CEMEX UK OPERATIONS LIMITED

CC INVESTIGATION INTO AGGREGATES, CEMENT AND RMX MARKETS

CEMEX RESPONSE TO THE COMPETITION COMMISSION'S UPDATED ISSUES STATEMENT

1 EXECUTIVE SUMMARY AND KEY ARGUMENTS

1.1 CEMEX UK Operations Limited ("CEMEX") welcomes the opportunity to comment on the Competition Commission's ("CC") Updated Issues Statement ("UIS") published on 27 November 2012. CEMEX notes that this response should be read together with all of CEMEX's previous responses to the working papers published by the CC and other submissions made by CEMEX to the CC. This response addresses the analysis and evidence put to CEMEX in the CC's working papers and putback papers published prior to 17 January 2013 as well as at CEMEX's hearing with the CC on 7 December 2012 (the "Hearing"). CEMEX reserves its right to supplement the arguments made in this response, make further arguments and comment on any subsequent working papers or analysis published by the CC.

1.2 This response is divided into **eleven** parts.

1.3 Parts 2 to 4 relate to Cement. CEMEX considers that the CC has not been able to demonstrate any adverse effect on competition in the cement market in terms of either unilateral market power or coordinated effects. CEMEX addresses each of the CC's theories of harm in turn, namely unilateral market power in cement and coordination between producers in cement.

1.4 Part 5 to 7 relate to Aggregates. CEMEX considers that the CC has not been able to demonstrate any adverse effect on competition in the aggregates market in terms of either unilateral market power or coordinated effects. CEMEX addresses each of the CC's theories of harm in turn, namely unilateral market power in aggregates and coordination between producers of aggregates.

1.5 Part 8 relates to competitive conditions in RMX. CEMEX agrees with the CC's analysis and conclusions in relation to the relevant product market, the absence of any significant barriers to new entry and that unilateral market power in the supply of RMX is unlikely. However, CEMEX addresses specific points in relation to volumetric trucks, site plants not being suitable only for large projects, and competitive conditions not being different for customers seeking large volumes.

1.6 Part 9 relates to vertical integration and exclusionary behaviour. CEMEX addresses two particular issues relating to the vertically integrated nature of GB Majors: the CC's concern that this may increase the barriers to entry for new RMX producers and for new cement producers or importers seeking to sell cement in GB; and the CC's concern that vertical integration may facilitate coordination in the GB cement market.

1.7 Part 10 relates to the effect of the acquisition of the divested assets by Mittal on the MIR. CEMEX believes that any findings made by the CC in relation to the historic conditions of competition in the market would be of limited relevance in the light of the purchase of assets, divested under the CC's decision in *Anglo/Lafarge* case, by Lakshmi Mittal. To the extent that the CC finds that there has

been any coordination in the GB market, the ability of GB cement producers to coordinate is significantly undermined by the entry of the Mittal controlled producer.

1.8 Part 11 relates to policy and regulation. CEMEX is in the process of reviewing the CC's working paper on competition effects on policy and regulation in the cement and aggregates market. CEMEX reserves its right to comment further on the CC's theory of harm in relation to policy and regulation. CEMEX therefore only makes a limited number of points in this instance, in relation to the EU ETS.

1.9 In this response, CEMEX comments in detail on a number of issues raised in the CC's UIS. However, for the purposes of this section, CEMEX wishes to highlight four key points, which CEMEX believes the CC has given insufficient weight to in reaching its provisional conclusions in the UIS.

The role of importers in the GB cement market

1.10 CEMEX believes that the CC, in its UIS, has fundamentally underestimated the constraint placed by importers on GB cement producers and hence the ability of cement importers to undermine any alleged coordination in the GB cement market.

1.11 By focussing on the higher variable costs of imported cement, the CC has failed to take account of the fact that, in general, cement importers have lower fixed and capital costs than GB producers and thus *total costs* of production for importers are similar to, or lower than, costs for GB producers. As explained to the CC at the Hearing, [✂].

