel, with [ ]%, are the only realistic competitors to the merged entity. The Commission understands that these operators offer a much smaller range of merchant products than the merger parties.

132 The majority of merchant product sourced by smaller operators is through imports. Both the merger parties are also significant importers of merchant steel products. The strong purchasing power of the merged entity is likely to aid its ability to respond to any potential large-scale entry. Imported merchant products appear to compete in

certain areas, and with respect to certain product ranges only. However, there is no evidence of entry at a significant scale across a wide range of products.

133 The Commission concludes that the potential incumbent response is likely to be considered as a substantial entry barrier.

Cost of Establishing Brand Loyalty and Reputation

134 As noted above, the merged entity enjoys an advantage over any potential entrant due to its established branding and reputation in the market. This is particularly so in the present case, where the merger parties have long standing reputations and established relationships with a wide variety of end users.

135 The Commission's investigation has found that knowledge of merchant steel product distributors, other than the merger parties, is low. Many industry sources did not know that Asmuss Steel or Vulcan Steel existed, or did not not consider that either Asmuss Steel or Vulcan Steel could supply the product required, within the necessary timeframe.

136 The lack of knowledge about other operators may be a reflection upon the strategic approach of both Asmuss Steel and Vulcan Steel, to offer a certain range of products only, and trade in relatively well defined geographic areas. Nonetheless, the response of consumers to questions about the availablility and effectiveness of other merchant steel distributors suggests that the brand loyalty and reputation of the merged entity represents a significant barrier to entry that would have to be addressed by any potential entrant.

Conclusion: Barriers to Entry

137 The Commission notes that for a new entrant, an effective level of entry would have to be at the high level of frequency and service currently offered by the merger parties. The costs associated with establishing and maintaining an extensive network are likely to be high.

138 The Commission also notes that an entrant is likely to encounter an immediate and vigorous response, due in the main to the purchasing power of the merged entity.

Assessment of the Constraint by Potential Competition

139 The Commission recognises that potential competition can act as a constraint on the exercise of market power. Hence, the assessment of the nature and extent of that constraint represents an important element in the evaluation of whether, in a business acquisition, the combined entity will acquire or strengthen a dominant position.[18]

140 In the present case the issue is whether Fletcher Steel will acquire or strengthen a dominant position in the national market for the distribution of merchant products through its acquisition of Steel and Tube. This depends upon whether the acquisition will have the effect of reducing the likelihood of entry.

141 In order for the threat of market entry to be a sufficient constraint on the exercise of market power, the Commission's approach is based on the "*lets*" test. Under this test,

[18] Commerce Commission, *Business Acquisition Guidelines*, 1999, p. 19.

to constitute a sufficient constraint, entry must satisfy all four of the following criteria: it must be *l*ikely, sufficient in *e*xtent, *t*imely and *s*ustainable.[19]

Likelihood and Sustainability of Entry

142 In order to be an effective constraint on incumbent market operators, entry must be likely in commercial terms. In addition, entry is likely only if there is likely to be a lasting economic incentive.

143 While Fletcher Steel claims that the market is competitive, and entry barriers are low, the question arises as to why successful entry has been so limited. The only examples of new entry into this market in recent years are those of Asmuss Steel and Vulcan Steel. Both these parties have a market share between [ ]%. Both parties offer a much smaller product range than the merger parties, and have not expanded either their market shares or products in significant ways in recent years.

144 The Commission also considers the history of past market entry as an indicator of the likelihood of future entry. The Commission recognises that entry has been effected by small operators, with limited product ranges, and on a limited geographic scale. The Commission also notes the absence of any large scale entry over the past decade.

145 Consideration of the barriers to entry, discussed above, and the history of entry into this market, suggests that potential entry at a scale that could provide an effective constraint on the merged party is unlikely. The ability of the merged party to provide a quick and vigorous response to any potential entry, in particular, reduces the likelihood of entry being made.

146 Industry sources did not consider that entry at a scale that could effectively constrain the merged party was likely, but that entry could occur on a smaller scale, offering a lesser product range and operating in certain defined geographic regions.

147 On the basis of the analysis and the information received, the Commission has concluded that entry on a significant scale is neither likely nor sustainable.

Extent of Entry

148 If entry is to constrain an otherwise dominant firm, then entry must potentially be at a scale and spread of operations as to impact significantly on its behaviour.

149 In the present case, the two merger parties are the only operators in the merchant steel distribution market with a recognised national network.

150 The Commission has found that entry on a modest or localised basis is not difficult, and there is evidence (in the form of Asmuss Steel and Vulcan Steel) of such entry having occurred on this scale previously. However, the Commission considers that entry at this scale is unlikely to be sufficient to provide an adequate constraint on the combined entity. To effectively constrain the conduct of the merged entity, it is likely to be necessary to establish a distribution network and services on a substantially larger scale, across a more comprehensive range of products.

151 Having regard to these factors, the Commission concludes that it is unlikely that new entry could be achieved on a scale sufficiently large to effectively constrain the combined entity.

[19] *Ibid*., pp. 19-20.

Timeliness of Entry

152 To constrain effectively the exercise of market power to the extent necessary to alleviate concerns about market dominance, entry must be likely to occur before consumers or users in the relevant market are detrimentally affected to a significant extent.[20] The Commission has said that the relevant time period has to be considered on a case-by-case basis.

153 The Commission notes that only two independent operators of note have entered the merchant steel products market in the last nine years. In addition, this entry has been limited to a certain range of merchant products only. Further, entry has been effected in a number of geographic regions only, and there appears to have been no extended coverage of note by entrants beyond their initial entry. It is therefore difficult to accurately assess the timetable needed to effect entry on a scale sufficient to constrain the merged entity.

154 Industry sources advised that entry could be effected within 12 months. This period refers to the time necessary to physically organise depot facilities, distribution networks, and the purchase of stock. It does not include the likely timeframe within which an entrant is expected to attain a certain degree of market share. Once entry has been effected, the entrant can start competing. Therefore, notwithstanding that entry to date has been on a more limited basis, the Commission considers that if a firm were to enter the market, entry could be achieved within 12 months.

Conclusion on Constraints from Potential Competitors

155 Given the above factors, the Commission concludes that the threat of entry at a level similar to that effected by Asmuss Steel and Vulcan Steel is unlikely to constrain the merged entity. The only entry to the merchant steel products market which would be likely to be sufficient to act as a constraint on the merged entity would involve an extensive national processing and distribution network, providing a range of products similar to that offered by the merged entity.

