



COMMERCE COMMISSION

Decision No. 558

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

FLETCHER CONCRETE AND INFRASTRUCTURE LIMITED

and

W STEVENSON AND SONS LIMITED

The Commission: Paula Rebstock
David Caygill
Peter JM Taylor

Summary of Application: The acquisition by Fletcher Concrete and Infrastructure Limited of certain business assets from W Stevenson and Sons Limited that comprise the Stevenson Building Product Division.

Determination: Pursuant to section 66(3) (b) of the Commerce Act 1986, the Commission determines to decline to give clearance to the proposed acquisition.

Date of Determination: 15 September 2005

**CONFIDENTIAL MATERIAL IN THIS REPORT IS CONTAINED IN
SQUARE BRACKETS**

CONTENTS	
EXECUTIVE SUMMARY	I
THE PROPOSAL	1
PROCEDURE	1
STATUTORY FRAMEWORK	1
ANALYTICAL FRAMEWORK	2
UNDERTAKINGS	3
THE PARTIES	4
Acquirer	4
<i>Fletcher Concrete and Infrastructure Ltd</i>	<i>4</i>
Target	4
<i>W Stevenson and Sons Ltd</i>	<i>4</i>
Other Parties	5
<i>Holcim (New Zealand) Ltd</i>	<i>5</i>
[].....	<i>5</i>
[].....	<i>5</i>
<i>Fern Cement</i>	<i>5</i>
<i>Global Cement</i>	<i>5</i>
<i>Auckland Readymix Operators</i>	<i>5</i>
INDUSTRY BACKGROUND	6
Cement	6
Readymix	6
Precast	6
Masonry	6
PREVIOUS COMMISSION DECISIONS	7
MARKET DEFINITION	7
Product	7
<i>Precast</i>	<i>8</i>
<u>Product</u>	<u><i>8</i></u>
<u>Geographic</u>	<u><i>9</i></u>
<u>Functional</u>	<u><i>9</i></u>

<i>Conclusion on Precast Market Definition</i>	<i>9</i>
<i>Masonry</i>	<i>9</i>
<u>Product</u>	<u>9</u>
<u>Geographic</u>	<u>10</u>
<u>Functional</u>	<u>11</u>
<i>Conclusion on Masonry Market Definition</i>	<i>11</i>
<i>Readymix</i>	<i>11</i>
<i>Cement</i>	<i>11</i>
Conclusion on Market Definition	13
COUNTERFACTUAL AND FACTUAL	13
Factual.....	13
<i>Composition Risks.....</i>	<i>14</i>
<i>Purchaser Risks</i>	<i>14</i>
<i>Asset Risks.....</i>	<i>15</i>
<u>Divestment Conclusion.....</u>	<u>15</u>
Counterfactual.....	15
COMPETITION ANALYSIS	15
The Auckland Precast Products Market	16
<i>Existing Competition in the Auckland Precast Products Market</i>	<i>16</i>
The Northland Masonry Market.....	18
<i>Existing Competition in the Northland Masonry Market</i>	<i>18</i>
<u>Conclusion on Existing Competition in the Northland Masonry Market</u>	<u>18</u>
<i>Potential Competition in the Northland Masonry Market.....</i>	<i>19</i>
<u>Barriers to Entry.....</u>	<u>19</u>
<u>De Novo Entry</u>	<u>19</u>
<u>The “LET” Test.....</u>	<u>20</u>
<u>Northland Merchants</u>	<u>20</u>
<u>Entry via Auckland Divestment Acquisition</u>	<u>21</u>
<i>Conclusion on Potential Competition in the Northland Masonry Market.....</i>	<i>21</i>
Conclusion on Competition in the Northland Masonry Market....	21
The Masonry Products Markets in Auckland and Christchurch..	22
The Auckland Readymix Concrete Market	22

Introduction.....	22
Inter-firm relationships	23
Holcim and Allied.....	24
Holcim and Atlas	24
<i>Competitive Dynamics between Holcim / Allied / Atlas and Fletcher.....</i>	25
Extent of Competition.....	25
Scope for co-ordination.....	26
Collusion	27
<i>The Independents</i>	28
Bridgeman.....	28
Counties and Wilsons	28
<i>Conclusion on Existing Competition in the Auckland Readymix Concrete Market</i>	28
Potential Competition in the Auckland Readymix Concrete Market	29
The LET Test.....	30
Likelihood of Entry.....	30
Extent of Entry.....	31
Timeliness of Entry.....	32
<i>Conclusion on Potential Competition in the Auckland Readymix Concrete</i> <i>Market.....</i>	32
<i>Countervailing Power in the Auckland Readymix Market</i>	32
Conclusion on Competition in the Auckland Readymix Market... 32	
The New Zealand Cement Supply Market..... 33	
Vertical Integration.....	33
Existing Competition in the New Zealand Cement Supply	33
Imported Cement.....	34
Competition Between Fletcher and Holcim.....	36
Conclusion on Existing Competition in the New Zealand Cement Market..... 39	
Potential Entry in the New Zealand Cement Supply Market 39	
Introduction.....	39
Overseas Buyer	39

<i>Local Purchaser</i>	47
<i>Conclusion on Potential Entry in the New Zealand Cement Supply Market</i>	48
Conclusion on Competition in New Zealand Cement Supply	
Market	49
OVERALL CONCLUSION	49
DETERMINATION ON NOTICE OF CLEARANCE	52
APPENDIX 1	53
APPENDIX 2	57

EXECUTIVE SUMMARY

1. Fletcher Concrete and Infrastructure Limited sought clearance to acquire from W Stevenson & Sons Limited the assets relating to the Stevenson Building Products division, as the transaction would result in aggregation in a number of building products markets.
2. The Commission may grant clearances for acquisitions under s 66 of the Commerce Act where it is satisfied that the proposed acquisition would not result in a substantial lessening of competition in a market.
3. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's *Merger and Acquisition Guidelines*. The analysis involves defining the markets, then assessing the difference between the likely outcomes with and without the acquisition. This approach enables the Commission to properly assess the likely extent of competition should the acquisition proceed compared to the extent of competition if the acquisition did not proceed. The Commission assesses the various possible competitive constraints – existing competition, potential competition and/or countervailing power of buyers or suppliers – and determines whether the Commission can be satisfied that the difference is such that the acquisition would not have, or would not be likely to have the effect of substantially lessening competition.
4. The key competition concerns in this Application arise in the cement market. Fletcher and Holcim have historically been the only two domestic cement suppliers, and both are substantially vertically integrated through ownership with downstream users of cement, such as readymix and masonry entities. There is currently weak price competition between the two firms in the New Zealand cement market, with prices being constrained only by the cost of imported cement. Evidence shows that New Zealand has amongst the highest cement prices in the world.
5. The Commission considers that this weak price competition would be likely to continue should Fletcher acquire Stevenson. Moreover, prices could rise further if the acquisition were to proceed, as the likelihood of any party importing cement to compete with Holcim and Fletcher would be limited.
6. In contrast, if Fletcher were not to acquire Stevenson, the Commission considers it is most likely that Stevenson would be acquired by a party independent of Fletcher and Holcim. Stevenson is in a unique position as a large independent user of cement, and located in the fast growing Auckland region. As such, Stevenson provides a likely vehicle for new entry into the cement market, as it has sufficient demand for cement to provide a large proportion of the critical mass necessary to support entry into the cement market.
7. The Commission considers that the most likely alternative acquirer of Stevenson would be an overseas firm.
8. The Commission is satisfied that Stevenson provides a unique opportunity for 'bridgehead' entry into the cement market, and that without Stevenson, new entry into the cement market is very unlikely within the next two years.
9. Further, the Commission considers that both Holcim and Fletcher are likely to be strongly constrained should an overseas entity buy Stevenson, relative to the situation where Fletcher made the acquisition, whether or not entry into the

cement market should occur immediately, as there would be an ongoing threat of entry.

10. Similarly, even if Stevenson were not acquired by an overseas firm, but was acquired by a New Zealand entity, Stevenson would be independent from Holcim and Fletcher, and the threat of entry into the cement market would also be present. Given the volume of its cement usage, Stevenson would be able to continue to threaten with some credibility to import cement, either by itself, or with one or more other significant cement users, or with an overseas cement supplier.
11. Therefore, whether the acquirer were an overseas firm or a New Zealand based firm, the beneficial impact of actual entry and/or the threat of entry into the cement market on cement prices would exist if the clearance were declined.
12. If a clearance was granted for Fletcher to acquire Stevenson, however, Fletcher would own Stevenson and, being vertically integrated, supply its cement requirements. The entry conditions in the cement market would be made significantly more difficult because of the foreclosure of Stevenson as a potential buyer of imported cement, such that an overseas cement supplier would be very unlikely to consider entry into New Zealand as a bulk cement supplier. The constraint on Holcim and Fletcher from imports, or the threats of imports, would therefore be significantly less compared to the situation where another party independent from Holcim and Fletcher acquired Stevenson.
13. The Commission considers that after comparing the two likely acquisition scenarios, it cannot be satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in the New Zealand market for cement. Consequently, the Commission declines to grant clearance to Fletcher Concrete and Infrastructure to acquire the Stevenson's Building Products division.
14. While that is sufficient to dispose of the Application, the Commission also considered the impact of the acquisition on competition in other markets. The other markets the Commission considered in this case were:
 - the manufacture and wholesale supply of precast concrete products in Auckland;
 - the manufacture and wholesale supply of masonry products in the three geographic separate markets in:
 - Auckland;
 - Christchurch; and
 - Northland; and
 - the manufacture and wholesale supply of readymix concrete in Auckland.
15. The Commission found that the acquisition would not significantly reduce the existing competition present in the Auckland precast concrete products market. The Commission therefore finds no substantial lessening of competition in this market.
16. With regard to the masonry products markets, the Applicant gave an undertaking to divest the Auckland and Christchurch Masonry operations. The Commission considered the viability of this offer, in terms of its ability to lead to the

establishment of viable, stand-alone, independent businesses. The Commission found there to be no significant risks to the likely viability of independent businesses, and accepted the divestment as part of the Application. As a consequence, the Commission was satisfied there was unlikely to be a substantial lessening of competition in the two markets for masonry products in Christchurch and Auckland.

17. In the Northland masonry products market there are currently two participants: Stevenson, which is the only manufacturer located there, and Fletcher, which supplies that market by transporting masonry product at some significant cost from Auckland. With the acquisition and divestment, Stevenson would be removed as an independent competitor, leaving Fletcher as the only masonry product supplier located in Northland. However, the Commission considered competition could occur from outside of Northland by the firm acquiring Fletcher's divested Auckland masonry business: it could transport product into that market as Fletcher has done. The Commission is therefore satisfied that a substantial lessening of competition would be unlikely to occur in the Northland masonry products market.
18. The central issue in the Auckland readymix market was whether the four major market participants – Holcim, Atlas, Allied and Fletcher – would constrain each other or whether they would have an enhanced ability to co-ordinate prices after the acquisition. The potential for this arose because of the inter-firm relationships between these parties, and the reduced incentive to constrain each other and/or the heightened risk of co-ordination between them through the removal of Stevenson as the largest of the remaining independent competitors.
19. The Commission considers that in either the factual or the counterfactual new entry is not likely to be significant or that expansion by independent firms is not likely to constrain significantly. The principle difference is with existing competition and the absence of Stevenson in the factual compared to the counterfactual. However, the Commission considers that the existing competition between Holcim, Atlas, Allied and Fletcher will remain, although this conclusion is taken very much on balance as the Commission remains concerned as to the relationships between those parties. Nevertheless, the Commission is satisfied that the acquisition would not have, or would not be likely to have the effect of substantially lessening competition in the Auckland readymix market.

THE PROPOSAL

1. A notice pursuant to s 66(1) of the Commerce Act 1986 (the Act) was registered on 20 June 2005. The notice sought clearance for the acquisition by Fletcher Concrete and Infrastructure Limited (Fletcher) of certain business assets from W Stevenson and Sons Limited (Stevenson) that comprise the Stevenson Building Products division.

PROCEDURE

2. Section 66(3) of the Act requires the Commission either to clear or to decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and the Applicant. Accordingly, a decision on the Application was required by 15 September 2005.
3. The Applicant sought confidentiality for specific aspects of the Application. A confidentiality order was made in respect of the information for up to 20 working days from the Commission's determination notice. When that order expires, the provisions of the Official Information Act 1982 will apply.
4. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Merger and Acquisition Guidelines.¹

STATUTORY FRAMEWORK

5. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have the effect of substantially lessening competition in a market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not satisfied, it must decline. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities².
6. The substantial lessening of competition test was considered in *Air New Zealand & Qantas v Commerce Commission*, where the Court held³:

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

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

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

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

minimal⁴. Competition must be lessened in a considerable and sustainable way. For the purposes of its analysis the Commission is of the view that a lessening of competition and creation, enhancement or facilitation of the exercise of market power may be taken as being equivalent.

8. When the impact of market power is expected to be predominantly upon price, for the lessening, or likely lessening, of competition to be regarded as substantial, the difference between the anticipated level of prices expected without the acquisition has to be both material, and ordinarily able to be sustained for a period of at least two years, or such other time frame as may be appropriate in any given case.
9. Similarly, when the impact of market power is felt in terms of the non-price dimensions of competition such as reduced services, quality or innovation, for there to be a substantial lessening, or likely substantial lessening of competition, the difference between the anticipated non-price dimensions also has to be both material and ordinarily sustainable for at least two years or such other time frame as may be appropriate.