1.12 The CC is incorrect to assume that importers price just below GB producers' prices.[1] In practice, because of the cost advantages referred to above, importers are in a position to price significantly below GB producers' prices and GB producers are forced to lower their prices to customers throughout the country in order to remain competitive.

1.13 This price erosion by importers is compounded by the provisions of the EU Emissions Trading Scheme ("EU ETS"). The EU ETS has led cement importers in countries such as Spain, Ireland and Portugal, which have experienced a significant construction boom and bust, to produce up to 100 percent more cement than required for domestic consumption. Hence the EU ETS has created a further incentive for importers to produce and export cement to GB in order to preserve their carbon credits.

1.14 The CC's provisional conclusions, based on a theoretical understanding of cement manufacturers' pricing strategy, ignores the realities of the GB cement market. The reality is that importers have been consistently growing, and continue to grow, their market share in the GB cement market at the expense of CEMEX and other GB producers. Further, the CC's provisional conclusions ignore the indirect effect cement importers have on GB cement prices as customers throughout the country consistently cite prices quoted by importers in an attempt to negotiate lower prices from GB cement producers. It is CEMEX's belief that every significant cement contract in the UK is bid

[1] *UIS*, paragraph 86.

against imported cement. This price ceiling effect is very real in the market and accordingly is a key factor in [✂].

The impact of entry by Mittal

1.15 CEMEX believes that any findings made by the CC in relation to the historic conditions of competition in the market would be of limited relevance in the light of the purchase of assets, divested under the CC's decision in *Anglo/Lafarge* (the "Divested Assets"), by Lakshmi Mittal ("Mittal"). To the extent that the CC finds that there has been any coordination in the GB market, the ability of GB cement producers to coordinate is significantly undermined by the entry of the Mittal controlled producer.

1.16 This is because, to the extent that the CC finds that there is unilateral market power or coordination in any of the reference markets, such market power and coordination is significantly undermined by the presence of a substantial new player in the market.

1.17 It is of particular importance that the Divested Assets have been purchased by Mittal, an owner with substantial financial resources, who does not have any existing relationships with GB producers in any of the reference markets and who has an incentive to compete aggressively and substantially grow its market share. Further, the CC's decision in *Anglo/Lafarge* indicates that if the Divested Assets are sold to a purchaser such as Mittal, it would significantly reduce the ability of GB cement producers to coordinate.[2]

1.18 Consistent with the CC's findings in *Anglo/Lafarge,* CEMEX believes that the sale of the Divested Assets has further increased the competitive constraints faced by CEMEX and the other majors and it is important that the CC take this into account in reaching its findings and considering remedies (if any).

The CC's approach to profitability in cement

1.19 CEMEX has consistently agued through the course of this market investigation that [✂]. CEMEX notes the indication at the Hearing that the CC's analysis confirms CEMEX's views that [✂].[3]

1.20 However, CEMEX believes that the Historical Cost Accounting ("HCA") basis adopted by the CC in measuring profitability has inflated not only CEMEX's profitability ([✂]) [✂] inflated other Majors' ROCE. CEMEX believes that the appropriate methodology for assessing profitability is the Modern Equivalent Asset ("MEA") approach as described below. If the CC were to adopt an MEA approach, CEMEX believes that it would indicate a consistently low ROCE in cement for all Majors with [✂]. Further, given the unprecedented changes in the reference markets in the recent years analysed by the CC, the results of the CC's profitability analysis may not be a meaningful indicator of normal levels of profitability in the industry. The CC should give consideration to the fact that most of the period 2008-2010 has been characterised by a sharp decline in the UK construction sector, which may have led firms in this sector into varying degrees of financial distress. When demand is low, debt service payments are spread over smaller volumes. As a result, a firm may

[2] CC, *Anglo/Lafarge Final Report*, 23 February 2012, paragraph 8.133.

[3] CC, *Notes of Hearing with CEMEX*, 7 December 2012, p. 56.

have to raise its unit margin to ensure it can cover its debt payments, which may lead to an inflated ROCE.