156 The Commission has not seen any evidence that entry or expansion to a level that is similar to that of the merged entity is likely. Conversely, the evidence indicates that entry only occurs, when it does occur, on a small scale, and with a limited range of products.

157 The Commission concludes that entry into the merchant steel products market might be expected to be achieved in a timely manner, but entry would not be likely, sufficient in extent or sustainable enough to constrain the potential market power of the merged entity.

Countervailing Power of Buyers and Suppliers

158 The Commission recognises that a firm may be constrained by countervailing power in the hands of its customers or, when considering monopsony (single buyer) power, suppliers.

159 Industry sources advised that the purchasers of merchant steel products covered a wide variety of end users, including manufacturers, building merchants, and the construction industry. In the case of larger purchasers, it is generally accepted that those purchasers

[20] *Ibid*., p. 19.

would be able to exert a degree of countervailing power on the merged entity, due to the purchasing power of these buyers, and their ability to source directly from the producer, either domestically or internationally.

160 However, that countervailing power does not exist for a significant number of small steel merchant users. The Commission received submissions from a wide variety of merchant product buyers, concerned at the potential ability of the merged entity to increase prices. It was not available for these consumers to source products from elsewhere, due to the relatively small volume of merchant steel products that they require.

161 The Commission considers that there is little or no countervailing power available to small to medium end users of merchant steel products, such that it may provide an effective constraint on the merged entity.

Conclusion on the National Market for the Distribution of Merchant Steel Products

162 Based on the information available the Commission concludes that the merged entity is likely to have a market share of [ ]%, with the larger of the other market participants having in the region of [ ]% each. While the merged entity is likely to face some competition in some product ranges and in some areas, it is unlikely to occur on a substantial scale. The level of competition is therefore considered unlikely to provide an effective constraint upon the merged entity. Evidence provided to the Commission suggests that while recent entrants have attained a small market position, they have not expanded their operations to provide an adequate competitive constraint.

163 Further, the Commission concludes that barriers to entry and expansion, when considered in totality rather than individually, are likely to deter any potential entrant from entering on a scale that will provide an effective constraint upon the merged entity.

164 Based on the information provided, the Commission is not not satisfied that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in this market.

The National Market for the Fabrication and Distribution of Reinforcing Steel

Market Share

165 Outlined below in Table Five are the estimated market shares for the market for the fabrication and distribution of reinforcing steel. On the basis of these figures, the merged entity's estimated market share of this market would be over 60%. [ ] would be the only competitor with a market share greater than 15%.

166 The merged entity would be outside the Commission's 'safe harbour' guidelines in the market for the fabrication and distribution of reinforcing steel. This indicator does raise potential dominance concerns, and an analysis of these markets will be conducted below.

Table Five

Estimated Market Shares in the National Market for the Fabrication and Distribution of Reinforcing Steel

Company/trading name	**Estimated Market Share**
Fletcher Steel	[ ]%
Steel and Tube	[ ]%
Merged Entity	**[ ]%**
Kiwi Steel	[ ]%
Vulcan Steel	[ ]%
Asmuss Steel	[ ]%
Steel Plus/Reofab Ltd	[ ]%
Other	[ ]%
Direct Imports	[ ]%
Independent Imports	[ ]%
Total	**100%**

Constraint from Existing Competition

167 The majority of reinforcing steel in the New Zealand market is produced domestically by Pacific Steel. In the year to June 1999 it produced 61,561 tonnes, whilst 10,132 tonnes were imported. Reinforcing steel is generally used in medium to large scale construction projects, and is purchased in bulk quantities for delivery to one site only. Construction projects are generally subject to the disciplines of the tender market, and this is a notable factor in the supply of reinforcing steel.

168 In the market for the fabrication and distribution of reinforcing steel the merged entity would have a market share of approximately [ ]. The major existing competitor is ReoFab, a subsidiary of United. ReoFab would have a market share of approximately [ ]. ReoFab operates in Auckland [ ]. Nauhria Building Supplies Limited (Nauhria) is another small competitor operating in Auckland and Christchurch. In areas in which ReoFab and Nauhria do not compete, the merged entity is likely to face competition from small regional operators.

Constraint from Potential Competition

169 The competencies required to compete effectively in the fabrication and distribution of reinforcing steel include knowledge and industry experience, a level of skill in machine operation, and the ability to secure a supply of steel.

170 To set up a business with a presence in the North and South Islands would require between $500,000 and $1 million. About half of the investment would be in plant and equipment whilst the remaining investment would be in inventory and debtors. The sunk cost component of this investment would be low. The skill required to operate this machinery is not high. It is the Commission's view that the barriers to entering this

market are not onerous, and that this acts as an effective constraint to existing market participants.

171 An assessment of the potential competition in the market for the fabrication and distribution of reinforcing steel differs from that of other steel products, including merchant steel products. Reinforcing steel is generally required in bulk purchases, to be delivered to a deisgnated site, normally a major construction project. Therefore, the need for an extensive distribution network is not as great as that for merchant products. Further, the lead times for construction projects are reasonably long, allowing for tender procedures, and buying and planning commitments to be addressed. The requirement for quick delivery of small volumes, as is the case with merchant products, is generally not present with respect to the fabrication and distribution of reinforcing steel. Accordingly, the barriers to entry into this market are specific to reinforcing steel, and the Commission considers that such barriers are not onerous.

Countervailing Power of Buyers and Suppliers

172 Pacific Steel is the only domestic producer of reinforcing steel, and the steel is produced to comply with New Zealand's Standards Specifications. Information provided to the Commission indicates that approximately [ ]% of reinforcing steel is imported. If the proposed merger was to proceed, supplies would likely still be sourced either domestically from Pacific Steel, or internationally through imports.

173 In the event that the merger proceeds, it is likely that the market will experience little change. In the event that market power does exist for any party, it is likely to continue to exist at the production level, and be exercised by Pacific Steel. The Commission understands that a significant amount of reinforcing steel used in construction projects must comply with the New Zealand Standard Specification. Reinforcing Steel to this standard is produced by Pacific Steel. It is likely that Pacific Steel will continue to have an incentive to produce this reinforcing steel for consumption in the domestic market, through distributors, as is currently the case.

174 At the fabrication and distribution level of this market, purchasers of reinforcing steel are likely to witness the same competitive tensions as currently exist. The main purchasers of reinforcing steel are construction companies or property developers. Given that large construction projects are generally tendered (in some cases internationally), it is likely that purchasers of reinforcing projects could exercise a degree of countervailing power over the merged entity.