ANALYTICAL FRAMEWORK

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

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

UNDERTAKINGS

13. Where the Applicant considers that it is appropriate to make a structural undertaking as part of the Application, section 69A of the Act provides that the Commission may accept such undertakings in writing given by, or on behalf, of the Applicant to dispose of assets or shares. An undertaking given to the Commission is deemed to form part of the clearance.⁵
14. In establishing the factual, the Commission assumes the Applicant will be under an obligation to divest the assets or shares, on the terms offered by the Applicant. The comparison between the factual and the counterfactual will test whether the divestment would, of itself, or in combination with other market conditions enable the Commission to be satisfied that there is not likely to be a substantial lessening of competition.
15. Divestments are to some extent uncertain as to their eventual impact on the market. If much rests on the divestment, the Commission must be satisfied that the divested business will, on terms offered, be capable of constraining the combined entity at substantially the same level as applies in the counterfactual. If the divested business fails or ends up being an ineffectual competitor, then a substantial lessening of competition may occur, and consumers will be harmed. Thus it is important for the Commission to consider all the relevant risks associated with the divestment proposal.
16. In order to make this assessment, the Commission will consider:
 - **composition risks:** these are risks that the scope of the divestiture package may be too constrained, or not appropriately configured, to attract a suitable purchaser, or may not allow a purchaser to operate effectively and viably in the market;
 - **purchaser risks:** these are risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser; and
 - **asset risks:** these are risks that the competitive capability of a divestiture package will deteriorate prior to completion of divestment, for example, through loss of customers or key members of staff.⁶
17. These risk assessments are made and taken into account when establishing the factual, and in the competition assessment.

⁵ Commerce Act, s69A(3).

⁶ This framework is based on the approach used by the United Kingdom Competition Commission. The Commission recognises that the United Kingdom Competition Commission has greater power to recommend actions (structural and/or behavioural) to be taken by the Applicant, to remedy, mitigate or prevent a substantial lessening of competition arising from the acquisition. Nevertheless, the Commission considers that this categorisation of types of risk provides a useful way for the Commission to ensure it has made a thorough assessment of all issues pertinent to the divestment and to establishing the factual.

THE PARTIES

Acquirer

Fletcher Concrete and Infrastructure Ltd.

18. Fletcher Concrete and Infrastructure (Fletcher) is a wholly-owned subsidiary of Fletcher Building Ltd (Fletcher Building). Fletcher Building is a stand-alone publicly listed company on the NZX, ASX and NYSE.
19. Fletcher Building is involved in the manufacture and distribution of building materials, and in residential and commercial construction. It has operations in concrete, steel, fibreglass insulation, aluminium extrusion, roofing, access flooring systems, sinkware, and laminates and panels. In the year ended June 2004, Fletcher Building's earnings after tax were \$261 million.⁷
20. Fletcher supplies aggregates, readymix concrete and a range of manufactured products. It is one of two cement manufacturers in New Zealand, with a plant near Whangarei.

[It is also the largest construction contractor and residential builder in New Zealand. Fletcher is divided into the following divisions:

- Firth;
- Fletcher Construction;
- Fletcher Residential;
- Golden Bay Cement;
- Humes Pipeline Systems;
- CSP Pacific;
- Waters & Farr;
- Stresscrete;
- Winstone Aggregates;
- Concrete Industries (Peru and Fiji);
- Rocla Pipeline Products;
- Rocla Quarry Products; and
- Fletcher Construction South Pacific.

Target

W Stevenson and Sons Ltd

21. W Stevenson and Sons Ltd is a privately-owned family company. It is involved in building products, resources (quarrying and mining), engineering, agriculture, and property. The Stevenson Building products division (Stevenson) is a separate division from the company's central body, and is the only division that is being sold.

⁷ 2004 Fletcher Building Annual Report, (2004), p68, available on www.fletcherbuilding.co.nz

22. Stevenson is involved in readymix concrete, masonry products, precast and terrazzo. It also has six sales yards in Auckland and one in Christchurch that sell Stevenson products, aggregates and other products.

Other Parties

Holcim (New Zealand) Ltd

23. Holcim (New Zealand) Ltd (Holcim) is New Zealand's other domestic cement manufacturer. It is a subsidiary of Holcim Limited, a Swiss company listed on the Swiss Stock Exchange and on the virt-x Exchange in London. The parent company is an international producer of cement, readymix concrete and aggregates, and has its headquarters in Switzerland. Holcim is involved in the manufacture, importation, sale and transportation of cement throughout New Zealand. It owns quarries and sells aggregates in the Auckland area, and has interests in lime production and related products. Holcim operates a cement plant near Westport. [] It also operates readymix concrete plants through its subsidiary, Holcim Concrete.

[]

24. []

]

[]

25. []

]

Fern Cement

26. Fern Cement Group Ltd NZ (Fern) was a previous cement importer that operated primarily in the Hawkes Bay region. The company is currently in liquidation. Fern had four depots in New Zealand at Papakura, Te Poi, Napier and Timaru.

Global Cement

27. Global Cement Ltd. (Global) is an Australian based operation that imports cement in bulk bags into New Zealand. Global began importing a small amount of cement into New Zealand at the beginning of 2005, and imports bags into []. It has been operating for eight years in Australia as an importer of cement.

Auckland Readymix Operators

28. Bridgeman Concrete Ltd. (Bridgeman) was established in 1967 and specialises in readymix concrete. It has a presence in the following regions: Hawkes Bay, Waikato and the Bay of Plenty. In 2000 Bridgeman expanded into the Auckland market.

29. Counties Readymix Ltd. (Counties) has been operating as a readymix concrete supplier in Auckland since May 1999.
30. Wilsons Readymix Concrete Ltd. (Wilsons) has been operating as a readymix concrete supplier in Auckland since 2002. It also has other operations in the manufacture and supply of precast concrete.

INDUSTRY BACKGROUND

Cement

31. Ordinary Portland or grey cement is manufactured by heating a mixture of finely ground raw materials – mainly limestone, together with silica, alumina and iron oxide – to a very high temperature in a rotary kiln, where it partially fuses into a material called “clinker”. The clinker is then cooled and ground (together with a small proportion of added gypsum) into a fine powder.

Readymix

32. Readymix concrete is a building product used for both commercial and residential purposes. It is made from mixing cement, water, sand, and coarse aggregates (of gravel or crushed stone).
33. Readymix concrete is produced in a batching plant. The readymix concrete is then delivered to the site by truck, where it is placed and allowed to cure. Readymix concrete is a perishable product with a maximum life span of about 60-90 minutes from the time of adding water to placement. This can be extended with the use of additives, but these add to the cost.
34. Readymix concrete is priced by the cubic metre. The price varies widely according to the cement content, additives used, the size of an order, and the amount purchased over a year. However, it is accepted industry practice to use the price of one cubic metre of 17.5 Megapascal concrete, delivered, and excluding GST, as the benchmark for describing pricing levels.
35. The bulk of readymix concrete appears to be purchased by small and medium-sized users for laying floors in houses, industrial buildings, driveways and footpaths. There are some large projects involving office buildings and various kinds of infrastructure (e.g., bridges, tunnels, dams, cold stores, etc.) that use large quantities of concrete.

Precast

36. Precast is concrete that is cured for a specific purpose in a mould, and reinforced with steel rods. Precast is made to order from readymix concrete, usually offsite, and once cured is delivered to the construction site as a finished product. Examples of precast products include wall panels, beams, columns, stairs, motorway barriers and flooring.
37. Precast is individually priced per job, usually by an open market tendering process. The majority of customers are large construction companies using the product for commercial buildings.

Masonry

38. The masonry category includes concrete blocks and pavers. These are made from cement, aggregates and water. The mix may also contain colouring agents and other agents for effect. Blocks and pavers are made by a masonry machine

molding dry readymix concrete. These blocks and pavers are then put through an accelerated curing procedure. Curing involves heating blocks in a steam kiln for up to 18 hours. The blocks and pavers are then stored on pallets.

PREVIOUS COMMISSION DECISIONS

39. The Commission has previously considered the readymix concrete industry in *Decision 416*,⁸ *Decision 466*,⁹ and *Decision 513*.¹⁰
40. The Commission has also investigated the relevant industries regarding market behaviour issues. The Commission investigated a plant sharing arrangement by Fletcher and Stevenson in 2000. As a result of the investigation letters were sent to both Fletcher and Stevenson, warning them that their conduct risked breaching the Commerce Act, in terms of substantially reducing competition in the Auckland readymix market and possible price fixing.
41. The Commission also investigated allegations of predatory pricing for readymix concrete for the purposes of substantially lessening competition in the national cement market. The investigation involved Fletcher and was concluded in 2002. As a result of the investigation, the Commission sent a warning letter to Fletcher stating that Fletcher's conduct put the company at serious risk of breaching the restrictive trade practices provisions of the Act.

MARKET DEFINITION

42. The Act defines a market as:

... a market in New Zealand for goods or services as well as other goods or services that as a matter of fact and commercial common sense, are substitutable for them.¹¹

43. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit-maximising, sole supplier of a good or service, not constrained by the threat of entry, would be able to impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of a market discussed below. The Commission generally considers a SSNIP to involve a five to ten percent increase in price that is sustained for a period of one year.

Product

44. The greater the extent to which one good or service is substitutable for another, on either the demand-side or supply-side, the greater the likelihood that they are bought and supplied in the same market.
45. Close substitute products on the demand-side are those between which at least a significant proportion of buyers would switch when given an incentive to do so by a small change in their relative prices.
46. Close substitute products on the supply-side are those between which suppliers can easily shift production, using largely unchanged production facilities and

⁸ *Milburn New Zealand Limited & Isaac Concrete Limited*, 26 January 2001.

⁹ *Firth Industries & Gill Construction Co Limited*, 26 July 2002.

¹⁰ *Holcim (New Zealand) Limited & Atlas Resources Limited*, 20 November 2003.

¹¹ Commerce Act 1986, s 3(1).

little or no additional investment in sunk costs, when they are given a profit incentive to do so by a small change to their relative prices.

47. The Commission has analysed the relevant markets for the following products:
- Precast;
 - Masonry;
 - Readymix concrete; and
 - Cement.

Precast

Product

48. The Applicant submitted that the relevant market is that for the manufacture and supply of precast products for Auckland.
49. Market participants informed the Commission that customers have a variety of building materials they can choose from, including steel, timber and concrete blocks. Market participants advised the Commission that what material is chosen by construction customers depends mostly on the type of project, fashion and function, rather than price. However, where price was a factor in a construction customer's decision, market participants told the Commission that precast is actually the more cost-effective option compared to steel, timber and bricks.
50. Therefore, given the above considerations, there appears to be some degree of demand-side substitution between precast, timber, steel and concrete block.
51. In terms of supply-side substitution, market participants informed the Commission that precast manufacturing requires specific moulds, cranes and storage equipment. These moulds and storage equipment cannot be used for anything other than manufacturing precast items. Therefore, there appears to be no supply-side substitution between precast concrete on the one hand, and timber and steel on the other.
52. The closest product to precast concrete, in respect of manufacturing processes and materials, is masonry blocks. Both masonry blocks and precast are pieces of cured concrete made off-site, and taken to construction sites and formed into structures. There is some demand-side substitutability between blocks and precast, given they perform a similar function.
53. However, on the supply-side, entirely different machinery and equipment is used to produce masonry blocks. Therefore, the Commission considers that if prices increased, suppliers of masonry blocks would not be able to quickly, easily and with little cost switch to manufacturing precast products.
54. The Commission concludes that there is some demand-side substitution between precast items and other building products like masonry blocks, steel and timber, but not enough to justify placing precast in a larger market. The Commission considers there to be no supply-side substitution between precast concrete products, on the one hand, and other building products like steel, timber and concrete blocks, on the other.
55. Accordingly, the Commission considers that precast concrete products form a discrete product market.

Geographic

56. The Applicant submitted that Auckland was the relevant geographical market for the manufacture and supply of precast products.
57. Auckland precast operators defined the market as Auckland, although it was acknowledged that precast can and is brought in from other regions. Market participants stated that Auckland is currently being serviced by firms from Rotorua and Hamilton because current demand is out-stripping supply in the Auckland region.
58. However, market participants also considered that once this extra demand levelled off, it would no longer be economically viable to bring precast into Auckland from other centres, as transport costs would outweigh any economic benefit.
59. The Commission agrees that once this high demand diminishes, and the premium that is currently being paid for precast reduces, transporting precast into Auckland from outside regions would no longer be an attractive business prospect.
60. Although the boundaries are somewhat blurred in the case of precast products, the Commission considers, for the purposes of this Application, that the appropriate geographic market for the manufacture and supply of precast concrete products is Auckland.

Functional

61. The Applicant submitted that the relevant functional level is the manufacture and supply of precast concrete products.
62. Market participants informed the Commission that precast products are made either: on a precast manufacturer's premises and transported to the construction site, or made at the construction site itself.
63. Precast is generally made to order and is generally not stockpiled.
64. The Commission therefore considers the relevant functional level to be the manufacture and wholesale supply of precast concrete products.

Conclusion on Precast Market Definition

65. The Commission concludes that the relevant market is the manufacture and wholesale supply of precast concrete products in Auckland.

Masonry

Product

66. The Applicant submitted that the relevant market definitions were those for the manufacture and wholesale supply of concrete masonry products in the Northland, Auckland and Christchurch regions.
67. The Applicant submitted that there is little demand-side substitutability between concrete blocks and pavers. Market participants informed the Commission that, by and large, concrete blocks are used to construct buildings and retaining walls, whereas pavers are used to surface driveways, paths and patios. Therefore, the Commission agrees that there is no demand-side substitutability between concrete blocks and pavers.

68. In terms of supply-side substitutability, market participants informed the Commission that concrete blocks and pavers are made by the same manufacturing process, and the same equipment is used for both. Any differences between manufacturing pavers and concrete blocks are minor. Those differences include the use of dyes to add colour, and different sizes and shapes of moulds.
69. The Commission therefore concludes that given this high supply-side substitutability, concrete blocks and pavers fall within the same market.
70. In addition, market participants informed the Commission that clay bricks are sometimes substituted by customers when the price of concrete blocks increases. The majority of these clay bricks are imported from overseas. Therefore, there appears to be some demand-side substitutability between clay and concrete bricks.
71. On the other hand, market participants told the Commission that the manufacturing process of clay bricks compared to concrete bricks is vastly different, with different machinery needed. Therefore, given the complete lack of supply-side substitutability the Commission concludes that clay bricks do not compete in the same market as masonry blocks and pavers.
72. The Commission also considered the degree of substitution between concrete blocks, and plasterboard, timber, steel and precast. Market enquires suggest that while there is some demand-side substitution (see precast market definition above), the manufacturing process between these products is completely different.
73. Even though there is some demand-side substitution, the Commission will in this case adopt an approach by giving greater weight to the lack of supply-side substitution. The Commission adopts this narrow definition because if no competition issues arise in the narrower market, the Commission would be unlikely to find problems in a broader market.
74. Accordingly, the Commission considers that the complete lack of supply-side substitution between concrete blocks, clay bricks, plasterboard, timber and precast, means that clay bricks, plasterboard, timber, steel and precast do not compete in the same market as concrete blocks and pavers. Therefore, the Commission considers that masonry concrete products, which include concrete blocks and pavers, form a discrete product market.