1.21 A finding of low levels of profitability for all Majors in cement would have significant implications for the CC's theory of harm regarding coordination in cement. A consistently low profitability in cement is consistent with a lack of coordination in the cement market and the CC would be required to show that GB cement producers coordinate, and continue to coordinate, in spite of such coordination not leading to high profits.

1.22 Further, CEMEX believes that the CC has not properly taken account of the implications of CEMEX [✂] compared to other Majors. The [✂] profitability indicate that, to the extent that any coordination might exist in the cement market, this would not be advantageous for CEMEX and hence CEMEX has an incentive to compete aggressively and win business at the expense of other Majors.

Lack of evidence of tacit coordination

1.23 CEMEX firmly believes that the CC has failed to put to CEMEX any documents or evidence of present tacit coordination. The CEMEX internal documents cited as evidence of tacit coordination by the CC are:

(a) largely historical and relate to 2005/2006 when the business was under different ownership and the dynamics of the UK cement market were very different and bear little relation to the present realities of the market;

(b) drafts for discussion prepared by external consultants and not approved by CEMEX; and/or

(c) taken out of context by the CC.

1.24 For the reasons above, CEMEX does not believe that any of the internal CEMEX documents cited by the CC is evidence of any present coordination. CEMEX does not discount the possibility that there are documents in the CC’s possession which the CC may consider demonstrate present coordination but CEMEX has not seen these documents and hence cannot comment on them.

2 CEMENT

2.1 CEMEX considers that the CC has not been able to demonstrate any adverse effect on competition in the cement market in terms of either unilateral market power or coordinated effects.

2.2 CEMEX addresses each of the CC's theories of harm below.

3 UNILATERAL MARKET POWER IN CEMENT

3.1 CEMEX notes that the CC has not reached a clear provisional conclusion in relation to the existence of unilateral market power in the GB cement market and will continue to analyse the possible existence and exercise of unilateral market power in cement.[4] CEMEX rejects any suggestion that it is able to exercise unilateral market power in any GB cement market but is unable to address this fully in the absence of a detailed analysis from the CC, which at least identifies the markets in which unilateral market power is alleged to exist and to be exercised.

3.2 CEMEX addresses, in detail in section 4 below, a number of observations made in the UIS regarding the GB cement market (e.g. profitability, barriers to entry etc.) in the context of the CC's provisional conclusions regarding possible coordination in the GB cement market. In this section, CEMEX makes only a limited number of points in relation to the CC's observations on unilateral market power.

[1] Concentration in the GB cement market

3.3 CEMEX notes the CC's observation in the UIS that the largest GB cement producer has a market share of 30 to 40 percent, with the four largest producers having a combined market share of 80 to 90 percent.[5]

3.4 CEMEX is unable to comment on the exercise of unilateral market power by other Majors but notes that [✂] means that it is extremely unlikely that a company is able to exercise unilateral market power. Hence CEMEX submits that it is virtually impossible for it to exercise any unilateral market power in a GB wide cement market.

3.5 CEMEX welcomes the CC's acknowledgement that the relatively homogenous nature of cement limits the ability of any particular company to exercise unilateral market power.[6] However, CEMEX notes that the CC has suggested that there are limits on the ability of GB producers to expand production above current capacity and the locations of GB cement producers and importers' terminals means that regional considerations may need to be taken into account. CEMEX also notes that the CC has indicated that there are certain counties in remote areas where only two or three Majors may have customers.[7]

3.6 CEMEX rejects the notion that the cement market in GB is regional and submits that the relevant geographic market is at least Europe-wide in scope. However, even assuming that regional

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4 *UIS*, paragraph 52.

5 *UIS*, paragraph 41.

6 *UIS*, paragraph 41.