Conclusion on the National Market for the Fabrication and Distribution of Reinforcing Steel

175 Post-merger, Pacific Steel is likely to remain the major supplier of reinforcing steel to local distributors and end users. Imports of reinforcing steel will also be available, as is currently the case. In the event that market power does exist with respect to reinforcing steel, it is likely to continue to exist at the production stage.

176 The Commission concludes that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the market for the fabrication and distribution of reinforcing steel.

The National Market for the Distribution and Processing of Steel Plate

Market Share

177 Summarised below in Table Six is the estimated market share for the market for the distribution and processing of steel plate. On the basis of these figures, the merged entity's estimated market share of this market is [ ]. The merged entity would face competition from Vulcan, Asmuss and Kiwi Steel who each have estimated market shares of [ ].

178 The merged entity would be outside the Commission's 'safe harbour' guidelines in the market for the distribution and processing of steel plate. This indicator does raise potential dominance concerns, and an analysis of these markets will be conducted below.

Table Six
Estimated Market Shares in the National Market for the Distribution and Processing of Steel Plate

Company/trading name	**Estimated Market Share**
Fletcher Steel	[ ]%
Steel and Tube	[ ]%
Merged Entity	**[ ]%**
Kiwi Steel	[ ]%
Vulcan Steel	[ ]%
Asmuss Steel	[ ]%
Steel Plus/Reofab Ltd	[ ]%
Other	[ ]%
Direct Imports	[ ]%
Independent Imports	[ ]%
Total	**100%**

Constraint from Existing Competition

179 In the market for the distribution and processing of steel plate, the merged entity would have approximately [ ]% market share. Kiwi Steel, Vulcan Steel and Asmuss Steel all have approximately [ ]%.

180 The constraint effected by current competition in this market appears similar to that evidenced in the merchant steel products market. Entry has occurred, however none of the three main competitors appears to have developed a market share through which it is likely to provide effective competition to the merged entity. Rather, as with merchant steel, parties appear to have entered the market and attained a modest market share, with little evidence of effective, widespread competition against either of the merger parties.

181 On the basis of information provided to the Commission, it is concluded that the competition provided by current competitors is not sufficient to effectively constrain the merged entity.

Constraint from Potential Competition

182 The entry and expansion conditions for the market for the distribution and processing of steel plate are similar to those for the merchant steel market. These conditions are discussed in para 121 to 154 above.

183 As with merchant products, it appears unlikely that entry, or potential entry, or expansion to a scale that is likely to provide an effective constraint upon the merged entity will occur.

184 An assessment of the constraint by potential competition, as measured by the *lets* test, results in a similar conclusion to that reached in the market for merchant steel products. That is, entry is not considered likely or sustainable. This is evidenced by the small number of operators entering this market in the past nine years, and the relatively modest market share attained by these parties. No single competitor has attained a market share that could be regarded as providing a sufficient constraint upon the behaviour of the merged entity.

185 An analysis of the entry and expansion of Asmuss Steel, Kiwi Steel, and Vulcan Steel in this market also indicates that entry has not been effected to a degree that is likely to constrain the merged entity. Any potential entry at a scale that will be effective against the merged entity is likely to be met by a significant incumbent response. The previous ability of the merger parties to provide some degree of response may be one reason why entry has not been attempted or achieved on a substantial scale. Having regard to these factors, the Commission considers that the extent of entry is unlikely to occur at the scale necessary to constrain the merged entity.

186 Entry into the steel plate market could, however, occur in a timely manner, all other things being equal. Some specialised knowledge is required for handling and cutting steel; however, the process is not highly skilled. Steel plate can be cut by oxyacetylene, laser or plasma cutting machinery. Currently there is limited laser cutting capacity in New Zealand. Plasma cutting machinery can be purchased new for between $100,000 and $200,000. Most of the large distributors have this cutting capacity.

187 The Commission concludes that, while entry into the steel plate market could occur in a timely manner, entry at a scale that will provide effective competitive constraint upon the merged entity is not likely, not sustainable, nor sufficient in extent.

Conclusion on the National Market for the Distribution and Processing of Steel Plate

188 The merged entity would have a market share of approximately [ ] in this market, with no other party having a market share in the order of 15%. These market shares place the merged entity outside the Commission’s “safe harbours”.

189 The Commission considers that, while there are other operators in the steel plate market, these other operators are not of a size or scale to effectively constrain the merged entity. The evidence provided to date suggests that Kiwi Steel and Vulcan Steel have been successful in entering this market and attaining a modest market share.

However, the Commission does not consider that these operators are likely to exercise a sufficient competitive constraint upon the merged entity.

190 For these reasons, the Commission is not satisfied that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in this market.

The National Market for the Distribution and Processing of Steel Coil

Market Share

191 Summarised below in Table Seven are the estimated market shares for the steel coil distribution and processing market. On the basis of these figures, the merged entity's estimated market share of this market is [ ], with the next biggest competitor, Kiwi Steel, having [ ].

192 The merged entity would have a market share inside the Commission's 'safe harbour' guidelines in the steel coil distribution and processing market. This indicator does not raise dominance concerns. However, a number of additional factors are considered below.

Table Seven
Estimated Market Shares in the National Market for the Distribution and Processing of Steel Coil

<table>
<tr><th>Company/trading name</th><th>Estimated Market Share</th></tr>
<tr><td>Fletcher Steel</td><td>[ ]%</td></tr>
<tr><td>Steel and Tube</td><td>[ ]%</td></tr>
<tr><td>Merged Entity</td><td>[ ]%</td></tr>
<tr><td>Kiwi Steel</td><td>[ ]%</td></tr>
<tr><td>Vulcan Steel</td><td rowspan="6">Jointly
[ ]%</td></tr>
<tr><td>Asmuss Steel</td></tr>
<tr><td>Steel Plus/Reofab Ltd</td></tr>
<tr><td>Other</td></tr>
<tr><td>Direct Imports</td></tr>
<tr><td>Independent Imports</td></tr>
<tr><td>Total</td><td>100%</td></tr>
</table>

Constraint from Existing Competition

193 In the market for the distribution and processing of steel coil, the merged entity would have approximately a [ ] market share. It would face competition from existing competitors, in particular from Kiwi Steel and Vulcan Steel who are large importers of the product, and who both distribute nationally from centralised locations. Both companies have operated in the market for a number of years and have established good supply relationships. They carry levels of inventory with capacity to increase if demand increases. Lead times are slightly longer for imported product, which is a factor that can be managed if demand does increase.

194 The Commission understands that large users of steel coil purchase direct from the steel mills. This ability to purchase direct from the manufacturer is also likely to act as a constraint upon the merged entity.