Geographic

75. The Applicant submitted that the relevant geographic markets for masonry are the Northland, Auckland and Christchurch regions.
76. Masonry is made and stored at plants, then supplied at wholesale either directly to bricklayers or to retail outlets. Market participants informed the Commission that masonry is expensive to transport, given the weight and bulk. Consequently, suppliers do not generally transport masonry blocks any considerable distance from the source of manufacture to the customer.
77. There is some overlap between regions. For example, Holcim transports masonry blocks into Auckland from its plant in Horotu, just north of Hamilton. Similarly, Fletcher transports a modest amount of masonry product from its Auckland plant into Northland.

78. The Commission considers that the most appropriate geographic markets in the present case are for Northland, Auckland and Christchurch.

Functional

79. The Applicant submitted that the relevant functional level is that for the manufacture and wholesale supply of masonry concrete products.
80. Market participants informed the Commission that masonry blocks and pavers are supplied directly to bricklayers and to retail outlets. Fletcher and Stevenson both have downstream retail operations that sell masonry products.
81. Accordingly, the Commission considers that the appropriate functional level is the manufacture and wholesale supply of masonry products.

Conclusion on Masonry Market Definition

82. The Commission therefore concludes that the relevant markets are those for the manufacture and wholesale supply of masonry concrete products in:
- Northland;
 - Auckland; and
 - Christchurch.

Readymix

83. The Applicant submitted that the relevant market is that for the manufacture and supply of readymix concrete in Auckland.
84. In Decision 513 the Commission previously considered the market for readymix concrete, and concluded that was the appropriate market.
85. Investigations in the present Application support the Commission's previous findings. Therefore, the Commission does not intend to discuss the readymix concrete market further.

Cement

86. The Applicant submitted that the relevant market definition is the one previously defined by the Commission nearly two years ago in Decision 513.¹² In that case, the Commission concluded that the relevant market was one for the national market for manufacture/import and wholesale supply of cement. The Commission has reconsidered this view in light of the circumstances, and additional information gathered, in the present case.
87. Decision 513 found that almost all cement used in New Zealand is manufactured at two sites in the country – Whangarei (Fletcher) and Westport (Holcim).
[] Cement is conveyed from the production sites to silo depots at a number of ports around the country by specialized coastal shipping. From those depots it is distributed in bulk by special road tankers to users, such as readymix makers, or bagged and distributed by ordinary trucks to retail outlets, such as the various hardware chains. The two manufacturers own their own distribution networks of ships, silos and trucks, although in some locations they supply each other with cement.

¹² Commerce Commission, *Decision 513: Holcim/Atlas*, 20 November 2003, p. 21.

88. [

] Fletcher has a much stronger presence in the North Island, where the bulk of the demand occurs.

89. Decision 513 went on to note that cement prices vary significantly between users across the country – a fact confirmed by the investigation on this case, where a range of about []% has been found – and put this down to a number of likely factors: the discount for volume; the closeness of the association with the supplier; and the customer’s location, implying different delivery distances and costs. These factors, plus the ones cited in the previous paragraph, indicate that there was and is scope for costs, and for the strength of competition, to vary across the country, and for this to be reflected in varying prices. This in turn suggests that the geographic market could be island or region based, rather than being a national one.
90. Decision 513, in reaching a conclusion for a national market, put weight on the ability of imports to enter the country through any of the country’s ports. It cited shipments of Asian cement that had been imported by Fern Cement through Napier, New Plymouth and Tauranga in the North Island, and Lyttelton and Timaru in the South Island. These imports were in the form of bulk bags, given that the importer did not have access to port silo facilities. However, it is likely that the cost of these imports varied, since they were of different sizes, and there were purchasing economies associated with scale available to the importer in both cement and shipping; all else being the same, a small shipment will cost more per tonne than a large one.
91. In addition, the present investigation has revealed that bulk bagged cement imports are expensive, relative to bulk imports on a reasonable scale, and hence are only likely to be successful for smaller centres where domestic prices are relatively high. Further, Fletcher has indicated that the incumbents []¹³ These findings taken together suggest that to the extent that the threat of imports may constrain (given that currently actual imports of cement are slight), they are likely to do so unevenly across the country.
92. The Commission’s analysis below indicates the likelihood that if there were bulk imports brought into the country, this would involve entry, at least initially, into the northern half of the North Island, particularly Auckland, where a substantial proportion of national demand is concentrated. In that event the impact might be to constrain prices there significantly, leaving the rest of the country relatively unaffected.
93. In summary, it is difficult to draw precise geographic boundaries for the cement market(s). The relevant markets might be island-based, or even regional in nature. Much would appear to depend upon the scale and scope of any import entry, and whether the importer would focus on the Auckland region or a wider area. Even if the initial focus were Auckland, it could well broaden over time as the importer becomes established, and this seems likely to be sooner rather than

¹³ Cement prices are discussed in detail in the section on the competition analysis.

later given that [] state that the actual point of entry is likely to be [].

94. Accordingly, the Commission, for the purposes of considering the competitive effect of this Application, has chosen to adopt a national market for cement, although it will still have regard to the possible implications of a narrower market when conducting the competition analysis. This section is discussed below.
95. On this basis, the Commission considers that the relevant market is one for the national market for manufacture/import and wholesale supply of cement.

Conclusion on Market Definition

96. The Commission adopts the following market definitions:
- the manufacture and wholesale supply of precast concrete products in Auckland;
 - the manufacture and wholesale supply of masonry products in:
 - Northland;
 - Auckland; and
 - Christchurch.
 - the manufacture and wholesale supply of readymix concrete in Auckland; and
 - the national market for manufacture/import and wholesale supply of cement (subject to the caveats mentioned above).

COUNTERFACTUAL AND FACTUAL

97. In reaching a conclusion about whether an acquisition is likely to lead to a substantial lessening of competition, the Commission makes a “with” and “without” comparison rather than a “before” and “after” comparison. The comparison is between two hypothetical future situations, one with the acquisition (the factual) and one without (the counterfactual).¹⁴ The difference in competition between these two scenarios is then able to be attributed to the impact of the acquisition.

Factual

98. Fletcher would acquire Stevenson, and would continue to operate in all of the defined markets.
99. As part of its Application, Fletcher has given an undertaking to divest certain assets of Stevenson. A copy of the undertaking is attached as Appendix One. The deed states that the Applicant will sell or procure to sell the business assets of the following Stevenson’s operations as going concerns within six months after the acquisition:
- the Auckland Concrete Masonry Business;
 - the Auckland Supply Yard Business;

¹⁴ Commerce Commission, *Decision 410: Ruapehu Alpine Lifts/Turoa Ski Resorts Ltd (in receivership)*, 14 November 2000, paragraph 240, p 44

- the Christchurch Concrete Masonry Business; and
 - the Christchurch Supply Yard Business.
100. In establishing the factual, the Commission considers the likely state of the market subsequent to the proposed acquisition and divestment. As outlined above, to make this assessment, the Commission has regard to the composition risk, purchaser risk and asset risk in relation to the divestment.
101. The Commission considers that the risk framework provides a useful way of identifying the risks that are inherent in divestment undertakings, and ensures the Commission has made a thorough analysis of all factors relevant to the factual. In particular, the risk framework is used to assess whether the divestment undertaking is viable and likely.

Composition Risks

102. In examining the composition risks of the proposed divestment undertaking, the Commission has assessed whether the terms of the proposed divestment undertaking contain all the components integral to producing the product or operation being divested.
103. Fletcher is planning to sell the businesses as going concerns, including the retail yards. Fletcher submitted that the sale of the retail yards would ensure that a buyer would have a channel through which to market its masonry products. At this stage, Fletcher would
[

] The Commission considers either option would not impede a purchaser from operating effectively and viably in the market.
104. The Commission notes that the undertaking provides to sell the businesses as going concerns, including all levels of manufacture, wholesale and retail of the products. Therefore, the Commission is of the view that there would be no appreciable composition risk in this case.

Purchaser Risks

105. Fletcher has advised the Commission that it is in discussions with potential buyers, including []. During the course of its investigation, the Commission also identified potential buyers.
[

] is interested in acquiring all the businesses.
106. All the firms the Commission and Fletcher identified are sound companies, with appropriate infrastructure and knowledge about industries associated with or connected to the masonry market. The Commission does not foresee any risks that Fletcher would dispose the assets to a weak or otherwise inappropriate purchaser.
107. Accordingly, the Commission is of the view that there would be no substantial purchaser risk in this case.

Asset Risks

108. The divestment would be completed within six months of the acquisition. The Applicant considers that it has commercial incentives to maintain the value of the businesses during the divestment period to ensure their sale at the best possible price.
109. The Commission is of the view that there is minimal commercial incentive for the Applicant to run down the brands to be divested, in the pre-divestment period. This is especially so as it is likely that Fletcher would seek to supply the new business owners with cement.
110. The Commission recognises the potential for the businesses to lose customers during the divestment. However, the Commission considers that this is mitigated by the businesses having their own retail outlets, and the incentives mentioned in paragraph above. Accordingly, the Commission is of the view that there would be no significant asset risk in this case.

Divestment Conclusion

111. The Commission does not foresee any significant risks associated with the divestment and accepts it forms part of the factual scenario.

Counterfactual

112. In the absence of the acquisition by Fletcher, the Commission considers that the most likely alternative scenario is that Stevenson would be sold to an overseas firm. Failing that, the Commission considers the next most likely scenario would be acquisition by a New Zealand firm. None of the currently identified potential acquirers of Stevenson have any significant existing interests in the cement or concrete product markets in New Zealand.

113. [

]

114. There are a number of New Zealand based entities interested in purchasing Stevenson which do not have other interests in the relevant markets or related markets. Should the acquirer be a local firm, Stevenson would be independent of the two cement suppliers, Fletcher and Holcim, and thereby provide an opportunity for an overseas cement supplier to enter the New Zealand cement market.
115. Under either of the alternative scenarios, Stevenson would operate independently in the relevant precast products, Northland, Auckland and Christchurch masonry, and Auckland readymix concrete markets.
116. The implications of this situation are discussed more fully in the cement supply section below.

COMPETITION ANALYSIS

117. The proposed transaction involves both horizontal aggregation and vertical integration. The horizontal aggregation occurs in the precast, masonry and readymix markets. The vertical integration occurs in relation to the Applicant's pre-existing cement supply operation and its proposed acquisition, which would

lead to an expansion of its downstream readymix, precast and masonry operations. The individual markets are considered below.

118. Existing competition occurs between those businesses in the market that already supply the product, and those that could readily do so by adjusting their product-mix (near competitors).
119. An examination of concentration in a market can provide a useful indication of the competitive constraints that market participants may place upon each other, providing there is not significant product differentiation. Moreover, the increase in seller concentration caused by a reduction in the number of competitors in a market by an acquisition is an indicator of the extent to which competition in the market may be lessened.
120. A business acquisition is considered unlikely to substantially lessen competition in a market where, after the proposed acquisition, either of the following situations exist:
 - the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is below 70%, the combined entity (including any interconnected or associated persons) has less than in the order of 40% share; or
 - the three-firm concentration ratio (with individual firms' market shares including any interconnected or associated persons) in the relevant market is above 70%, the market share of the combined entity is less than in the order of 20%.
121. The Commission recognises that concentration is only one of a number of factors to be considered in the assessment of competition in a market. In order to understand the impact of the acquisition on competition, and having identified the level of concentration in a market, the Commission considers the behaviour of the businesses in the market.

The Auckland Precast Products Market

Existing Competition in the Auckland Precast Products Market

122. The total value of precast sold in Auckland for the year ending March 2005 was approximately \$[] million. Market shares are show in Table 1.

Table 1: Precast Market Share Figures by Sales Value

Manufacturer	Share (\$)
Stevenson	[]
Stresscrete (Fletcher)	[]
Combined Firm	[]
Wilco Precast	[]
Wilson's Precast Construction	[]
Busck Prestressed Concrete	[]
Atlas Tilt Slab	[]
Nauhria Precast	[]
Stahlton Prestressed Flooring	[]
Concrete Structures (NZ)	[]
Mediterranean Pre-Cast	[]
Other	[]
Total	100%

Source: Market participants.

123. The Applicant submitted that post-acquisition, the combined entity's market share would be within the Commission's safe harbours. The three-firm concentration would be [], and the combined firm's market share would be approximately [], which is within the Commission's safe harbours.
124. The Commission notes that there is little substantive difference between the factual and the counterfactual. The acquisition would reduce the number of precast product suppliers from ten to nine, with no firm having a large market share. The Commission considers that this would leave a high level of existing competition post-acquisition. Each of the remaining competitors are of relatively similar sizes and all compete on price and quality of service.
125. While precast manufacturers consider service and a good finish on products an important element of the business, the main competition is on price. Precast manufacturers emphasised an ability to deliver on time, and general reliability, as being essential in order to compete for large commercial jobs. The Commission acknowledges that while service and quality do play a role in the precast market, price is the driver. Market participants informed the

- Commission that big jobs are put out to commercial tender and then are chosen on price.
126. Stevenson's competitors stated that if prices were raised by the combined firm, they would then seek to supply affected customers. This reaction from competitors indicates that they would continue to be a competitive constraint on the combined entity.
127. The Commission considers that existing competition in the supply and manufacture of precast products market would sufficiently constrain the combined firm, and that this acquisition would not lead to a material difference in competition in the market relative to the counterfactual. Therefore, the Commission has not gone on to consider potential competition or countervailing power.
128. Accordingly, the Commission is satisfied that the acquisition would not have, nor would be likely to have, the effect of substantially lessening of competition in the Auckland market for precast products.

The Northland Masonry Market

Existing Competition in the Northland Masonry Market

129. The total value of masonry sold in the Northland masonry market for the year ending March 2005 was \$[]¹⁵ Stevenson is the only Northland manufacturer, with its plant in Whangarei. Fletcher supplies the market by transporting masonry products from its Auckland plant into Northland.