7 *UIS*, paragraph 41.

cement markets exist, CEMEX submits that it does not have unilateral market power in any region in GB. This is because CEMEX estimates that [✂].[8]

3.7 CEMEX invites the CC to identify which geographic cement markets the CC considers that CEMEX may have, and is exercising, unilateral market power in, before commenting further on this aspect of the CC's case.

[2] Barriers to entry in GB cement market

3.8 CEMEX refers the CC to paragraphs **4.18 - 4.23** of this response, where it has addressed in detail the CC's observations regarding barriers to entry in the GB cement market.

3.9 While CEMEX accepts that there may be certain barriers to entry in terms of constructing a new cement plant, it does not accept that there are barriers to entry into the GB cement market (or any hypothetical regional cement market to the extent that such regional markets exist and are identified by the CC) for:

(a) importers entering GB or any regional cement market;

(b) a new entrant setting up a grinding mill and importing cement into GB to service all of GB or a regional cement market; or

(c) any existing GB cement producer supplying a regional cement market in which it is not currently present (as the CC has acknowledged it is not difficult for an existing producer to increase production up to capacity and there is significant excess capacity within GB).

3.10 Each of the entry routes identified above further reduces the ability of CEMEX (and indeed, any other Major) to exercise unilateral market power in any GB cement market.

[3] Profitability and margins in the GB cement market

3.11 CEMEX refers the CC to paragraphs **4.68 – 4.75** of this response, where it addressed in detail the CC's observations regarding profitability and margins in the GB cement market.

3.12 CEMEX notes the confirmation from the CC at the Hearing that [✂].[9] CEMEX submits that [✂] of its inability to exercise unilateral market power. CEMEX [✂] as it does not believe that regional cement markets exist. However, whilst profits are tracked on a total GB sales basis, CEMEX is confident that, if the CC were to carry out an analysis, it would find that CEMEX [✂]. This indicates that, to the extent that any regional cement markets exist, CEMEX does not have unilateral market power in any of these markets.

3.13 CEMEX notes that the CC has indicated that each of the Majors has high margins.[10] CEMEX has not seen the CC's working paper on margins (although it has seen a putback) and is hence unable to fully comment on this point at this stage. However, CEMEX submits [✂] when compared to the

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8 CEMEX is not aware of any source of data which records market shares in the cement market at a county level. This estimate is therefore an internal CEMEX estimate based on its general market experience.

9 CC, *Notes of Hearing with CEMEX*, 7 December 2012, p. 56.

10 *UIS*, paragraph 51.

margins in any other capital intensive industry and this serves as a further indication of CEMEX's inability to exercise unilateral market power in the cement market in GB.

Conclusion on unilateral market power in the GB cement market

3.14 The CC has indicated in the UIS that it has not made any findings on the existence, or exercise, of unilateral market power in any cement market in GB. The points made in the paragraphs above indicate that CEMEX at least has no unilateral market power in any cement market in GB, particularly in view of its GB market share of [✂] and the ease of entry into both the GB cement market and any hypothetical regional cement markets.

3.15 CEMEX invites the CC to confirm that it does not consider CEMEX to have any unilateral market power in the GB-wide cement market and, if relevant, identify those regional cement markets in which the CC considers that CEMEX may have unilateral market power.

4 COORDINATION BETWEEN PRODUCERS IN CEMENT

4.1 CEMEX rejects the CC's provisional conclusions that competition is not working effectively in the GB cement market. CEMEX notes that it is the CC's provisional view that the evidence seen by the CC is consistent with a degree of coordination between at least some GB producers and that such coordination is enhanced by the conduct of the companies in the market.[11]

4.2 CEMEX believes that the CC has been unable to produce any evidence consistent with coordination in the GB cement market and, in any case, the evidence relied upon by the CC (and visible to CEMEX) is consistent with normal conditions of competition in the GB cement market. Further, to the extent that the conditions for coordination in the GB cement market exist, the CC has been unable to demonstrate any conduct at least on the part of CEMEX, which enhances coordination in the market.