Constraint from Potential Competition

195 The relatively modest market share held by the merged entity is some reflection of the ease with which potential entrants can enter this market. As with steel plate distribution a distinguishing factor is the requirement for processing capabilities.

196 Coil processing involves two processes, ‘cutting to length’ and ‘slitting’. To be able to provide these services, investment in machinery costing between $1 and $2 million is required. There is over-capacity in coil processing, however such capacity is required in order to provide a full range of services, such capacity is required.

The Countervailing Power of Buyers and Suppliers

197 Purchasers of steel coil include roofing manufacturers and producers of other manufactured products. Large purchasers of the product are concentrated and have the ability to exercise countervailing power by purchasing direct from the steel producers. Switching costs are relatively low for such buyers.

Conclusion on the Market for the Distribution and Processing of Steel Coil

198 The merged entity would have an estimated market share within the Commission’s ‘safe harbour’ guidelines. It would face effective competition from existing competitors and is likely to be constrained by the relatively low barriers to entering the market. The ability of large purchasers to purchase direct from steel producers also provides a degree of countervailing power upon the merged entity.

199 The Commission concludes that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in this market.

The Market for the Manufacture and Distribution of Domestic Roofing Products

Market Share

200 Fletcher Steel has submitted that the New Zealand roofing market has an estimated size of [ ] steel equivalent tonnes. Approximately [ ] of the market is comprised of industrial roofing, whilst [ ] is residential roofing.

201 The estimated market shares are summarised below in Table Seven.

Table Seven
Estimated Market Share in the National Market for the Manufacture and Distribution of Domestic Roofing Products

Company	**Estimated Market Shares**
Fletcher Steel	[ ]
Steel & Tube	[ ]
Merged Entity	**[ ]**
Other Roll-Formed steel manufacturers	[ ]
Metal Tiles	[ ]
Concrete Tiles	[ ]
Butynol	[ ]
Total	**100%**

202 The merged entity's market share is approximately [ ] and would fall within the Commission's safe harbour guidelines. This indicator does not raise potential dominance concerns. However a number of additional factors are considered below.

Constraint from Existing Competition

203 The major competitors of the merged entity would be Metalcraft Industries which manufactures and distributes roll-formed steel roofing, AHI Roofing which manufactures and distributes metal tile roofing, and Monier Roofing which manufactures and distributes concrete tile roofing. All of these competitors have nationwide distribution networks. For low slope roofs the merged entity would also compete against the manufacturers and distributors of roofing rubber membranes. Skellerup and Norcross Marketing are both nationwide distributors of these types of products.

204 The merged entity would also face competition from regional operators in the domestic roofing materials market. There are approximately 30 manufacturers and distributors of roll-formed steel roofing in the New Zealand market. Some of these competitors operate large regional businesses, and are currently providing a competitive constraint to market participants. Calder Stewart Limited, which operates in the South Island, is an example of such a business. There are also regional manufacturers and distributors of both metal tiles and concrete tiles that are providing a level of competitive constraint, such as Ross Roofing Limited.

205 It is the Commission's view that the existing competitors are likely to offer a sufficient level of constraint to the merged entity in this market.

Constraint from Potential Competitors

206 There are low barriers to expansion or entry in the manufacture and distribution of roll-formed steel roofing. This proposition is supported by evidence of the large number of regional operators that provide roll-formed steel roofing. A potential entrant would require access to a supply of steel coil, which can be obtained from a number of nationwide suppliers, which purchase steel coil from domestic producers or from international producers. Information provided to the Commission suggests that a second hand roll-form machine can be obtained for about $100,000 and that a new machine can cost between $200,000 and $300,000. The manufacturing process is not unduly technical and does not require a high degree of competency. Given these factors, the Commission considers that the barriers to manufacturing this product are relatively low.

207 In the manufacture of metal tiles, access to a supply of metallic coated steel coil is required. This can be obtained direct from the mill for large purchases, or from steel merchants. Industry estimates suggest that a reasonable quality second hand machine capable of pressing metallic tiles can be obtained for between $200,000 and $300,000. The manufacturing process is not unduly technical. The barriers to manufacturing and distributing this product are relatively low. Similar entry conditions also apply to the manufacture and distribution of concrete tiles.

The Countervailing Power of Buyers and Suppliers

208 On the supply side, steel coil is supplied by steel merchants, or for large purchases, direct from a steel mill. Globally, there is excess capacity in steel production and a large number of suppliers. There is only one major supplier of steel coil in New Zealand, but barriers to importing are not high and steel coil is imported. Globally, suppliers of steel coil are fragmented and do not have a large degree of countervailing power. However, because of the characteristics of the product required in New Zealand, the supplier, New Zealand Steel, has a degree of countervailing power.

209 On the demand side, roofing products are purchased by roofing contractors, and construction companies on behalf of the building owner or developer. These acquirers are fragmented, but, when purchasing product, they generally obtain alternative bids for supply from a large number of suppliers in a competitive tender process, thereby exercising a degree of countervailing power. Large purchasers also have the ability to by-pass distributors and purchase direct from steel manufacturers. Substitute products can be specified at the design stage, especially for residential construction, thereby offering some countervailing power.

Conclusion on the National Market for the Manufacture and Distribution of Domestic Roofing Products

210 The merged entity would have a market share, which is inside the Commission’s ‘safe harbour’ guidelines. The merged entity would face effective competition from existing competitors, and would be constrained by the threat of entry or expansion. New Zealand Steel, which supplies ‘coloursteel’ and ‘zincalume’, products unique to New Zealand, has a degree of countervailing power.

211 The Commission concludes that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in this market.

The Market for the Manufacture and Distribution of Industrial Roofing Products

Market Share

212 In this market the merged entity would have an estimated market share of [ ], and would face competition from other manufacturers/distributors of roll-formed steel roofing, which include Metalcraft and Calder Stewart Limited. The merged entity would also face competition from the manufacturers/distributors of rubber membrane roofing products, whose market share is estimated to be [ ]. These manufacturers include Skellerup Limited and Norcross Marketing Limited, which are both large manufacturers/distributors of these roofing products. The estimated market shares for this market are summarised below in Table Eight.