Table 2: Supplier revenue figures for the Northland masonry market for the year to March 2005.

Supplier	Revenue (\$)
Stevenson	[]
Firth Industries	[]
Total	[]

Source: Applicant and Stevenson.

130. Fletcher has [] Northland masonry customers, [] of which are nationwide customers. Fletcher states that it does provide a level of constraint upon Stevenson's ability to increase prices in Northland.
131. However, Fletcher informed the Commission that its ability to compete on price is constrained by the fact it is at a significant cost disadvantage given it services the region from its Auckland manufacturing facilities.

Conclusion on Existing Competition in the Northland Masonry Market

132. The Commission considers that under the counterfactual there would be two masonry suppliers, and the counterfactual, in effect, would be similar to the current competitive position. Under the factual, however, the existing competitive constraint that Fletcher provides on Stevenson would be absent, given they would both be owned by Fletcher. Accordingly, it is necessary to consider whether potential competition and countervailing power would be sufficient to constrain the combined firm in the factual.

¹⁵ Based on wholesale revenue figures.

Potential Competition in the Northland Masonry Market

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

Barriers to Entry

134. The likely effectiveness of the threat of new entry in preventing a substantial lessening of competition in a market following an acquisition is determined by the nature and effect of the aggregate barriers to entry into that market. The Commission is of the view that a barrier to entry is best defined as anything that amounts to a cost or disadvantage that a business has to face to enter a market that an established incumbent does not face.

De Novo Entry

135. The Applicant submitted that it was "relatively straight forward" to establish a masonry manufacturing facility.
136. The Commission considers the following requirements are necessary for entry into the Northland masonry market:
- plant and equipment – hoppers, conveyers, mixers, racks for trucks, block machines, buildings;
 - land;
 - Resource Management Act (RMA) approval;
 - access to raw materials – aggregates, sand, cement, additives;
 - labour – 4-6 semi-skilled people for a single shift operation; and
 - capital of \$2.5 – 5 million (excluding land).
137. Both new and used plant is available from the USA. New plant is made to order with an estimated lead-time of 12-18 months from the commencement of design to commissioning. The specialised nature of the equipment would mean investment in it would be a sunk cost.
138. An appropriately zoned site of approximately 2-3 hectares would be required for a new block plant. The Commission would not expect that the availability of land in Whangarei to be especially difficult, although the amount required may mean this requirement would be a costly one.
139. RMA approval for a masonry block plant is estimated to take approximately 12 months.
140. Stevenson informed the Commission that it was not aware of any issues that might impede access to raw materials. It did say, however, that in terms of labour, skilled technical and supervisory staff are difficult to come by, and machine operators are less so.
141. The Commission considers that the capital investment of \$2.5 – 5 million (excluding land) is significant compared to the relatively small size of the total Northland masonry market at approximately \$[] million of which an

incumbent would possess 100%. The Commission considers this to be the most serious barrier to entry.

142. Overall, the Commission considers the barriers to entry are high in the Northland masonry market.

The “LET” Test

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

- Likely in commercial terms;
- Sufficient in extent to cause market participants to react in a significant manner; and
- Timely, i.e., feasible within two years from the point at which market power is first exercised

(the LET test).

144. Given that the amount of capital needed to establish a masonry plant is large compared to the overall size of the market, the Commission considers de novo entry would be unlikely even in the face of a 5-10% price increase by the combined firm. Therefore, the Commission will not go on to consider whether entry is likely to be sufficient in extent or timely.

Northland Merchants

145. Northland masonry customers informed the Commission that if the combined firm raised the price of blocks, merchants would have the option of bringing in blocks from Auckland. Further, customers informed the Commission that this has occurred in the past, to let “Stevenson know they didn’t have a monopoly in the market”.
146. Fletcher and Stevenson are the main suppliers in Auckland. There are two minor operators – the Cobblestone Factory, and the Brick and Cobble Factory – that specialise in paving. Holcim occasionally sends masonry blocks into Auckland from its plant in Horotiu, just north of Hamilton.
147. However, customers also said that transporting blocks from Auckland was expensive because of the freight component, and that doing so may not be sustainable long-term. Customers were clear, however, that bringing in blocks from Auckland could be used to threaten the local supplier if its prices increased.
148. Customers told the Commission they would consider supporting a new entrant or a local merchant who brought in blocks if the price of local blocks rose by 5%, and if prices rose by 10% they would definitely switch.
149. In terms of the LET test criteria, the Commission considers that a customer may transport blocks from Auckland, but that it would most probably be a short-term measure only, as the incumbent would be likely to respond by dropping prices to a point that would make that unsustainable. Moreover, given this incumbent response is likely to occur relatively quickly, it appears unlikely that entry by way of customer self-supply or by way of a customer supplying other merchants is likely to be sufficient in extent.

Entry via Auckland Divestment Acquisition

150. As discussed in the factual section, the Applicant has offered to divest the Stevenson Auckland masonry plant. The Applicant submitted that post-acquisition, the current level of constraint that Fletcher provides would continue under the factual on the basis that Fletcher would divest the Auckland masonry operations, thereby enabling the purchaser to transport product into the Northland region as Fletcher has done.
151. The Commission considers that for a new owner of the Auckland plant to be successful in entering, it would need support from Northland merchants and other retail outlets to access their residential and trade customer bases. As stated above, current customers advised the Commission that if the combined firm raised its price by 5% they would consider switching, and if the rise was as high as 10% they would definitely switch to another supplier.
152. Another requirement the potential entrant would need to satisfy is the ability to service customers by means of travelling sales representatives. The Commission does not consider this poses a significant barrier.
153. In terms of the LET test criteria, the Commission considers that it is likely an acquirer of the Auckland masonry plant would be incentivised to enter the Northland market in response to a price increase, given the ease with which entry can be affected and the likely support from disaffected customers.

[

]

154. The extent of that entry would only need to be on the scale that Fletcher is now in order to be sufficient; the Commission considers that this modest level would be achievable within two years.

Conclusion on Potential Competition in the Northland Masonry Market

155. De novo entry into the Northland masonry market, as well as entry by way of a Northland merchant bringing in masonry products from Auckland, appears unlikely. However, the Commission considers that the owner of the divested masonry plant in Auckland would have the ability to enter the Northland market, given that the extra requirements needed – customer support and a sales representative – are not significant barriers.

Conclusion on Competition in the Northland Masonry Market

156. The Commission considers that the current level of competition between Fletcher and Stevenson in the Northland masonry market is small. That level of competition is likely to best represent the counterfactual level of competition. The Commission is satisfied that in the factual, entry could occur by the new owner of the divested masonry plant in Auckland. Therefore, there is unlikely to be any significant difference in competition terms in this market between the factual and counterfactual scenarios.
157. Accordingly, the Commission is satisfied, on balance, that the acquisition would not have, nor would be likely to have, the effect of substantially lessening competition in the Northland masonry market.

The Masonry Products Markets in Auckland and Christchurch

158. As referred to above, the Commission does not foresee any significant risks associated with the divestment offered in these markets and accepts it forms part of the factual scenario. Consequently, there are no significant competition issues to consider in the Auckland and Christchurch masonry markets and those markets will not be discussed further.

The Auckland Readymix Concrete Market

Existing Competition in the Auckland Readymix Concrete Market

Introduction

159. The total volume of readymix sold in the Auckland region for the year ending March 2005 was [] million cubic metres.¹⁶ Market shares are outlined in Table 3.

Table 3: Auckland Readymix Market

Firm	Revenue	Share (\$)	Volume (C3)	Share (V)
Fletcher	[\$]	[]%	[]	[]%
Stevenson	[\$]	[]%	[]	[]%
Combined Firm	[\$]	[]%	[]	[]%
Holcim Combined	[\$]	[]%	[]	[]%
<i>Allied</i>	<i>[\$]</i>	<i>[]%</i>	<i>[]</i>	<i>[]%</i>
<i>Atlas</i>	<i>[\$]</i>	<i>[]%</i>	<i>[]</i>	<i>[]%</i>
<i>Holcim</i>	<i>[\$]</i>	<i>[]%</i>	<i>[]</i>	<i>[]%</i>
Counties	[\$]	[]%	[]	[]%
Wilsons Readymix	[\$]	[]%	[]	[]%
Bridgeman	[\$]	[]%	[]	[]%
Total	[\$]	100.0%	[]	100.0%

Source: Market participants

160. Table 3 indicates that the three firm concentration would be []%, and that the combined firm would have a market share of []%, above the 20% threshold, and so both thresholds are outside the Commission's safe harbour guidelines.

161. There are variously sized jobs that readymix producers supply: large jobs include the big commercial construction projects, medium jobs include factories and car parks; and smaller jobs include residential housing construction. Fletcher and Holcim do all sizes of jobs, with a particular focus on large commercial construction jobs. Allied does mostly medium to small, with the occasional large job. Counties focuses on residential jobs south of Auckland,

¹⁶ The actual amount sold in the Auckland market may be smaller as this figure is based upon data collated by the Department of Statistics that includes the Pukekohe to Wellsford areas.

Wilson's medium to small jobs, and Bridgeman typically medium to smaller, but also sometimes large jobs.

162. The Commission will focus on three key areas in the following existing competition discussion:
- The competitive impact of the inter-firm relationships between participants in the readymix concrete market:
 - Holcim and Allied; and
 - Holcim and Atlas.
 - The competitive dynamics between Holcim, Atlas and Allied / Fletcher:
 - Extent of competition; and
 - Potential for co-ordination.
 - The role of the independent readymix concrete operators:
 - Bridgeman; and
 - Counties and Wilsons.

Inter-firm relationships

163. The Applicant submitted that existing competition would continue to provide a substantial constraint on the ability of the combined firm to exercise unilateral market power. In particular, the Applicant submitted that in the factual, Holcim and Allied concrete would provide a sufficient constraint.
164. The Commission must first consider the nature of the inter-firm relationships between Holcim, Atlas and Allied, before it can assess whether these firms compete independently with each other and with Fletcher. When examining inter-firm relationships, the Commission determines whether the firms in question have strong formal relationships or less formal relationships. The presence of a strong formal relationship generally raises the presumption that the firms in question do not provide a competitive constraint on one another. Likewise, there may be a reduction in competition between those parties that are found to have less formal relationships.
165. In determining the nature of the relationships the Commission examines a range of factors, including:
- historical links;
 - contractual relationships;
 - ownership and contractual relationships that give rise to differences in:
 - distribution channels and facilities;
 - raw materials;
 - capital;
 - technology; and
 - essential facilities.

Holcim and Allied

166. Holcim and Allied have a number of commercial relationships with each other and the Commission has considered the effect of the relationships in previous decisions. For example, in Decisions 416, 466, and 513, the Commission determined that Holcim was interconnected with Allied through its joint venture AML. As Holcim owns 50.1% of AML, under section 5(1)(a)(ii) of the Companies Act 1993 AML is its subsidiary. As AML is Holcim's subsidiary, the Commission considered that Holcim and AML were deemed to be interconnected. Those relationships remain in place.
167. Allied owns 49.9% of AML and constitutionally has the casting vote on the AML Board. As Allied Concrete is in a position to control the voting on the AML Board, AML is also a subsidiary of Allied under s 5(1)(a)(i) of the Companies Act 1993. Therefore, the Commission considered that the two firms were also interconnected. Again this position is unchanged.
168. In Decision 416 and 513 the Commission considered that Holcim and Allied were interconnected with AML, and also that Holcim and Allied were interconnected.
169. The situation since Decision 513 has not changed. Holcim still own 50.1% of the AML shares, and Allied still has the majority on the Board. The Commission considers Holcim and Allied continue to enjoy a strong formal relationship.
170. Holcim told the Commission that it competes with Allied in readymix to a moderate degree. This is because:
- the companies have slightly differing geographic coverage;
 - Allied supplies market segments that Holcim has not traditionally supplied, e.g., industrial flooring; and
 - Allied offer finished concrete floors and Holcim offer wet concrete.
171. Allied stated that Holcim was its biggest competitor. Allied also has a close relationship with Fletcher. For instance, Fletcher and Allied have [
-].¹⁷
172. The Commission considers that while Holcim and Allied appear to be competing to some degree at the moment, it is doubtful that it is to such a degree as to constrain each other significantly. The Commission considers that Holcim's and Allied's strong formal relationship means that they do not provide a significant competitive constraint on one another. Also as noted by Holcim, Allied and Holcim compete to a moderate degree, if at all, given the different focus of each company. The Commission considers that this situation is likely to continue under both the counterfactual and factual scenarios.

Holcim and Atlas

173. In Decision 513, the Commission stated that Holcim and Atlas were associated because of:

¹⁷ For a more detailed breakdown of these relationships see below.

- commonality of interest stemming from shareholding;
 - Holcim having one member on the Atlas Board; and
 - the likely sharing of strategic information.
174. The situation since Decision 513 has changed because Holcim has reduced its shareholding to 25%.
175. To determine whether these companies are likely to constrain each other the Commission has considered the links between them. Holcim's representation and influence on the Atlas Board means there is a risk that it has the ability to influence the Atlas Board and that there is a real risk that they could share strategic information.¹⁸ While Holcim is not in a position to control Atlas, it nevertheless has the ability to have an impact upon the development of the company. Accordingly, the Commission considers that Holcim and Atlas have a strong formal relationship.
176. Holcim informed the Commission that Atlas competes with Holcim in readymix to a moderate degree only. Holcim considers the level of competition to be moderate because the firms have different geographic coverage. Holcim told the Commission that it bought shares in Atlas partly because
- [

] Given these factors, the Commission considers that Atlas and Holcim do not provide a strong competitive constraint on one another, and that this situation is likely to continue under the counterfactual and factual scenarios.

177. Overall, the Commission concludes that Holcim, Atlas and Allied do not, and are not likely to, significantly constrain each other in the Auckland readymix concrete market.