[1] Aspects of market structure and product

4.3 The UIS states that there are certain features of the GB cement market which make it conducive to coordination.[12] CEMEX notes that, while the CC suggests that it has identified structural features of the GB cement market which make it conducive to coordination, the CC has not presented evidence of actual coordination leading to an adverse effect on competition. In summary, the UIS alleges that the following structural features of the GB cement market make it conducive to coordination:

(a) a high degree of concentration with only four GB producers;

(b) cement is a relatively homogenous product;

(c) structural links between GB producers in the form of joint ventures and membership of the MPA;

(d) high barriers to entry;

[11] *UIS*, paragraph 99.

[12] *UIS*, paragraph 81.

(e) a considerable degree of symmetry in cost structures;

(f) a high degree of transparency of each producers' market share; and

(g) the inability of imported cement to constrain GB producers.

4.4 CEMEX does not believe that the structure of the GB cement market makes it conducive to coordination and addresses, in turn, each of the issues outlined above.

(a) A degree of concentration in a capital intensive and competitive industry does not make it conducive to coordination

4.5 The CC provisionally concludes that there is a high degree of concentration in the GB cement market based on the fact that the four largest producers have an 80 to 90 percent market share.[13] However, it is not unusual in a capital intensive industry to have only four or fewer major players, with a similar level of concentration. For example, CEMEX notes that in 2007 the CC approved a merger in the brick market (*Wienerberger Finance Service BV and Baggeridge Brick plc*), which was highly concentrated with 4 producers accounting for 85 percent of the market. It is important to note that, in approving the merger, the CC did not raise any concerns in relation to coordinated effects. It is therefore not possible to conclude that a high degree of concentration necessarily makes a market conducive to coordination.

4.6 A high degree of concentration is only relevant to coordination in a market that is not competitive. As set out in CEMEX's response to the initial statement of issues on 24 April 2012 (the "Initial Response"), the GB cement market is extremely competitive with a range of suppliers present in the market.

4.7 Reproduced at Table 1 below, from the Initial Response, are the estimated market shares for grey cement in GB.

Table 1 - Estimated Market Shares for Grey Cement in Great Britain in 2011

Supplier	Great Britain Market Share (%)
CEMEX	[✂]
Hanson	[✂]

[13] *UIS*, paragraph 41.

Lafarge	[✂]
Tarmac	[✂]
Importers (including Holcim)	[✂]

Source: CEMEX internal estimates

4.8 As can be seen from the table above, consistent with a competitive market, there is wide range of market shares between Majors. CEMEX notes that in the UIS the CC indicated that the relevant geographic market for cement is *at least* regional in scope.[14] CEMEX believes that the geographic market for cement is at least Europe-wide in scope as importers place a significant competitive constraint on GB producers (see below). However, even assuming for the purposes of argument, that the GB cement market were national or regional in scope, CEMEX notes that each of the Majors is able to, and does, supply cement over large distances. By way of example, CEMEX notes that it supplies approximately [✂]. CEMEX also notes the CC's observation at paraagraph 94 of its working paper on barriers to entry and expansion where the CC quotes Lafarge, which states that a train can transport approximately 1,750 tonnes of cement in one shipment compared to 30 tonnes by road tanker. This means that, absent a refusal to supply by any Major, each customer has a choice of at least four domestic suppliers (plus a large number of importers). CEMEX notes that the CC has not set out any evidence regarding a refusal to supply by CEMEX or any other Major. As the CC is aware, a choice of four or more suppliers is usually considered an indication of healthy competition in a market.[15]

4.9 Further, as set out in the Initial Response, customers have both the ability and incentive to switch cement suppliers (whether a domestic producer or an importer) if their expectations on price or service levels are not met. The preferred *modus operandi* for purchasing for the vast majority of customers (at least 75 percent) is through formal or informal tenders, which allows customers to compare prices and service levels across suppliers and forces CEMEX (and presumably other GB producers and importers) to lower its prices in order to retain existing customers and gain new customers. Further, a vast majority of contracts entered into by CEMEX [✂] (whether a domestic producer or an importer). CEMEX notes that this aspect of customer behaviour, which ensures competition amongst GB producers, has not been addressed by the CC in the UIS.