Table Eight
Estimated Market Share of the National Market for the Manufacture and Distribution of Industrial Roofing Products

Company	**Estimated Market Shares**
Fletcher Steel	[ ]
Steel & Tube	[ ]
Merged Entity	**[ ]**
Other roll-formed steel manufacturers	[ ]
Metal Tiles	[ ]
Concrete Tiles	[ ]
Rubber Membrane	[ ]
Total	**100%**

Constraint from Existing Competition

213 An important factor in the choice of roofing materials for industrial buildings is price. Roll-formed steel through its price advantage is the most widely used roofing material in this market. Rubber membrane roofing is a substitutable product for steel, for low pitched roofs, and this is a consideration at the design stage. Roofing tiles are a weaker substitute because they are generally more expensive.

214 The merged entity would face competition from other roll-formed steel manufacturers, Metalcraft, which operates a national distribution network, and Calder Stewart, which is a large regional operator. Smaller regional roll-formed steel manufacturers would also offer a level of constraint. The merged entity would also compete with Skellerup and Norcross Marketing, which are large manufacturers/distributors of rubber membrane roofing materials. Both of these competitors operate nationwide distribution networks and have established brands in the market.

Constraint from Potential Competition

215 In this market entry and expansion conditions are similar to those in the domestic roofing market. These conditions have been discussed at paragraphs 206 and 207 above.

The Countervailing Power of Buyers and Suppliers

216 Similar factors apply to this market as the market for domestic roofing. These are discussed at paragraphs 208 and 209 above.

Conclusion on the Market for the Manufacture and Distribution of Industrial Roofing Products

217 The merged entity would have a market share, which is inside the Commission's 'safe harbour' guidelines. It would face competition from other manufacturers of roll-formed roofing and also from manufacturers of rubber membrane roofing products. The barriers to entry and expansion are low and this fact provides a level of constraint to market participants.

218 The Commission concludes that the acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in this market.

OVERALL CONCLUSION

219 The Commission has considered the likely impact of the proposal in the following markets:

- the national market for the distribution of merchant steel products;
- the national market for the distribution and processing of steel reinforcing;
- the national market for the distribution and processing of steel plate;
- the national market for the distribution and processing of steel coil;
- the national market for the manufacture and distribution of domestic roofing products; and
- the national market for the manufacture and distribution of industrial roofing products.

220 Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is not satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in any of the following markets:

- the national market for the distribution of merchant steel products; and
- the national market for the distribution and processing of steel plate.

221 Having regard to the various elements of section 3(9) of the Act, and all the other relevant factors, the Commission is satisfied that the proposal would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in any of the following markets:

- the national market for the distribution and processing of steel reinforcing;
- the national market for the distribution and processing of steel coil;
- the national market for the manufacture and distribution of domestic roofing products; and
- the national market for the manufacture and distribution of industrial roofing products.

DETERMINATION ON NOTICE OF CLEARANCE

222 Accordingly, pursuant to section 66(3)(b) of the Act, the majority of the Division of the Commission declines to give clearance for the proposed acquisition by Fletcher Challenge Steel Products Limited of up to 100% of the shares in Steel and Tube Holdings Limited.

223 The Deputy Chairman Mr M N Berry has dissented from the majority decision and his opinion is annexed hereto.

Dated this 4th day of November 1999

____

M J Belgrave
Chairman

DISSENTING OPINION OF M N BERRY

1 I agree with the market definitions adopted by the majority. I also agree with the conclusions reached by the majority that no dominance is likely to result from the proposed acquisition in the reinforcing steel, steel coil, domestic roofing products and industrial roofing products markets. However, my assessment of the dominance issues in the remaining markets differs in some material respects, leading me to reach the conclusion, contrary to that of the majority, that dominance is not likely to result in those markets either.

Basic Principles

2 Read in conjunction, sections 66(3) and 47(1) require, in essence, that the Commission must give clearance to a proposal if it is satisfied that implementation of the proposal would not, or would not be likely to, result in the acquisition or strengthening of dominance in any market.

3 The dominance threshold contained in section 47(1), and defined in section 3(9), is high. This is emphasised in the judicial pronouncements on the test of dominance, which the Commission is bound to follow. The most useful statement of dominance principles is contained in the decision of McGechan J in *Commerce Commission* v *Port Nelson Limited* (1995) 6 TCLR 406. The following statements of general principle from this judgment (at 441-42) illustrate the height of the dominance threshold:

> 'Dominance' includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a high degree of market *control.*
>
> How high? Clearly, not absolute control. There need not be monopoly. There need not be ability to act totally without regard to competitors, suppliers, or customers…. (However), [t]he firm must be able to set terms of trading independently of significant market constraints. It must be able to set prices or conditions without significant constraint by competitor or consumer reaction.

The Court of Appeal in *Port Nelson* affirmed that dominance involves a rigorous threshold: *Port Nelson Limited* v *Commerce Commission* [1996] 3 NZLR 554,573.

4 The height of this dominance threshold has been recognised by the Commerce Commission in paragraph 7 of its *Business Acquisition Guidelines* 1996 (as revised in 1999) ("the Guidelines"):

> A person in a dominant position in a market will be able to set prices or conditions without significant constraint from competitor or customer reaction.
>
> A person in a dominant position will be able to initiate and maintain an appreciable increase in price, or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short or long run.

In short, the Commission recognises that for a firm to be dominant, it must have considerable discretion to behave in a manner different from that which a competitive market would allow. The Guidelines also dictate that the assessment of dominance requires dynamic analysis by taking into account likely competitive responses to appreciable increases in price over the short or long run.

5 Various factors impact on the assessment of dominance. These factors are set out in section 3(9), and have been elaborated upon in *Port Nelson* (1995) 6 TCLR 406, 442-43. The most significant of these factors are, in the present case, market shares and entry barriers.

6 Market shares are static and provide a starting point for the analysis of dominance. However, dynamic analysis is required to assess dominance. This necessarily involves predictions about future market structure and conduct. It has been consistently held that while "the presumption of dominance increases as market share rises, it is the cumulative impact of various factors that is important in determining whether or not a dominant position would be acquired or strengthened": see for instance *Telecom Corporation of New Zealand Limited* v *Commerce Commission* (1991) 4 TCLR 473, 509.

7 Entry barrier analysis, on the other hand, is dynamic and can be pivotal to the assessment of dominance. As Tipping J observed in *New Zealand Magic Millions Limited* v *Wrightson Bloodstock Limited* [1990] 1 NZLR 731, 755:

> …a substantial market share without barriers to entry will seldom, if ever, be indicative of dominance.

8 With these principles in mind, I now consider dominance issues in the merchant steel products and steel plate markets. I first respond to the reasoning contained in the majority's opinion. Some concluding remarks will then follow.