Competitive Dynamics between Holcim / Allied / Atlas and Fletcher

Extent of Competition

178. There is some evidence suggesting that Atlas and Allied compete with Fletcher in readymix. One readymix customer informed the Commission that Allied had approached him in the past offering cheaper prices than Fletcher. This operator was also offered [] by Atlas as an incentive for switching his business from Fletcher to Atlas. Another readymix user informed the Commission that Holcim and Fletcher appear to compete, and that Holcim has been pro-active in seeking out his business through visits from sales representatives.
179. The Commission was informed that the quality of the concrete, and a supplier being close to a job, were more important to customers than price, given the present building boom. Customers said, however, that the boom is declining and, as a consequence, they were looking closely at the impact that the price of readymix had on their margins. The importance of quality varies according to the type of job. For instance, a factory floor did not require as high quality concrete as a floor in a printing operation, which needs a level floor for special equipment it uses. Location was also important. Concrete operators like Fletcher, Stevenson and Allied have an advantage over the smaller independents

¹⁸ Decision 513,[

].

given they have plants dotted around Auckland, and can run a circuit of trucks to fill the order. The smaller independents would have to run their trucks back and forth from their single plant located in the south of the city; a less desirable option for customers.

180. The Commission has confirmed that Allied, Atlas and Holcim have spare capacity to meet extra demand should the combined firm raise prices or decrease quality or service.

181. On the other hand, there are relationships between Fletcher and Allied that may have an impact on the level of competition between them. During its investigations, the Commission became aware that Fletcher and Allied have the following relationships:

- Rangitikei Aggregates Limited – Allied Concrete Limited & Fulton Hogan Limited jointly own 50%, and Fletcher Concrete and Infrastructure Limited owns 50%;
- probable equal ownership of joint venture readymix operation in [];
- Fletcher has a
[

] plant.

182. The Commission considers that these relationships must weaken the level of competition between Fletcher and Allied.

183. The Commission also notes that Fletcher, Allied and Holcim are involved in Canterbury Sand Ltd. Fletcher and AML own Canterbury Sand in equal shares. AML is a subsidiary of both Holcim and Allied. The Board of directors of Canterbury Sand is Chris Ellis (Winstone Aggregates – Fletcher, General Manager), Peter Carnahan (Allied Concrete General Manager), Marc Hainen (Firth - Fletcher South Island Regional Manager) and Rex Williams (Holcim NZ Managing Director).
[

]

184. The Commission accepts that presently there appears to be a degree of competition between Holcim, Allied and Atlas on the one hand, and Fletcher on the other. This state of competition is likely to be similar under the counterfactual. However, a key question for the Commission is whether the factual scenario changes the likelihood of co-ordinated behaviour, thereby decreasing the competition between Holcim, Allied and Atlas, and Fletcher.

Scope for co-ordination

185. The Commission is of the view that where an acquisition materially enhances the prospects for co-ordination between businesses in the market, the result is likely to be a substantial lessening of competition.

186. In broad terms, effective co-ordination can be thought of as requiring three ingredients: collusion, detection and retaliation.

Collusion

187. Collusion involves businesses in a market either each individually coming to a mutually profitable expectation as to co-ordination (tacit collusion), or together reaching agreement over co-ordination (explicit collusion).
188. The key issue in this case is whether the removal of Stevenson would heighten the likelihood of Holcim, Atlas, Allied and Fletcher co-ordinating to fix prices in the Auckland readymix market.
189. Stevenson is currently the largest independent supplier of readymix concrete with a share of []%. Post-acquisition Fletcher's share would increase to []%, more in line with Holcim's, Atlas' and Allied's combined share of []%. The remaining []% share would be held by three independent readymix operators. Therefore, as a consequence of the acquisition, the Auckland readymix concrete market would be relatively evenly divided between Fletcher on the one hand, and Holcim, Atlas and Allied, on the other, and could increase the incentive for the parties to co-ordinate to increase prices in the readymix market. Furthermore, as discussed above, Holcim, Atlas and Allied, and, to some extent, Allied and Fletcher have close ties that may facilitate co-ordination.
190. Stevenson's presence in the market currently undermines the potential for co-ordination between the above firms, as it is large enough to be able to undercut any attempted concerted price rise. This competitive effect would continue under the counterfactual, but be removed under the factual.
191. However, weighing against any achievable effective co-ordination is the difficulty of coordinating in terms of different sized jobs. As stated above, Atlas and Allied mostly do medium to small jobs, with the occasional large job. Holcim and Fletcher, on the other hand, engage in large commercial, medium and small jobs. The price charged per job varies according to volume, with volume discounts being a fundamental characteristic of the market. Additionally, coordination would be difficult because of the large range of products over which prices would have to be coordinated. Also, the lack of price transparency in most cases would make it difficult for each firm to monitor the others' bid. These variables increase the difficulty for all parties to agree to charge one price to all customers. The removal of Stevenson under the factual does not influence these market characteristics.
192. The Commission must compare the firms' close relationships and the removal of the constraining effect of Stevenson, both of which heighten the risk of co-ordination, against the variables present in this market making co-ordination difficult, which exist under both the factual and counterfactual.
193. While the Commission remains concerned about the increasingly close relationships between the firms, it considers that in the present case, the different sizes of jobs, different products and lack of price transparency make it difficult for the four parties to co-ordinate effectively, tacitly or otherwise. However, this conclusion is a finely balanced one. Consequently, the Commission leaves it open to revisit the issue of co-ordination between the above parties in future clearance applications, or investigations, should the commercial relationships between those firms grow any closer.

194. Given that the Commission has decided that collusion would not be likely to be effective in this instance, the Commission will not go on to consider the other two aspects of effective co-ordination: Detection and Retaliation.

The Independents

195. The Applicant submitted that the combined firm would continue to face competition from other competitors including Bridgeman, Counties, Wilsons and Wharehine. The Commission considers that Wharehine's operations are too far North to warrant inclusion in an Auckland market. The Applicant believes that Bridgeman provides a competitive constraint, given that it is in the process of constructing a second plant in Tamaki.
196. In Decision 513, the Commission considered that these independent operators were primarily price followers, and as such did not exert a significant degree of competitive pressure on the larger participants.

Bridgeman

197. During this investigation,

[

]

198. [], a major readymix customer, told the Commission that it had recently given jobs to Bridgeman on the basis that Bridgeman will [] informed the Commission that Bridgeman was [] dropped its price in response to this. However, [] also said that the price difference was not significant and that prices in readymix were "much of a muchness."

199. Bridgeman informed the Commission that [] It has built a new plant, which has a capacity of an estimated [] cubic metres per year. Its other plant has a capacity of [], and this plant currently has spare capacity and is able to service a further [] cubic metres of concrete per year. Together the Bridgeman plants have an estimated capacity of [] cubic metres of concrete per year. The Commission considers that Bridgeman would provide some constraint upon the combined firm, mainly in southern Auckland, central Auckland and the edge of Waitakere, given the location of its plants.

Counties and Wilsons

200. The Applicant submitted that Counties and Wilsons would also provide a constraint upon the combined firm, "given their ability to increase utilisation of their existing capacity or to add to their productive capacity."
201. The Commission could not find any evidence that the remaining independents – Counties and Wilsons – were a constraint upon the other firms in the readymix market. Counties informed the Commission that it had spare capacity that would allow it to increase supply to [] cubic metres.

Conclusion on Existing Competition in the Auckland Readymix Concrete Market

202. The Commission concludes that, on balance, the acquisition does not materially increase the risk of co-ordination between Holcim, Fletcher, Atlas and Allied, and that the current level of existing competition, representing the level of

competition likely in the counterfactual, between these parties is not likely to be significantly less under the factual. However, any further aggregation or increase in the ties between the above parties may heighten the risk of co-ordination to an unacceptable degree.

203. The Commission considers that under the counterfactual and factual, Holcim, Allied and Atlas would continue to compete with Fletcher. Further, Bridgeman would provide the same level of constraint in relation to small to medium residential jobs and in certain areas of Auckland, and this may strengthen more with time []. The Commission considers that Counties and Wilson are not in themselves presently a significant constraint in the market in either the factual or counterfactual.
204. The issues relating to expansion by existing competitors are, in this case, similar to those to be considered for de novo entry, therefore both are considered in the following section on potential competition.

Potential Competition in the Auckland Readymix Concrete Market

205. The Applicant submitted that expansion by the independents and potential entry into the Auckland readymix market could occur. It stated that Australian readymix concrete suppliers could extend their operations into New Zealand, and that there are a number of domestic readymix operations in other regions that could enter the Auckland market.
206. The requirements to establish a small operation of one plant and fourteen trucks are:
- suitable land;
 - resource management consent (RMA);
 - cement, aggregates, sand supply; and
 - capital investment (\$3,500,000 – 5,000,000).
207. The Commission considers that although land may be difficult to acquire in central Auckland, it would be possible to acquire suitable land on the outskirts of Waitakere, Manukau and Northshore.
208. Industry participants have suggested that obtaining resource management consent can be a lengthy and costly process. Resource consents have also become considerably harder to obtain in the last decade, and carry an increasing number of conditions concerning noise, dust and roading. The Commission is of the view that resource consents represent a barrier to entry and expansion into the readymix concrete market.
209. Any potential new entrant would also require a supply of aggregates and sand. The most efficient way of sourcing these materials is to own a quarry, but due to changes in the granting of resource consents, this is becoming more difficult. It would also indicate entry at two levels of the production chain increasing the costs and the risks of entry.
210. The Commission considers that the capital investment of \$3.5-5 million may be a barrier to small operations like Counties and Wilsons, especially given the significant sunk cost component.

211. Sunk costs are generally understood as being that portion of capital and other outlays (such as on advertising) that could not be recovered should the firm exit the market. Plant and equipment that are highly use-specific, and which have little value in alternative uses, are sunk assets.¹⁹ A firm considering entry will weigh up the possible outcomes, ranging from 'success' to 'failure'. Where entry would involve investing in sunk assets, a potential entrant will factor into the possibility of 'failure' the consequences of exit and the loss of the sunk costs. Although the sunk assets might have value to another entrant, the fact that the assets are being sold by an exiting (and unsuccessful) firm is likely to lead to a substantially discounted price. Thus, by increasing the downside costs, entry overall is rendered less attractive.²⁰
212. At the same time, incumbents, unlike the possible entrant, have already made their investments in sunk costs. They are thus in a different position to the entrant. They would have an incentive to 'fight' entry in order to avoid the costs of exit. The entrant can be presumed to know this, and is thus likely to be further discouraged from entering.²¹
213. Sunk costs are therefore considered to be barriers to entry from the perspective of prospective entrants, even though they would by entering incur costs that the incumbents had already incurred. The Commission considers that the extent to which sunk costs constitute an entry barrier should include an assessment of the proportion of sunk costs to the overall investment that an entrant would need to make, the risk of failure, and the possible response of incumbents. In terms of establishing a readymix concrete operation, an evaluation of these factors would suggest that sunk costs do represent a barrier to entry.
214. The Commission notes that existing competitors have some advantages over new entrants. For instance, they have access to a customer base, pre-existing reputations and, importantly, they have direct knowledge and experience in the Auckland readymix market, and so would know the most optimal location for a plant.
215. The Commission is of the view that there are low to moderate barriers to entry and expansion into the readymix concrete market, of both a structural and strategic nature. Overall, the entry requirements do not appear so onerous as to deter expansion or entry on a small scale, should there be a sufficient incentive to expand or enter.

The LET Test

Likelihood of Entry

216. In recent years there have been several instances of entry into the readymix concrete market, as indicated by the Applicant in its clearance application. These include Counties, which established itself in 1999, Bridgeman in 2000 and Wilsons in 2002. The recent occurrences of entry into the market may reflect the fast-growing nature of the Auckland suburban area. The size of the

¹⁹ Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach*, Boston: Irwin, pp. 52, 119.

²⁰ Douglas F Greer, *Industrial Organization and Public Policy* (third edition), New York: Macmillan, 1992, p. 240.

²¹ Dennis W Carlton and Jeffrey M Perloff, *Modern Industrial Organization*, Glenview, Ill.: Scott, Foresman, 1990, p. 173.

Auckland area also may allow for niche entry, such as supplying pre-cast operators.

217. Given the history of entry into the market, an important question is whether conditions have changed, or circumstances have altered, since the entry of the firms noted above. The only circumstance where this appears to be the case is in regards to resource consents. Industry participants suggested that resource consents were becoming increasingly difficult to obtain, with more conditions and undertakings being placed on them.
218. The Commission spoke with some [] and they informed the Commission that they would not enter de novo as Auckland was already well serviced. They stated clearly they would enter only through acquisition. This is discussed more fully below in the cement market section.
219. The Commission was unable to identify any likely [] entrants. The Commission considers that Auckland readymix operators have a particular incentive to expand as they are already operating in the Auckland region, whereas the incentive to enter for new entrants is not nearly as strong. Further, even if new entry were likely, it would most probably be on a small scale not sufficient to constrain the combined firm.

Extent of Entry

220. If entry is to constrain market participants, then the threat of entry must be at a level and spread of sales that is likely to constrain market participants to a significant degree. The Commission does not consider entry that might occur only at relatively low volumes, or in localised areas, to represent a sufficient constraint to alleviate concerns about market power.
221. Small-scale entry into a market, where the entrant supplies one significant customer, or a particular product or geographic niche, may not be difficult to accomplish. However, further expansion from that 'toe-hold' position may be difficult because of the presence of mobility barriers, which may hinder firms' efforts to expand from one part of the market to another. Where mobility barriers are present in a market, they may reduce the 'extent' of entry.
222. Industry participants have informed the Commission that entry is more likely on a smaller scale, servicing small volume jobs in residential areas. Smaller participants have lower overheads than larger competitors, and thus can quickly establish small but efficient operations.
223. The Commission is of the view that entry is more likely on a small scale servicing primarily small to medium jobs, and accordingly that the extent of new entry may not be sufficient to provide an effective competitive force in the market.
224. In terms of expansion of existing participants, the Commission considers that further
[] Should these firms decide to expand, however, this would also strengthen their current position as competitors and act as a modest constraint, at least in respect of small to medium sized jobs.

Timeliness of Entry

225. If it is effectively to constrain the exercise of market power, entry must be likely to occur before customers in the relevant market are detrimentally affected to a significant extent. Entry that constrains must be feasible within a reasonably short timeframe from the point at which market power is first exercised.
226. Industry participants reported that setting up a readymix concrete plant may take anywhere from six months to two years depending on the location and the conditions on, and objections to the granting of, the resource consent.
227. The Commission is of the view that the time required to obtain resource consent for the concrete plant is likely to be between six months to two years. Given the history of previous entry the Commission is of the view that, on the balance of probabilities, entry could occur within a two year time period.