4.10 As set out in the Initial Response, in addition to competition from Majors, CEMEX also regards producers of GGBS and producers of PFA [✂] as competitive constraints as these operators are able to make direct supplies to concrete product manufacturers and to RMX producers who are able to self-blend CEM II and CEM III. Not only does this [✂], but customers are able, particularly in relation to RMX, to substitute CEM I, CEM II and CEM III with one another,[16] which means that

[14] *UIS*, paragraph 16.

[15] See The OFT and the CC Joint Merger Assessment Guidelines, para. 5.3.5, which states, "*the OFT has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above).*"

[16] See for example paragraphs. 5.10 – 5.14 of the CC's *Anglo/Lafarge Final Report*, 23 February 2012. CEMEX also refers to its responses to Questions 11 - 15 of the CC's Market Questionnaire in relation to the technical characteristics and substitutability of cementitious products.

either GGBS or PFA can be increased in proportion to CEM I in concrete, exercising a direct constraint on the price of CEM I, i.e. if CEM I is priced excessively in relation to GGBS and PFA, RMX customers will substitute a larger proportion of CEM I for these products. CEMEX notes that the volume of GGBS and PFA present in the UK market is significant with 1.6 million tonnes of ash and slag sold each year in the UK (see MPA quarterly report at **Annex 1)**. CEMEX understands from the UIS that the CC will analyse further the effect of the supply of GGBS on the UK cement market. However, there is no indication in the UIS that the CC has taken into account CEMEX's concerns regarding the ability of GGBS and PFA producers to constrain the market behaviour of GB cement producers. For example, [✂] purchases ash directly from [✂] and self-blends its CEM II. Another example is [✂] RMX producer, which uses "N" grade" ash purchased from power stations at low cost (CEMEX understands sometimes as low as £3 per tonne) to replace CEM I up to the maximum limits permitted in concrete. This is a strategy pursued by many independent RMX producers. The widespread nature of such sales constrains CEMEX's prices to a significant extent.

4.11 Finally, and most importantly, CEMEX and other GB producers face intense, and growing, competition from importers, which the CC has failed to take into account in analysing whether a relatively concentrated market may facilitate coordination. The role of importers in the GB cement market is addressed in detail in paragraphs **4.38** – **4.67** below.

4.12 In the light of the range of suppliers available, the intensity of competition in the market, customer purchasing behaviour and the capital intensive nature of the industry, CEMEX believes that it is wrong for the CC to conclude that a degree of concentration is conducive to coordination in the GB cement market.

(b) Cement is a relatively homogenous product but cement producers are able to differentiate themselves

4.13 CEMEX agrees with the CC's provisional conclusion in the UIS that cement is a relatively homogenous product. However, while this means that quality levels of cement are not a key differentiator between producers, there are other non-price factors which are taken into account in choosing a supplier:

(a) Service levels – Reliable service levels are of vital importance to CEMEX's customers. The ability to provide suitable products in correct quantities is thus an important factor, which is taken into account when choosing a cement supplier. For example, CEMEX's service commitment is to achieve 95% of deliveries on time and in full.

(b) Relationship with supplier – CEMEX understands that in order to retain existing customers, and gain new ones, it is necessary for CEMEX to, over time, build relationships with its customers, impressing upon them that their business is important to CEMEX. The ability to service customers in a user-friendly manner is another consideration that is taken into account in choosing a supplier.

4.14 On the basis on the above factors, CEMEX believes that there is scope for cement suppliers to differentiate themselves to customers in order to gain a competitive edge over other suppliers.