Merchant Steel Products

9 I deal first with the majority's view on the existing competition. The majority characterises Asmuss Steel and Vulcan Steel as fringe players essentially for two reasons. First, following entry in 1990 and 1996 respectively, their market shares increased initially, but not beyond [ ] and [ ]. Secondly, many end-users are not apparently aware of them. The view is also expressed that scale advantages exist now for the merger parties, and that these are likely to be accentuated post-merger. The majority finally concludes, at paragraph 118, that competition in this market is unlikely to change post-merger. It follows, in the majority's opinion, that the so-called fringe operators will always remain as such.

10 In my opinion, the majority (1) misrepresents Asmuss Steel and Vulcan Steel as fringe players; (2) fails to take into account the competitive effect of these companies on the market; (3) places questionable reliance upon scale advantages; and (4) takes an unduly static view of this market.

11 Asmuss Steel is a division of a privately owned industrial company, HJ Asmuss & Co Limited. While HJ Asmuss & Co Limited has been in business for 75 years, Asmuss Steel has only been active in steel distribution for approximately 10 years. It is involved in the nationwide distribution and processing of steel plate, merchant steel products and steel reinforcing, and has steel distribution outlets in Auckland, New Plymouth, Wellington (Steel Traders Limited) and Christchurch (Tudor Pipeline Supplies Limited). In 1999, Asmuss Steel's estimated sales revenue for steel products was approximately [ ]

12 Asmuss Steel's merchant product range includes structural sections, hollows and mild steel sections. The company has an estimated market share of [ ] in the merchant steel products market. This means that Asmuss Steel is of a sufficient size to be recognised as a significant competitor under the second of the Commission's safe harbour tests: see paragraph 4.3 of the Guidelines.

13 Vulcan Steel commenced business in early 1996 in Auckland and since that time has expanded its business to become a national distributor of steel plate, steel merchant products and steel coil. Vulcan Steel also has a steel processing capability. Currently, it has distribution outlets in Auckland, Palmerston North, Nelson, Christchurch and Dunedin. In the 1999 financial year, Vulcan Steel's sales revenue was [ ]

14 Vulcan Steel's merchant product range includes mild steel sections, merchant bar, hollow sections and structural sections. It has an estimated market share of approximately [ ] in the merchant steel products market. Therefore, Vulcan Steel does not fall far short of the significant competitor standards established under the second of the Commission's safe harbours.

15 In my opinion, Asmuss Steel and Vulcan Steel are both significant competitors in the market. They operate across both Islands, the former having four outlets and the latter five. Their market shares are sizeable, and that of Vulcan Steel has been built up in only three years. Small scale entry, in my opinion, is not indicative of fringe competition. Rather, it is a common approach to deal with the inherent risks of entry, and the fact that market share typically can be built up only gradually over time. While Asmuss Steel and Vulcan Steel offer a lesser product range than either Fletcher Steel or Steel and Tube, this reflects their approach of concentrating on stocking the fast-moving lines.

16 The reliance of the independents primarily upon cheaper imported merchant steel products (which, for merchant bar products from Taiwan, are said currently to be up to 30% cheaper than the equivalent domestic product) has forced the two merger parties to switch to a large extent to importing product and to reducing supplies from their integrated steel producers. This has happened notwithstanding the considerable excess capacity of those producers. Some [ ] of market demand for merchant steel products is now met from imports. In the absence of independent distributors, the two merger parties would, in my opinion, be likely to return to favouring their integrated steel producers by restricting imports to those products which are not made domestically. Moreover, the Commission understands that distributor margins have declined across all products at least since the entry of Vulcan Steel, from an average of about [ ] in 1996 to about [ ] in 1999, and that further downward pressure remains. This is indicative of competition in distribution. In the light of these various factors, the independents cannot, in my view, be properly considered to be "niche" operators. Rather, they are significant competitors.

17 The majority asserts at paragraph 117 that there are scale advantages for the large distributors and that these will be likely to be accentuated post-merger. The precise nature of these scale advantages is not set out. Presumably, they stem from the bulk buying power of the large distributors, who are said to be able to negotiate advantageous terms for the purchase of stock. The Commission has been told that a price reduction of 1-2% for the merger parties would typically be available. Post-merger, it also could be speculated that the combined entity would rationalise its

distribution sites, eliminating duplication, and thereby increasing the turnover through those remaining.

18 While these potential efficiency gains would appear to offer some competitive advantage to the combined entity, none of the independent distributors spoken to by the Commission expressed any concerns about the proposed acquisition. Indeed, they considered that it would provide an opportunity for them to gain market share at the expense of the combined entity. They felt that they offer a more flexible service, and that the combined entity would suffer from difficulties in merging two companies with differing cultures. In addition, it is difficult to compare the cost structures of the independents with those of the two merger parties. For example, the former do not have the heavy overheads associated with a decentralised branch structure, and their stock turnover is said to be greater, and their inventory levels lower, than that of the two merger parties. This is likely to give them a cost advantage, albeit at the expense of not being able to meet the requirements of all customers for particular products, or for "just in time" service. In short, different approaches to business are being used by the merger parties and the independents, and it is far from clear which is likely to be the more effective in the long term.

19 Finally, I find it difficult to conclude that the market will not change as a result of this merger. If many end users are not presently aware of Asmuss Steel and Vulcan Steel, they are presumably content for the moment to deal with Fletcher Steel and Steel and Tube. Would those users be content to deal with just one supplier post-merger? The users in question include building merchants, manufacturers and others in the construction industry. The profitability of such businesses depends upon their obtaining supplies of merchant steel products at competitive prices. To accept that these businesses will remain locked in to Fletcher Steel depends on the assumption that Asmuss Steel and Vulcan Steel will not look to expand, and that many contractors will not attempt to achieve a competitive advantage through seeking more competitive terms from a supplier other than Fletcher Steel. For reasons which I will develop further below, I do not think that this assumption can be made.

20 Therefore, I consider that the majority do not properly address the significance of existing competition. The *Port Nelson* test of dominance requires that the following question be asked. Would Fletcher Steel, post-merger, be able to set its distributor margins without significant constraint by competitor or consumer reaction? In my opinion, this is unlikely where significant independents are poised to expand.

21 I turn next to consider the constraints from potential competition in this market. The majority identifies three entry barriers. The first is that an extensive distribution network is required for a new entrant to be competitive. Implicit in this finding is the assumption that capital is an entry barrier. The second is that an incumbent response is likely, and is considered to be a substantial entry barrier. Finally, the cost of establishing brand loyalty and reputation is considered to be a further barrier.