Conclusion on Potential Competition in the Auckland Readymix Concrete Market

228. The Commission is of the view that the barriers to entry in the readymix concrete market are low to moderate, and that whilst entry may occur, it would likely be small in scale and thus insufficient to provide any great degree of competitive constraint either in the factual or the counterfactual.
229. In terms of expansion of existing participants, the Commission considers that it would be likely that Counties, Wilsons and Bridgeman would expand in the face of a 5-10% price rise by a market participant either in the counterfactual or the factual. However, this expansion is likely to be moderate and occur on a plant by plant basis. Therefore, the constraint that Counties and Wilsons (both of which have only one plant) is likely to have if they chose to expand would be small and restricted to medium to small jobs. Bridgeman, on the other hand, would become a stronger constraint if it continued to expand, given this expansion would build upon two existing plants.

Countervailing Power in the Auckland Readymix Market

230. The Applicant submitted that large construction companies have a relatively high degree of countervailing power in the sense that they can and do play the major readymix suppliers off against each other in seeking to obtain the best price.
231. The Commission considers there to be some degree of countervailing power in the hands of purchasers of readymix concrete, particularly with regard to high volume commercial jobs, and customers who have repeat business. These high volume jobs are tendered for, and the purchasers are often more familiar with what constitutes a good price for the work to be done. As a result, readymix concrete suppliers can be leveraged against each other in order to achieve a lower price, whilst the jobs still remain attractive to large suppliers due to the volumes involved.
232. The Commission is, therefore, of the view that there is not likely to be any significant difference between the level of countervailing power held by larger purchasers of concrete in the factual compared to the counterfactual.

Conclusion on Competition in the Auckland Readymix Market

233. The Commission considers that in either the factual or the counterfactual new entry is not likely to be significant or that expansion by the independents is

likely to constrain significantly. The principle difference is with existing competition and the absence of Stevenson in the factual compared to the counterfactual. However, the Commission considers that, notwithstanding the absence of Stevenson, the existing competition between Holcim, Atlas, Allied and Fletcher will remain, and that the overall level of competition as between the factual and counterfactual will be similar. This conclusion is taken very much on balance, and the Commission remains concerned as to the relationships between those parties. Nevertheless, the Commission is satisfied that the acquisition will not have, or would not be likely to have the effect of substantially lessening competition in the Auckland readymix market.

The New Zealand Cement Supply Market

Vertical Integration

234. Vertical acquisitions are those that involve businesses operating at different functional market levels in the production of a particular good or service. Where a vertical acquisition also has horizontal implications, the Commission considers each aspect of the acquisition in its own right.
235. The Commission is of the view that, in general, the vertical aspects of acquisitions leading to vertical integration are unlikely to result in a substantial lessening of competition in a market unless market power exists at one of the functional levels affected. Where such a situation is found to exist, the Commission considers whether the acquisition would strengthen that horizontal position, or have vertical effects in upstream or downstream markets, and whether that change relative to the counterfactual would substantially lessen competition.
236. The Applicant has applied for clearance to acquire various operations downstream of cement. This would result in increased vertical integration between the Applicant's cement supply and its expanded downstream operations in readymix, masonry and retail. These downstream operations are required to buy their cement from within the group. In the absence of the acquisition, the Commission considers that Stevenson will be an independent downstream purchaser of cement.
237. In respect of cement, the Commission must consider the following key issues:
- the level of existing competition between Holcim and Fletcher under the counterfactual, and whether that would change under the factual with the acquisition of Stevenson by Fletcher; and
 - the potential in the counterfactual for entry by a new player into the cement market through the acquisition of Stevenson, either by an overseas or domestic firm, and whether the loss of that potential under the factual would amount to a substantial lessening of competition.
238. Each issue will be considered in turn.

Existing Competition in the New Zealand Cement Supply

239. New Zealand cement consumption is estimated to have been approximately [] million tonnes in the March 2004-05 year. Holcim and Fletcher are the only two domestic manufacturers of cement. Their market shares in that year [] are shown in Table 4. Their shares as they would

be post-acquisition – when all, rather than as now a part, of Stevenson’s cement demand would be sourced from Fletcher, and certain divestments would have taken place – are shown in Table 5. Fletcher has []% of the market in the first, and []% in the second. In addition to the two large manufacturers, Global Cement is a recent entrant with a modest bulk bag cement importation operation. Its import of [] tonnes in 2004-05 is [] in the tables.

Table 4: Holcim and Fletcher Current Cement Supply Shares, for the year ending 31 March 2005

Firms	Volume (T)	Share
Fletcher	[]	[]%
Holcim	[]	[]%
Global Cement	[]	[]%
Total	[]	100%

Source: Market participants.

Table 5: Cement Market Shares Adjusted for Fletcher Acquisition of Stevenson*

Firms	Volume (T)	Share
Fletcher	[]	[]%
Holcim	[]	[]%
Akl & ChCh Masonry divestment	[]	[]%
Global Cement	[]	[]%
Total	[]	100%

Source: Market participants.

* Fletcher’s market share is calculated minus the anticipated divestment of the Auckland and Christchurch masonry market.

240. The cement market is thus essentially a duopoly, with the North Island-based Fletcher having a slightly larger market share than the South Island-based Holcim. This has broadly been the situation since at least 1986, when import licensing, price control and tariffs on cement were removed. Significant import competition in recent times occurred with the entry of two importers of cement in bulk bags. There are therefore two sources of existing competition: that between the two incumbents, and that arising from the actual competition from imports. We deal with each in turn.

Imported Cement

241. [

]

242. [

]

243. There have been two independent, bagged cement importing businesses in operation over recent years – Fern Cement and Global Cement – but volumes have been low. Fern entered in about 1997, and was placed into liquidation early this year, citing the fact that it could not get enough customer support as the reason for its failure. Fern entered at a particularly favourable time for cement importing into New Zealand: the so-called “Asian economic crisis” had resulted in excess capacity, and consequent very low prices, for cement and for shipping; and the NZ\$ exchange rate was at a high level, making imported goods relatively cheap. It was essentially a one-person marketing operation: the principal would seek out sufficient customers to justify a shipment, which would effectively be pre-sold before it was ordered. As mentioned above, Global is a small, relatively new operation that operates on a similar basis.
244. [] that to be a real threat a bulk bag importing operation would need to be done by a firm with a large infrastructure. It told the Commission that the reason why Fern was not successful was because it did not have a sufficiently large infrastructure. [] informed the Commission that Global Cement was not a real threat.
245. [] stated that to be an effective constraint a bulk bag operation would need to be of a size able to withstand the volatility of importing, because of a fluctuating exchange rate and shipping costs, and the like. [] stated that recent bulk bag imports did not cause the domestic price of cement to go down; in fact, domestic prices had risen in the last few years despite cement imports.
246. [] said that importing by means of bulk bags was practical for low levels of imports, or for part-shipments, especially into smaller centres, but the costs would be too high to be competitive in the larger centres. Although bags are relatively easy to handle, there are dusting problems, and the penalties and clean-up costs for spillage from burst bags are high. There are also debagging costs. In the large centres imports would only be competitive when imported in bulk on a reasonable scale.
247. Cement users told the Commission that they were reluctant to support cement importing operations because of fear of Holcim’s and Fletcher’s response. Firstly, independent readymix producers were concerned about a backlash in their local markets, in that the incumbents would cut prices in readymix to a point that was unsustainable for them.
[

]

248. The second concern for cement users was that if they were to purchase imported cement, there would be a risk that supply would be interrupted, or that the operation would ultimately be unsuccessful. The Commission would add that the ‘backlash’ from the incumbents just mentioned would also jeopardise the success of the entrant, and the entrant’s lack of sunk investment means that it could exit easily if the going became difficult, thereby undermining any claims to longevity in the market. Customers informed the Commission that should supplies be interrupted or exit occur, they – who typically have the capacity to

hold very limited stocks – would have to return to Fletcher or Holcim for cement, and the incumbents would make them “pay through the nose”.

249. [] also informed the Commission that the “culture of fear” amongst independent cement users was a barrier for it.

[]

250. []

[]

251. Accordingly, the Commission does not consider that bulk bag importing operations provide a significant constraint upon the incumbents, as they are not on a large enough scale. [] Hence, the Commission agrees that there is no difference between the factual and counterfactual on this account. However, the scope for larger scale entry, which has not yet been attempted, is considered under “Potential Competition” below.

Competition Between Fletcher and Holcim

252. The incumbents were asked about the extent to which they competed. [] informed the Commission that presently Holcim and Fletcher do not compete for customers because both their plants are operating at full capacity, and they are just focusing on keeping up with demand. [] However, [] stated that although the market is running at capacity, things can change rapidly, and as “every cement player wants to be running at full capacity”, there is competition between the incumbents on price.

253. Further,

[]

[]

254. []

[] was large enough to be able to import cement given it has excess capacity in its Asian plants, and so would act as a constraint on the combined firm.

255. Both Holcim and Fletcher informed the Commission that cement customers do not generally switch. Rather a customer will approach its supplier with a quote of a lower price, either from the other incumbent or an importer, and use that to negotiate a better price.

256. Cement customers told the Commission that the price difference between Holcim and Fletcher was marginal, and that delivery on demand was the most important factor at the moment. A number of cement users purchase their cement from both incumbents in varying proportions. Some customers advised the Commission they do this to “keep the parties honest”, but admitted there was very little price difference between the two. The large construction companies

informed the Commission that they received discounts because of their volume, rather than through playing one cement supplier off against the other.

257. There is a definite perception among readymix operators that Holcim and Fletcher have a “cozy relationship” in the cement supply market, although they were unable to point to any substantive evidence to support this view.

258. The Commission considers that there are various factors suggesting an absence of any significant level of competition between Holcim and Fletcher,
[] First, Fletcher and Holcim share various logistical arrangements. The Applicant reported that Holcim and Fletcher have entered into:

“... co-operative arrangements for the coastal shipping of cement, whereby only Holcim discharges cement into the Port of Taranaki and only Golden Bay discharges cement into Tauranga. In New Plymouth, Holcim then sells some of this cement to Golden Bay, and in a similar way Golden Bay on-sells cement to Holcim in Tauranga. There is a similar agreement between Golden Bay and Holcim whereby Golden Bay on-sells cement to Holcim in Auckland and Holcim on-sells cement to Golden Bay in Christchurch.”

259. [

]

260. Secondly, although individual cement buyers perceive no great differences in the prices they are offered by the two suppliers, pricing information by customer for each supplier (where the prices are the ‘realised’ delivered prices, not list prices subject to volume discounts) show considerable variations. In part these price differentials appear to reflect volume discounts, varying delivery costs and premia for bagged cement. However, in one case, a cement user affiliated with one of the incumbents paid a price []% less than an independent user for bulk cement, despite using only about a quarter of the independent’s volume. Overall, for Fletcher, the highest price exceeds the lowest by []%; for Holcim, the same differential is []%.²² These differentials seem large for what is essentially an undifferentiated product.

261. Thirdly, the Commission has found that the average sale price per tonne (whether calculated on a simple or weighted basis) differs between the two companies by a figure of []%. It seems unlikely that such a [] difference can be accounted for by possible cost differences between the two companies, or that it would be sustainable in a fully competitive market.

262. Fourthly, the Commission is concerned that although the collaborative supply arrangements between Holcim and Fletcher referred to above are likely to reduce aggregate delivery costs, they may also help to sustain prices in some areas.

[

] While this should allow both to avoid the longer delivery runs from their respective cement works, it could also facilitate each paying the same price for supplies of cement in each of these areas. This might help to explain why one company is able to charge [] average prices than the other, without apparently being undercut by the other.

²² Source: These figures are derived from information provided by Holcim and Fletcher.

263. Fifthly, another indicator that the current level of price competition between Holcim and Fletcher is muted is that the New Zealand cement price is almost the highest in the world, according to an international survey of ex-works prices per tonne across 40 countries. The survey was conducted by Credit Suisse First Boston, drawing on the *International Cement Review*, and is dated 9 September 2004.²³ New Zealand cement prices are quoted as being US\$120/tonne. Only Mexico had higher prices at US\$121/tonne, and only one other country had a price above US\$100/tonne. Twenty-six countries had prices below US\$80/tonne, and 12 were below US\$60/tonne. The simple average across the 40 countries was US\$68.50, equivalent to about 57% of the New Zealand price.
264. When these survey figures were put to the incumbents by the Commission, neither disputed that the New Zealand cement price was high by international standards. Both had explanations as to why this is so. Fletcher said that it believed the reason was that New Zealand's remote location made it unattractive to importers, given the costs of shipping. The Commission interprets this as meaning that the domestic industry is protected to some degree by international freight charges (and other factors to be discussed below) from competition from imported cement. In discussing the viability of importing cement (see below), Fletcher stated that it was able to
[] is
indicative of the lack of competition between the two incumbents.
265. Holcim's explanation was that the higher New Zealand price was cost-based. It argued that the internal difficulty of delivering cement to customers compared to other countries more than doubled the price of delivery. However, this explanation is not convincing as the prices quoted in the survey are ex-works.
266. Holcim said further that the capacity of each of the two New Zealand plants of between [] tonnes per annum was relatively uneconomical by international standards, and that modern plants could produce one million tonnes per annum. While the Commission accepts that more modern, larger plants are likely to be more efficient, and produce at a lower cost per tonne partly because of economies of scale (and therefore also be a source for importation), it finds it hard to accept that this would account for the majority of the difference between the New Zealand and average international prices. This is especially so given that the two domestic plants have been operating at full capacity in recent years, and so have had the ability to spread their fixed costs to the maximum extent possible.
267. The Commission is sceptical that the cost-related factors used by the incumbents to justify in part the relatively high New Zealand cement price explain more than a small proportion of the difference. It considers that prices above the competitive level are a common characteristic of long-standing duopoly markets, and that aggressive pricing in such markets is uncommon, especially one like cement that has existed for many years, is substantially vertically integrated with downstream users, and has not been greatly threatened by imports.

²³ See Appendix Two.

268. The Applicant claimed that despite the high prices, high costs mean that the incumbents are not earning high profits. However, [] said that they thought that the incumbents' cement operations were likely to generate high margins, given their knowledge of average sale prices and estimates of likely production costs.