(c) Participation by Majors in the MPA and Joint Ventures does not make the GB cement market conducive to coordination

4.15 CEMEX notes that the CC has indicated that structural links between the Majors, as a result of common membership in the Minerals Products Association ("MPA") and joint ventures, may make the GB cement industry conducive to coordination.[17] The CC has however not elaborated in sufficient detail in the UIS or any working papers published to date on how the structural links identified help facilitate coordination between Majors. As a result, CEMEX is unable to comment fully on this aspect of the CC's case. However, CEMEX wishes to make a limited number of points in relation to this feature of the cement market identified by the CC.

4.16 First, the MPA, like any other effective trade association, provides a valuable forum for exchanging non-confidential ideas within the aggregates, cement and RMX industries. For example, the MPA allows its members to exchange ideas on improving site safety, sustainable manufacture and technology employed. As far as CEMEX is aware, and the CC has not presented any evidence to the contrary, the MPA has not been used as a forum for any form of coordination. Clearly, the mere existence of a trade association cannot be used as evidence that an industry is conducive to coordination and hence requires investigation/remedies.

4.17 Second, CEMEX wishes to note that it does not have any cement joint ventures with other Majors. All of CEMEX's joint ventures are in relation to aggregates other than a single joint venture with Lafarge in relation to PFA (Processing Ash LLP, details of which have already been provided to the CC). It is not clear to CEMEX how an aggregates joint venture can be used to facilitate tacit coordination in the cement market and the CC has not presented any evidence to demonstrate that this is the case. Please see **Annex 2** which provides details of each of CEMEX's joint ventures.

(d) Barriers to entry into the GB cement market are overstated by the CC

4.18 CEMEX agrees with the CC that there are significant barriers to entry in terms of the capital costs to be incurred in building a new cement plant. However, CEMEX believes that the CC has overstated the barriers to entry via: (a) import of cement into the UK; and (b) building a new grinding mill. Entry by cement importers is discussed in paragraphs **4.39 - 4.47** below. In this section, CEMEX addresses the possibility of new entry by building a new grinding mill and importing clinker.

4.19 CEMEX notes that the CC has rejected the idea of entry by building a grinding mill for two reasons: (a) the capital investment is likely to be considerable; and (b) securing a reliable supply of clinker. Each of these are addressed below.

Capital investment in building a grinding mill is overstated

[17] *UIS*, paragraph 81.

4.20 CEMEX notes that the CC has based its estimate of capital costs of a grinding mill of £50 million solely on the cost of CEMEX's grinding mill in Tilbury, built in 2009.[18] However, this estimate is misleading as it relates to a modern, state of the art facility, which [✂] - such additional works would not have been required [✂].

4.21 A grinding mill of a lower specification (which is still able to impose a competitive constraint on GB producers) can be constructed at considerably lower costs and there are numerous examples of this form of recent entry in continental Europe. CEMEX notes, in particular, that due to the current economic climate there is significant availability of good second hand milling equipment for significantly less cost than the equipment purchased by CEMEX for use at its Tilbury plant. On this basis, CEMEX estimates that a fully functional grinding mill with an approximate capacity of its Tilbury facility can be constructed at a cost of approximately £30 million.

A reliable source of clinker can be easily secured

4.22 CEMEX rejects the CC's provisional conclusion that it is difficult to secure a reliable source of imported clinker. As mentioned in the Initial Response, clinker is a globally traded commodity and available to be imported from a wide range of suppliers. For example, each of the counterparties that CEMEX's international trading arm trades with is able to produce and export clinker. This list, which contains the names of over 20 producers, has been provided to the CC by email on 17 December and is reproduced at **Annex 3** for ease of reference.

4.23 CEMEX notes that it is the CC's provisional view that clinker importers will face the same cost disadvantage, relative to GB producers, as those faced by cement importers.[19] However, as explained in paragraphs **4.48-4.51** below, cement importers do not face a cost disadvantage when compared to GB cement producers and similarly clinker importers will not face a cost disadvantage when importing clinker into GB.