22 As a preamble, it is important to note that the application involves an aggregation at the distribution functional level of the relevant market. The intrinsic nature of most distribution markets (their limited economies of scale or scope, low entry costs, absence of significant sunk costs, limited technology or informational requirements, the small numbers of buyers to communicate with in the case of intermediate goods like steel) combined in this case with the market being nationwide and the product being standardised, all suggest that dominance is most unlikely to arise.

23 The majority's discussion on the distribution network (paragraphs 124 – 28) is difficult to reconcile with its analysis of the geographic market (paragraphs 56 – 65). The majority accepts that the market is national in extent. This view is doubtless underpinned by the availability of a swift and efficient system for transporting the product, an ability and a willingness of a proportion of end-users to source product out-of-region from various distributors, and the willingness of some large end-users to import for themselves. The majority's conclusions on the current nationwide patterns of distribution make it difficult to accept the argument that a new entrant requires an extensive distribution network. Even if this were the case, it is difficult to see how the establishment of such a network poses a significant entry barrier on these facts. To the extent that the majority identifies an entry barrier in this context, it is one of cost to the new entrant. But the costs of entry are not significant in this case, and had to be incurred previously by the merger parties. The costs of entry are no more than the costs of doing business in this market.

24 The Commission has been told that to set up a business with a nationwide distribution network on the scale of Asmuss Steel would require capital of about [ ]. A large proportion of this investment would be for inventory and for debtors, who normally require 60-90 day terms for purchases. A reasonable range of stock would be required. As minimal processing is required, processing equipment costs are low. The cost of warehouse facilities and plant, such as cranes and forklifts, is also included in the overall estimated entry cost of [ ]. The time to set up such a business would be between six and 12 months. The sunk cost component of this investment would be low. Entry on a lesser scale would correspondingly be reflected by a lower entry cost.

25 In my opinion, on the basis of the facts given, the argument of the majority that entry on a large scale is necessary for entry to be a competitive constraint on the combined entity is questionable. The market has been accepted by the majority to be a nationwide one, in which case relatively centralised distribution of product by independents should be feasible. However, contrary to this the majority then argue that, in fact, a decentralised distribution network is required. From this stems the view that entry costs are significant, and therefore constitute a barrier to entry. However, even if this view were to be accepted, the evidence available to the Commission suggests that the conditions for entering even on a nationwide basis are not particularly onerous. Moreover, there is tangible evidence of entry having been successfully undertaken, with two firms present in the market who entered in 1990 and 1996 respectively.

26 Speculative incumbent responses, of the kind suggested in paragraph 130 of the majority's decision, can be easily constructed. However, without clear articulation of the merged firm's cost advantage, and without recognition of the potential impact of imports, these theories can just as easily be rejected. Entry deterrence theories are more complex than the majority suggests: see for instance Scherer and Ross, *Industrial Market Structure and Economic Performance* (3rd ed, 1990, chapter 10). In the present case, it is difficult to see how the incumbents could respond to entry so as to discourage entry. Because the market has been acknowledged by the majority to be national in extent, the response to entry would have similarly to be across the whole country. The combined entity, therefore, could not initially hope to deter entry by limiting its margin-cutting to the area in which the entrant chooses to locate its business. Margin cutting would thus be potentially so expensive to the incumbent as to be a most unlikely

strategy. Sunk costs associated with entry are also low, which would limit the ability of the incumbent to exploit its established position in the market. Moreover, there is no evidence that either of the two merger parties responded to the entry that has occurred in the past in any predatory way. In the case of Vulcan Steel's entry, distributor margins reduced, but that would appear to be the normal outcome of the enhanced competition, and it had no apparent effect in limiting or deterring the entry of that company. In my opinion, incumbent response should only be accepted as an entry barrier where it is possible to construct a viable and credible entry-deterring strategy available to the incumbent, and that has not been done here.

27 The question as to whether brand loyalty and reputation is an entry barrier is debatable from a theoretical point of view. There are extreme views in both directions in the economics literature. There is, nonetheless, strong authority for the view that established buyer preferences will not ordinarily be a serious entry barrier: see Areeda and Turner, *Antitrust Law: An Analysis of Antitrust Principles and their Application* (1978, Volume II, 302). Some support for this proposition can be taken from the decision of the High Court in *Fisher & Paykel Limited* v *Commerce Commission* [1990] 2 NZLR 731, 741, 748, 767. On the present facts, I do not accept that the cost of establishing brand loyalty and reputation should be regarded as an entry barrier. In any case, the scope for the development of brand loyalty and reputation seems rather limited with steel products, which are standardised by type and widely traded internationally. Steel is a commodity which is not susceptible to physical forms of branding. End-users such as manufacturers and builders would be expected to be familiar with product types, and to be price-conscious, making it difficult for particular distributors to take advantage of brand loyalty or reputation to set margins above the competitive level. The competitive downstream markets in which end-users operate would also militate against differential pricing for steel inputs.

28 Finally, I note that the combined entity would have no power to foreclose supplies of product to independent distributors by virtue of its being vertically integrated with Pacific Steel. Imports are available, often more cheaply, over the full range of products. Further, New Zealand Steel will no longer be integrated should the shares held by Tubemakers in Steel and Tube be sold. New Zealand Steel is an alternative domestic manufacturer of merchant steel products, and is the only domestic manufacturer of steel plate. By ceasing to be vertically tied to its own distributor, it would have an incentive to compete strongly for sales to all distributors.

29 The majority's analysis of the constraint by potential competition continues (paragraphs 139 – 154) with an analysis of the "*lets*" test contained in paragraph 5 of the Guidelines. These Guidelines have no legal foundation, but nonetheless identify common sense factors which need to be considered when addressing constraints from potential new entrants. The "*lets*" test which appears in the Guidelines is, in fact, based upon the "*lets*" test which was originally formulated in paragraph 3 of the United States Department of Justice and Federal Trade Commission Horizontal Merger Guidelines 1992 ("the US Guidelines").

30 The material contained in this part of the majority's decision reflects earlier themes. However, before addressing these points in further detail, one preliminary observation needs to be made. In paragraph 140 the majority asserts that the acquiring or strengthening of dominance "depends upon whether the acquisition will have the effect of reducing the likelihood of entry". This is not, strictly speaking, the right question to ask when applying the "*lets*" test. Rather, the basic test formulated in the US

Guidelines is as follows: "A merger is not likely to create or enhance market power or to facilitate its exercise, if entry into the market is so easy that market participants, after the merger, either collectively or unilaterally, would not profitably maintain a price increase above pre-merger levels". This question is consistent with the Commission's Guidelines.