[]

269. Although the above evidence is not conclusive – as it can never be for tacit forms of collusion – it is generally suggestive of a “cosy duopoly” in which price competition is muted, if not non-existent.

Conclusion on Existing Competition in the New Zealand Cement Market

270. The Commission considers that in the factual scenario, the current weak price competition between Holcim and Fletcher would be likely to continue. The acquisition of Stevenson by Fletcher would see a significant difference in the underlying competition dynamics with the counterfactual by removing the impact of a major independent user of cement and the threat of imported cement. The factual scenario would see greater vertical integration with a foreclosing of an opportunity for a new entrant into the cement market and the possibility that incumbents would have the ability to raise cement prices.

271. In contrast, under the counterfactual, where Stevenson would be acquired by a party other than Fletcher (or Holcim), the Commission considers that there will be a much greater threat of import competition. The Commission considers the most likely outcome in the counterfactual is an overseas purchaser of Stevenson and a real threat of new entry into the cement market, or alternatively, reduced prices [] new competitive threat. The entry of a third party cement supplier through the acquisition of Stevenson is a significantly different outcome than the factual. This is the issue to which we now turn.

Potential Entry in the New Zealand Cement Supply Market

Introduction

272. As previously discussed, the Commission considers that the counterfactual scenario would involve a party other than Fletcher acquiring Stevenson, as would happen in the factual. The most likely buyers other than [] – would be either an overseas cement supplier, or alternatively a domestic purchaser, possibly not one that has prior associations with the industry.

273. The Commission will consider the competition implications of these two possible counterfactual scenarios: first, where the buyer of Stevenson would be an overseas cement supplier; and then where a domestic company would be the buyer.

Overseas Buyer

274. The Commission identified [] firm advised the Commission that it wanted to acquire Stevenson as a means of providing bridgehead entry into the New Zealand cement market. [] engaging in the bidding process. The Applicant raised a number of reasons why it considers that

such import entry would be unsuccessful. All of these issues are now considered.

275. [

]

276. Following the purchase of Stevenson, the

[

]

277. [

]

278. [

]

279. [

]

280. [

]

281. These import costs for cement do not seem unduly low.

[

]

282. Further, [] said that they would not enter the New Zealand cement (or readymix) market at all without Stevenson, because without Stevenson they would not be able to reach the minimum scale within a reasonable period of time.

283. In addition to the requirement for entry by acquisition, [] said that other necessary requirements for entry into the New Zealand cement supply market were: an accessible cement supply; access to local aggregates supply; establishing a terminal; and capital investment. The Commission considers that these requirements could be met, providing sufficient scale could be achieved.

284. [

] It stated that:

“[

]”

285. The Applicant has also stated that

[

] Its view was

that imports of cement in bulk were therefore remote whoever owned Stevenson.

286. The Commission put the Applicant's view that it will

[

] It suggested that once the

investment

[

]

287. [

]

288. The Commission recognises that a strategic ‘game’ would be played out regarding

[

] the Commission

understands that direct competition in cement is unusual internationally; usually the competition plays out in readymix. The incumbents will target the users of the imported cement by subjecting them to strong price-cutting. This strategically is a much more effective way for the incumbents to tackle the competition from imported cement, because the price-cutting can be confined to the few local readymix markets involved, whereas cutting the price of cement across the board would result in enormous losses as it would apply to all customers.

[

]

289. However, such a strategy would have been more difficult to apply had Fern managed to secure an Auckland readymix customer, especially a large one like Stevenson, because then the incumbents would have had to have cut readymix prices across the large Auckland market. This would have been very expensive. Hence, Stevenson is important not only because of its size, but also strategically because of its location in the Auckland readymix market. Thus, the sale of Stevenson provides a significant potential point of entry for a new competitor in cement, because it would provide both the scale needed, and hinder the ability of the incumbents to fend off entry through the usual strategic response in readymix. However, recognising that entry by this means could substantially change the face of the cement market, the issue is whether the incumbents would respond by taking the relatively extreme step of cutting readymix prices across the whole of the Auckland market.

290. The Applicant said that one reason a bulk importing operation would not occur is because the Applicant would

[

] The Commission takes this to indicate that the incumbents might choose to 'accommodate' entry, rather than to 'fight' it as just discussed. The new owner would have a [] for otherwise its downstream user would be disadvantaged relative to other users by paying too much for its cement. The Commission considers that the Applicant's claim seems reasonable, since the incumbents have a strong incentive to supply all domestic cement demand in order to maintain the full capacity working (and hence the efficient operation) of their plants and to preserve the current duopoly, although this approach would be tempered by the prospect that lower cement prices in Auckland might filter to other areas as well.

291. [

]

292. [

]

293. Market participants informed the Commission that pressure on cement prices at one point generally flows across the market. For instance, [] stated: "You can't just pick one or two customers and give them an outstanding price because the market is so concentrated customers hear about it. So the leverage from the small players is quite significant." On this basis, any downward pressure on price that a new owner of Stevenson could exert would be expected to flow across the market. However, this is contradicted somewhat by evidence cited earlier that independents are generally unsuccessful in trying to wring concessions by trading off one supplier against the other, and by the evidence of considerable price variation between buyers. Nonetheless, it seems likely that if the incumbents were to grant favourable terms to the new overseas owner of Stevenson, they would be forced sooner or later to do the same for other independents, for otherwise the cost advantage would allow Stevenson to gain readymix market share at the expense of those independents.

294. A further consequence of greater cement usage by Stevenson would be that imported cement would be made more viable, because of the substantial scale of economies in cement importing. This would add to the constraint on domestic prices.
295. The Applicant argued that the fact that entry had not occurred in the last twenty years was evidence that entry [] is totally unlikely. The Commission put this claim []
-]
296. [] said that it had begun researching the New Zealand cement market approximately 12 months ago, principally because it saw the market as a platform for growth, and because there are limited expansion opportunities []].
297. The Applicant stated “that if ever there was an opportunity for a new cement supplier to enter the market, it would have been over the last few years when the local manufacturers have been operating at capacity.” As just mentioned, [] said it has been waiting for the opportunity to enter New Zealand for the last twenty years, and that Stevenson now potentially provides that entry point.
298. The Applicant’s own submission lends weight to that fact that opportunities in the New Zealand cement market are limited. It stated:
- “The geographic isolation of New Zealand and consequent high shipping costs means the margins available to importers are not especially great when it considered that importers need to price below locally manufactured cement to compensate for the advantages of locally manufactured cement over imported cement (in particular, reliability of supply and consistency of quality) and the value customers place on these factors. Fluctuations in shipping costs, the exchange rate, and the availability and price of overseas cement mean that the margins available fluctuate greatly. The small population bases means that the volume available to an importer is relatively low. Even at the prevailing cement price it would be difficult to turn much profit importing cement into New Zealand.”
299. [] are less pessimistic for otherwise they would not be considering entry at all. But the Commission does consider that the incentive to enter New Zealand cement is limited, and that from a commercial standpoint a firm is unlikely to invest too heavily in time and money, given that the returns may not be as large as firms would expect to achieve by investing that time and money elsewhere.
300. The Applicant said that it is very unlikely that entry by an overseas cement manufacturer would occur under the counterfactual or factual, but argued that if an overseas company were determined to enter, and Stevenson were not available to it, then it could do so by acquiring other independents, and reaching the minimum scale required that way. It pointed out that there is a lot of contestable demand (i.e., demand not ‘captive’ by ownership through the vertical integration of the incumbents) nationwide – by its estimate, [] tonnes – and even in the Auckland region alone there would be [] tonnes. The loss of Stevenson would make no difference.

301. In addition, the Applicant said that its
[

]

302. The Commission doubts that this would be the case.
[] would enter only through acquisition,
and their initial customers at least would need
[] Therefore, the contestable cement
tonnage referred to by the Applicant is too broad a concept; it must be
disaggregated into downstream operations able to be purchased or supplied by
the entrant.

303. Table 6 lists the independent users of cement, and shows their location and
cement tonnage consumed.

Table 6: Independent Cement Users, Locations and Tonnages

Company	Locations	Tons	%
Stevenson	Akld, mainly NI, some SI	[]	[]%
Bridgeman*	Akld [], rest in NI	[]	[]%
Higgins*	No Akld presence, but NI	[]	[]%
ChCh readymix*	SI	[]	[]%
James Hardie	Auckland	[]	[]%
Fulton Holgan	National	[]	[]%
Mitre 10	National	[]	[]%
Hynds Pipes	Auckland [], rest NI and SI	[]	[]%
Counties Readymix	Auckland	[]	[]%
Supacrete	No Akld presence, but NI	[]	[]%
ITM	National	[]	[]%
Wilson's Readymix	Auckland	[]	[]%
Hi Way Stabilisers	Akld [], rest NI	[]	[]%
Rosscrete Bag	--	[]	[]%
Carters	Small Akld, bulk other NI areas	[]	[]%
Bowers Bros		[]	[]%
Wharehine Contractors	Upper NI	[]	[]%
Monier Brickmakers	Akld, rest SI	[]	[]%
OnSite Concrete	No Akld presence, but NI	[]	[]%
Benchmark		[]	[]%
Bowers & Son	No Akld presence, but NI	[]	[]%
Whitianga & Mercury Bay	No Akld presence, but NI	[]	[]%
Stahlton Prestressed	-	[]	[]%
McCallum Bros	Akld only	[]	[]%
Concrete & Metals	-	[]	[]%
Other (Less than 5 T)	Variable	[]	[]%
Total		[]	100%
Total w/o Stevenson		[]	

Source: Holcim and Fletcher.

*These firms are part of a buying group called the Tons group.

304. Some of the firms in the Table have both South Island and North Island operations, whereas others are in one island only. Stevenson is easily the largest independent consumer of cement, and even the fourth largest uses less than [] tonnes. This fragmentation of demand would clearly make it difficult to achieve the scale necessary to effect entry into the cement market. If Stevenson were not available,

[

The Commission's own investigations found that Auckland was one of the fastest growing regions, with big infrastructure projects, such as roading.

[

305. The type of downstream operations is also a factor that [] would take into account. Readymix operations account for []% of the entire cement demand, and so would be the most desirable operations to acquire. Further, the

Commission considers it unlikely that [] would seek to acquire large retail operations like Mitre 10, ITM, James Hardie, Carters or Benchmark merely to access those firms' cement supply. It also seems unlikely that [] would seek to acquire Fulton Hogan, a large construction company. However, the Commission considers that it may be likely that [] would approach these firms to supply them [] acquire Stevenson.

306. The Commission asked [] if they would consider acquiring a number of smaller cement users to get the critical mass they needed, should Stevenson not be available. [] said that it had looked into the scope for buying other concrete operations and building upon them, but had decided against this approach. It informed the Commission that prior to the Stevenson assets being put up for sale, it had approached [] with a view to acquiring it. [] estimated [] has a similar annual revenue turnover to Stevenson, but not the same sort of cement usage. However, the company was not for sale. Further, [] said that it had abandoned the idea of picking up one or two of the other independents because "it just takes too long." It said:

[]

307. []

[] Subsequently, [] response to the Commission's question was that entry without Stevenson would not be viable:

[]

308. The Commission also considered whether green-fields entry into readymix would be a feasible alternative entry strategy to acquisition for [] said it would not consider de novo entry into the Auckland readymix market as the area is already "well catered to, and it would be difficult to establish a new business and achieve an adequate return on the investment." [] said that:

"it would be very difficult for us to enter the readymix concrete market in Auckland through a Greenfield entry and build a market position with sufficient scale to enable competitive sourcing of cement, sand and aggregate.... Ensuring competitive sourcing of raw materials is crucial to a successful readymix concrete business, particularly if one is competing with vertically integrated competitors who own their own cement and aggregate operations."

309. The Commission considers that if green-fields entry for [] were a likely option, it would have occurred during the last few years when conditions were most favourable because of the Auckland construction boom. The same might be said of entry by acquisition of a number of small independents.

310. Taking a commercially pragmatic approach, the Commission agrees that establishing a green-fields operation, or acquiring a number of small independents, would not be an attractive option for firms like [] is large, international company that monitors investment opportunities across a number of countries, meaning that for [] the New Zealand cement market is small in the overall scheme of things. Should entry

become too difficult, firms like [] are likely to proceed with more promising opportunities elsewhere.

311. The Commission has carefully considered the proposals and other information put forward [] a

great deal of experience in cement manufacture and supply and downstream businesses. The Commission has also carefully considered the arguments and submissions made by the Applicant in response, and its view of the counterfactual. The Commission has formed the view that the [] and information put forward by [] are commercially credible and therefore form the basis of the counterfactual, which includes [] the successful purchaser, or (as discussed below) the sale being to an independent local purchaser which will maintain the credibility of import substitution.

312. In sum, the Commission considers that the advent of Stevenson's sale provides [] with a unique opportunity for bridgehead entry into the cement market, and that it is unlikely that [] would enter the New Zealand cement market through purchasing a number of small cement using operations, or through establishing a green-fields readymix operation. An overseas buyer of Stevenson, like [] would be likely to act as a new, strong, competitive force in the cement market. The single purchase would take the entrant a [] become viable, and the more demand it was able to acquire beyond that, the lower the cost would become. As an importer, it would compete directly with the incumbent duopolists, which, by the admission of one of them, do not compete on price. []

]

313. Alternatively, if the incumbents were to respond by offering to supply the overseas entrant with cement at a price lower than the import cost, this would seem likely to undermine current and likely future duopoly price discipline in the factual, also thereby promoting price competition. At the same time, cement importation would be a real and ever-present threat. In either case, then, competition in the factual is likely to be substantially less than in the counterfactual.

314. The bidding process for Stevenson continues, and the outcome is presently uncertain. However, going forward the Commission considers it reasonably probable that that acquisition would be by []

]

Local Purchaser

315. The alternative counterfactual scenario is that Stevenson might be acquired by a domestic purchaser that might have no prior association with the cement and concrete industries. The Commission now turns to consider the competition outcome relative to the factual in this possible scenario.

316. If a domestic firm (other than Fletcher or Holcim) were to purchase Stevenson, this would in effect maintain the status quo in the cement market, in the sense that Stevenson would remain independent of the two vertically integrated incumbents, and would continue to have the potential to constrain the incumbents. []

should it come up for sale in the future. Stevenson would also be able to continue to threaten with some credibility to import cement, either by itself, or with one or more other significant cement users, or with an overseas cement supplier. All of those pro-competitive options would be foreclosed completely in the factual, when Stevenson would be acquired by, and absorbed within, Fletcher.

317. Stevenson provided the Commission with the following statement about its negotiating stance over contracting for cement supplies with the two incumbents:

[

]

318. This statement indicates that Stevenson has recently

[

] Both the Applicant and []

discount its ability to import, because its tonnage is not regarded as being sufficient. However, it could conceivably team up with other users to reach a critical mass. Overall, to the extent that Stevenson's [] is credible, it may inject some additional competitive pressure into the mix. Further, so long as it remains independent it remains an important option as a bridgehead for entry by an overseas cement supplier.

319. As discussed above, Stevenson is important not only because of its size, but also because of its strategic location in the Auckland readymix market. It alone amongst the remaining independents provides an acquirer with both the scale and the ability to fend off any targeted, price-cutting response to entry in readymix by the incumbents. If purchased by a local buyer, Stevenson would be independent, and be available as a potential source of demand for imported cement.

Conclusion on Potential Entry in the New Zealand Cement Supply Market

320. The Commission has had to consider the potential for entry into the cement market under the factual, when Stevenson would be acquired by Fletcher, and compare that with the scope for entry under the counterfactual, when Stevenson would be acquired by an independent, [] with no necessary connection to these industries.

321. The Commission has taken into account that in assessing the views of parties in its investigations, it cannot discount the likelihood that responses will be coloured by self-interest.

322. Under the factual, entry conditions are such that a vertically integrated entrant would not likely consider entry into the New Zealand cement market as an option, as the remaining independent volume is too fragmented, and too dispersed throughout the country. It has been 19 years since the cement industry was deregulated, and significant and sustained entry has yet to occur. In effect, the acquisition of Stevenson by Fletcher – one of the two incumbents – would eliminate the first real prospect of substantial entry into the market.
323. With respect to the counterfactual, the Commission, after careful consideration of [] entry prospects. [] have attempted entry in the past as conditions were not conducive. Conditions have changed because of the unique opportunity to acquire an entry point, or bridgehead, through the availability of Stevenson. [] indicated an interest in entering the cement market by placing [] with Stevenson for its downstream building products division. Should [] acquire Stevenson, the Commission considers that entry into the cement market is likely to occur. However, even if this entry were not to occur, [] would have considerable countervailing power by virtue of their ownership of Stevenson, enabling it to achieve a lower price for cement than would be likely be the case under the factual, and this would benefit other users of cement.
324. Alternatively, if a local purchaser were to acquire Stevenson, the Commission considers that Stevenson would continue to provide a substantial competitive constraint on the incumbents in cement, by virtue of its ability, given its size, to threaten to import cement either individually or as one of a group, and it would remain as a potential entry point for a cement importer in the future.
325. The Commission considers that it cannot be satisfied that the acquisition would not or would not be likely to have the effect of substantially lessening competition relative to the counterfactual in the cement market. The actual or real threat of importation in the counterfactual will apply a significant pricing constraint on the two incumbent suppliers, which would not be present under the factual. Although the initial focus of an overseas entrant would be on the Auckland region, by reason of the Auckland focus of Stevenson,
[

] Hence, the impact of entry could soon expand to other parts of the North Island. The Commission considers that there is likely to be a significant price differential between the factual and counterfactual.

Conclusion on Competition in New Zealand Cement Supply Market

326. The Commission concludes that it cannot be satisfied that the acquisition would not have, or would not be likely to have, the effect of substantially lessening competition on the New Zealand market for cement.

OVERALL CONCLUSION

327. The Commission has considered what impact the acquisition would have on competition in the following markets:

- the manufacture and wholesale supply of precast concrete products in Auckland;
 - the manufacture and wholesale supply of masonry products in:
 - Auckland;
 - Christchurch; and
 - Northland;
 - the manufacture and wholesale supply of readymix concrete in Auckland; and
 - the national market for manufacture/import and wholesale supply of cement.
328. There is minimal difference between the counterfactual and factual scenario in the Auckland precast products market. Existing competition would be strong and constrain the combined firm, despite an increase in aggregation in that market.
329. The Commission considered the viability of Fletcher's offer to divest the Auckland and Christchurch masonry operations, by assessing certain risk factors including: composition, purchaser and asset risks. The Commission does not foresee any significant risks associated with the divestment and accepts it forms part of the factual scenario. Consequently, there are no significant competition issues to consider in the Auckland and Christchurch masonry markets.
330. The Northland masonry products market would see a reduction from two competitors to one in the factual compared to the counterfactual if the acquisition were to go ahead. Under the counterfactual, a third party would acquire Stevenson, essentially maintaining the status quo. However, scope for potential competition exists under the factual as the buyer of the divested Fletcher plant in Auckland could also transport product into Northland without facing significant barriers. The Commission is therefore satisfied that this potential competition means the loss of competition in the factual as compared to the counterfactual is unlikely to be substantial.
331. The acquisition would see a significant increase in aggregation in the Auckland readymix market. This market is characterised by pre-existing relationships between the main competitors. The nature of these relationships ranges from sharing resources, such as sand and aggregates, through to board representation. Relationships such as these – close and numerous – are conducive to potential co-ordination.
332. One reason the Commission does not consider that co-ordination is occurring presently is because Stevenson is large enough to undercut any price fixing behaviour and so prevents co-ordination, a situation that would continue under the counterfactual scenario. The question for the Commission is whether the removal of Stevenson under the factual scenario leaves the way open for the remaining connected competitors to co-ordinate.
333. The Commission considers that under the factual, effective co-ordination would be difficult given the effort needed to co-ordinate to fix prices on different sized jobs and a large range of products. However, the Commission also considers that this factor may be outweighed in the future should the ties between the firm grow any closer. Overall, the Commission found that all firms compete to a

degree, that the potential for expansion by independent operators [] and countervailing power, at least in respect of large jobs, would continue under the factual scenario and constrain the combined firm.

334. The New Zealand cement market was the primary area of concern for the Commission. The factual would see the continuation of a long standing domestic cement supply duopoly between Fletcher and Holcim, as well as the continuation of weak price competition between the two firms. Further, the removal of Stevenson would mean entry conditions would be unfavourable to a vertically integrated firm, as the remaining untied cement demand is too fragmented and geographically dispersed.
335. The Commission considers that under the counterfactual, Stevenson would be acquired by either an overseas firm with cement manufacturing capabilities or a domestic buyer with no significant pre-existing involvement in the industry. After careful consideration of all the parties' evidence, the Commission considers that should the buyer be [] there would be strong potential for entry into the cement market. Alternatively, should the acquirer be a domestic party, Stevenson would be independent from the two domestic cement suppliers and provide the opportunity for entry into the market, thereby presenting a competitive constraint in the market.
336. In comparing the counterfactual and factual, the Commission concludes that the loss of competition between the two scenarios would be substantial in the New Zealand cement market.
337. Therefore, the Commission declines to grant clearance to Fletcher Concrete and Infrastructure to acquire the Stevenson's Building Products division as the Commission is not satisfied that the proposed acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in the New Zealand market for cement.

DETERMINATION ON NOTICE OF CLEARANCE

338. Pursuant to section 66(3) (b) of the Commerce Act 1986, the Commission determines to decline clearance for the proposed acquisition by Fletcher Concrete and Infrastructure Limited of certain business assets that comprise the Stevenson Building Product Division of W Stevenson and Sons Limited.

Dated this 15 day of September 2005

Paula Rebstock
Division Chair
Commerce Commission

APPENDIX 1

**ANNEX C
DIVESTITURE UNDERTAKING**

DIVESTMENT UNDERTAKING

between

FLETCHER CONCRETE & INFRASTRUCTURE LIMITED

and

COMMERCE COMMISSION



THIS DEED is dated the _____ day of _____ 2005

BETWEEN **FLETCHER CONCRETE & INFRASTRUCTURE LIMITED**, a duly incorporated company having its registered office at Auckland (the "Covenantor")

AND **COMMERCE COMMISSION**, a body corporate established by section 8 of the Act (the "Covenantee")

BACKGROUND

- A.** The Covenantor submitted the Application to the Covenantee pursuant to section 66(1) of the Act which Application, pursuant to a supplemental submission, included an undertaking to divest certain assets pursuant to section 69A of the Act.
- B.** This Deed sets out the terms upon which such divestment shall be made.

WITNESSES AS FOLLOWS:

1. INTERPRETATION

In this deed unless the context indicates otherwise:

1.1 Definitions:

"Act" means the Commerce Act 1986;

"Agreement" means any binding Agreement for Sale and Purchase between the Covenantor and the Vendor in respect of the Assets;

"Application" means the notice dated 20 June 2005 submitted by the Covenantor to the Covenantee pursuant to section 66(1) of the Act seeking clearance for the proposed acquisition by the Covenantor of the Assets;

"Assets" means all the assets associated with Stevenson Building Products and which include without limitation the Auckland Supply Yard Business, the Christchurch Supply Yard Business, the Auckland Concrete Masonry Business and the Christchurch Concrete Masonry Business;

"Auckland Concrete Masonry Business" means the concrete masonry manufacturing and wholesale distribution business presently operated by the Vendor in Auckland and proposed to be acquired by the Covenantor;

"Auckland Supply Yard Business" means the supply yard business presently operated by the Vendor in Auckland and proposed to be acquired by the Covenantor;

"**Christchurch Concrete Masonry Business**" means the concrete masonry manufacturing and wholesale distribution business presently operated by the Vendor in Christchurch and proposed to be acquired by the Covenantor;

"**Christchurch Supply Yard Business**" means the supply yard business presently operated by the Vendor in Christchurch and proposed to be acquired by the Covenantor;

"**Stevenson Building Products**" means the building products division presently operated by the Vendor and proposed to be acquired by the Covenantor;

"**Vendor**" means W Stevenson & Sons Limited, a duly incorporated company having its registered office at Auckland;

- 1.2 Defined Expressions:** expressions defined in the main body of this deed have the defined meaning in the whole of this deed including the background;
- 1.3 Headings:** section, clause and other headings are for ease of reference only and will not affect this deed's interpretation;
- 1.4 Negative Obligations:** any obligation not to do anything includes an obligation not to suffer, permit or cause that thing to be done;
- 1.5 Parties:** references to parties are references to parties to this deed;
- 1.6 Persons:** references to persons include references to individuals, companies, corporations, partnerships, firms, joint ventures, associations, trusts, organisations, governmental or other regulatory bodies or authorities or other entities in each case whether or not having separate legal personality;
- 1.7 Plural and Singular:** words importing the singular number include the plural and vice versa;
- 1.8 Schedules:** the schedules to this deed and the provisions and conditions contained in these schedules have the same effect as if set out in the body of this deed;
- 1.9 Sections, Clauses and Schedules:** references to sections, clauses and schedules are references to this deed's sections, clauses and schedules; and
- 1.10 Statutes and Regulations:** references to any statutory provision include any statutory provision which amends or replaces it, and any subordinate legislation made under it.

2. COVENANTS

- 2.1 Divest:** The Covenantor will sell or procure the sale of the following business assets as going concerns within six months after the Covenantor completes the acquisition of the Assets pursuant to the Agreement:

- 2.1.1 the Auckland Concrete Masonry Business;
- 2.1.2 the Auckland Supply Yard Business;
- 2.1.3 the Christchurch Concrete Masonry Business; and
- 2.1.4 the Christchurch Supply Yard Business,

2.2 Sale to Person Unrelated to Covenantor: Any sale of a business asset contemplated by clause 2.1 shall be to a purchaser which is not an interconnected body corporate (as that term is defined in the Act) or an associated person (as that term is defined in the Act) of the Covenantor.

2.3 Notification: The Covenantor shall notify the Commission of each sale of business assets contemplated by clause 2.1 upon completion of such sale.

2.4 Conditions: The covenants contained in this Deed are subject to the following conditions precedent and shall have no effect unless and until such time as such conditions are satisfied:

2.4.1 Clearance: the Covenantor granting clearance to proceed with the proposed acquisition of the Assets pursuant to the Act;

2.4.2 Closing: the closing of the Agreement.

3. MISCELLANEOUS

3.1 Binding and Enforceable: The Covenantor confirms that in entering into this Deed it intends to create binding and enforceable legal obligations in favour of the Covenantor.

3.2 Governing Law: This deed is governed by the law of New Zealand and the parties accept the exclusive jurisdiction of the New Zealand courts.

3.3 Counterparts: This Deed may be executed in any number of counterparts each of which is deemed an original, but all of which together are to constitute an instrument. It is acknowledged that this Deed may be executed by an exchange of facsimile copies and the execution of this Deed by that means is valid and sufficient execution.

Executed as a deed.

APPENDIX 2

ing Sector

09 September 2004

Figure 30.1. Major market cement prices
Per tonne of cement sold ex-works

	Local currency	US dollars
Australia	A\$125	84
Belgium	€88	101
Canada	C\$101	67
Chile	n/a	78
China	RMB280	34
Colombia	n/a	90
Czech Republic	€60-€75	69-86
Denmark	€59	68
Egypt	n/a	34
Finland	€62	71
France	€60	92
Germany	€30-€35	35-40
Greece	€55	63
Hong Kong	n/a	55
Hungary	€40-€47	46-54
Ireland	€55-€60	63-69
Indonesia	n/a	35-37
Israel	NIS 255	63
Italy	€62	71
Japan	n/a	61
Kenya	n/a	81
Malaysia	n/a	52
Mexico	n/a	121
Morocco	n/a	60
The Netherlands	€63	72
New Zealand	n/a	120
Nigeria	n/a	80
Norway	NKr520	82
Philippines	PS2240	91
Poland	€47	54
Portugal	€71	82
Singapore	S\$71	37
South Korea	Won 69,553	59
Spain	€57	66
Switzerland	n/a	98
Thailand	n/a	38-41
Turkey	n/a	35
United Arab Emirates	n/a	52
United Kingdom	£53	86
United States of America	n/a	75

Source: International Cement Review GCR 4th and 5th Editions, CSFB research