31 The majority's analysis of the "*lets*" test does not consider likely competitive responses of new entrants should the merged entity attempt to raise prices above pre-merger levels. Yet this is the appropriate test, for entry is unlikely even with low entry barriers if the market price stays at the competitive level. In that case, the lack of entry is not indicative of a lack of constraint. On the contrary, the incumbents would be constrained by the potential for entry to occur. The potential for entry would be high because entry barriers were low. That is all that is required for incumbents to be constrained by potential entry. This point was recognised by the High Court in *Magic Millions*, as earlier noted. Evidence of actual entry is not required although, given that the height of an entry barrier is not always easy to measure, the presence of entrants may provide comfort that the analysis leading to the finding of low entry barriers is correct. Some comfort can be taken from the entry of Asmuss Steel and Vulcan Steel. Further, all of the majority's analysis assumes the potential effectiveness of new entry should be given little weight unless it is on a large scale. As mentioned above, however, the national characteristics of the market pose real difficulties for the acceptance of this assumption.

32 One particular difficulty with this part of the majority's analysis is the manner in which they have addressed the competitive significance of Asmuss Steel and Vulcan Steel. Insufficient consideration has been given to the prospect that these companies may look to expand. No consideration is given to the possibility that Kiwi Steel may also switch into this market. Indeed, some minor switching by Kiwi Steel has recently occurred. Neither has consideration been given to the possibility that entry in the past was restricted by the shrinkage of the total steel market, and by the possibility that competitive margins were being offered by the incumbents. As emphasised in the previous paragraph, even an absence of entry is not necessarily indicative of the absence of a constraint from potential competitors.

33 The Commission has, in fact, been advised by [ ] that it has expansionary plans and all competitors of the merged entity have indicated to the Commission that they see this proposed merger as an opportunity to expand. This information, coupled with a continuing reduction in tariffs (reducing to 5% in August 2000 and to be removed from 1 July 2001) and an international surplus in merchant steel products, suggest that the potential expansion of these companies, and the new entry of others, poses a real threat to the combined entity.

34 It follows, in my opinion, that the majority have under-rated the competitive constraints from potential competitors. The *Port Nelson* test requires that, for the merged firm to be dominant, it "must be able to set terms of trading independently of significant market constraints". What would be likely to happen if the merged entity were to raise prices above pre-merger levels? Significant competitors are poised to expand and the barriers to new entry are, in my opinion, low. These factors will clearly impact upon the merged entity's ability to set terms of trade independently. Consequently, I consider the "*lets*" test requirements are met. Potential entry would be both likely, sufficient in extent, timely and sustainable, should the combined entity attempt to effect an increase in distributor margins and hence in selling price.

35 The final section of the majority's decision considers the countervailing power of buyers and suppliers. The majority focuses upon the purchasing power of larger end-users, and the potential inability of medium and small end-users to source from other than the merged entity. However, the point regarding small and medium end-users once again overlooks the position accepted by the majority that the market is nationwide in scope. Such users cannot be disadvantaged in a national market, because by implication they can source product from out-of-region. In any case, in my opinion, the majority position represents an unduly pessimistic view of the workings of the market in a dynamic setting. Users whose apparent lack of choice (or imperfect information about alternatives) might be exploited by the combined entity would have an incentive to look elsewhere for supplies, and other suppliers would have an incentive to supply them. The use of "just in time" purchases of supplies might have to be modified, so that planned requirements are ordered in advance, as indeed happens in centres such as Queenstown where there are significant amounts of building activity but no distributors with a physical presence.

36 Therefore, in my opinion, there will be buyer constraint in this market of a kind which, in combination with the other factors outlined here, will preclude the acquisition of dominance under the *Port Nelson* test.

Steel Plate

37 The majority's discussion on the steel plate market requires only brief comment because, as the majority points out, the analysis of this market is essentially the same as for merchant steel products.

38 In considering the constraint from existing competition, the majority do not expressly repeat the fringe competition argument. It is nonetheless implicit. For the reasons discussed above, I do not accept that Asmuss Steel and Vulcan Steel should be characterised as fringe participants. The same can also be said of Kiwi Steel.

39 Kiwi Steel is a private New Zealand company, which was formed in 1990. Its majority shareholder is a Korean steel trading house. Kiwi Steel is involved in the nationwide distribution of steel coil and steel plate and also distributes a small amount of merchant product. The company has distribution outlets in Auckland and Christchurch, and has an estimated market share of [ ] in the steel plate market, and [ ] in the steel coil market. In 1999, Kiwi Steel's sales revenue was approximately [ ]. Again, these market shares are significant when judged against the second of the safe harbours. [ ]

40 The majority again makes much of the need for entry to be on a substantial scale before it may be accepted as an effective constraint on the merged entity. Likely incumbent responses are also noted. My views on these arguments have already been given above.

41 In its analysis of entry and expansion in this market the majority again takes a static perspective of the issue, and fails to apply the appropriate test, which involves testing the likelihood of a competitive response should the merged entity attempt to raise prices above the competitive level.

42 There is no reference to buyer constraints in the majority's discussion of the steel plate market. In my opinion, these are likely to be significant, as argued above for the merchant steel products market.

43 It follows, in my opinion, for the reasons given above in relation to the merchant steel products market, that the *Port Nelson* test of dominance is also not met in the case of the steel plate market.

Concluding Remarks

44 I am satisfied that this proposal would not, or would not be likely to, result in the acquisition or strengthening of a dominant position in each of the markets identified in the majority decision. In particular, I consider that dominance, within the meaning given that term in *Port Nelson*, would not, or would not be likely to, result in the national markets for the distribution of merchant steel products, and for the distribution and processing of steel plate for the following main reasons.

45 The markets are recognised to be national. It follows that competitors of the merged entity can readily supply throughout the country, and that purchasers can explore various acquisition opportunities. There may need to be some changes in the way that some medium to small end-users source product, but this is no reason to discount the potential competitive impact of relatively centralised distribution networks.

46 There are significant competitors in all markets with the desire and ability readily to expand.

47 Barriers to entry are low. There are ready supplies of import product at competitive prices. The capital costs of entry are not high, with the sunk cost component of this investment being low.

48 In markets exhibiting the above characteristics, buyer constraint is likely to be significant and this, in my opinion, will be the situation here.

49 Taking these considerations cumulatively into account, I do not consider that the merged entity would be able, in terms of the High Court's test in *Port Nelson*, to "set terms of trading independently of significant market constraints", or that it would " be able to set prices or conditions without significant constraint by competitor or consumer reaction."

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M N Berry
Deputy Chairman