(e) Symmetry in cost structures does not make the GB cement market conducive to coordination

4.24 CEMEX does not have detailed information on its competitors' costs. However CEMEX would note that [✂] to that of the cement plants of its Major competitors, because of [✂]. CEMEX's kiln at South Ferriby is [✂]. In addition, none of CEMEX's cement terminals [✂]. These factors have given CEMEX [✂].

4.25 CEMEX also notes that there are considerable asymmetries in the Majors' structures of vertical integration, which would have the effect of hindering any attempt at collusion between them. Significantly, differences in the relative significance of each Major's upstream and downstream operations, respectively, are capable of undermining the ability to reach an understanding.

4.26 In any event, even if there were a broad similarity in the cost structures of GB cement producers, CEMEX would question whether any similarity in cost structures in cement would be greater than

[18] *UIS*, paragraph 45.

[19] *UIS*, paragraph 45.

that prevalent in other capital intensive industries and therefore whether it would indicate that conditions conducive to coordination were present in this market.

4.27 Lastly, the fact that, according to the CC, CEMEX [✂] seems to suggest that differences in costs exist and that CEMEX has different pricing incentives to its competitors.

(f) Transparency of each producer's market share and ability to monitor market share or wins/losses does not allow the Majors to reach a tacit understanding and is, in any case, overstated

Inability to reach a tacit understanding

4.28 CEMEX notes that the CC has provisionally concluded that there is a high degree of transparency in the market and monitoring of wins/losses of cement customers. Hence, the CC concludes, the focal points for coordination are likely to be one or more of shares of production, shares of sales and/or wins/losses of customers.[20]

4.29 CEMEX notes that the CC has not, in either the UIS or any working papers published to date, addressed the fundamental problem, identified in CEMEX's Initial Response, with the CC's notion that market sales, shares of production or wins/losses of customers can act as a focal point for coordination; in its Initial Response, CEMEX noted that it would be very difficult for GB cement producers to agree tacitly on what metric to adhere to. For example, it is not clear to CEMEX, and possibly it is not clear to the CC, whether the CC is alleging that the Majors coordinate on:

(a) shares of sales;

(b) shares of production; and/or

(c) wins/losses of customers.

4.30 CEMEX notes that the differences between each of the metrics above is considerable. Further, taking the simplest scenario of coordination in relation to one metric only and assuming, for the sake of argument, that the CC is alleging that coordination relates to shares of sales, it is not clear if this includes:

(a) internal sales or only relates to external sales or both; and/or

(b) sales made by importers.

4.31 Each of the focal points of coordination proposed by the CC has elements of considerable uncertainty, which make it impossible to reach a tacit understanding on any proposed metric. This uncertainly is compounded in a market in which the market share of GB importers is rising steadily (as acknowledged by the CC at the Hearing[21] and explained further in paragraphs **4.56 – 4.60** below). Even assuming that the Majors were able to tacitly agree on a focal point for coordination (for example, shares of external sales) the CC has not explained how the Majors would tacitly agree on redistributing their decreasing market share as a result of the growth of importers. Would

[20] *UIS*, paragraph 84.

[21] CC, *Notes of Hearing with CEMEX*, 7 December 2012, p. 144.

it be in proportion to their current market shares (and, if so, which market shares)? Or by some other metric such as proportion of market share lost to importers? It would clearly be impossible to reach any tacit agreement in the face of such uncertainty.

4.32 Even assuming that the Majors were able to overcome the uncertainly outlined above and reach a tacit agreement on a certain metric, it is not clear how the agreement would be maintained in light of Mittal acquiring the Divested Assets and the *Anglo/Lafarge* joint venture becoming operational. [✂]

4.33 CEMEX discusses, in detail, the implications of the CC's remedies package in *Anglo/Lafarge* on the market investigation in paragraphs **10.1 – 10.21** below.

4.34 Finally, the UIS states that the CC has noted the view taken in *Anglo/Lafarge* regarding stability of market shares in the period 2001 to 2010.[22] The CC has yet to consider the significance of trends in market and production shares but has stated it intends to do so in due course. CEMEX does not therefore make any submissions on this point at this stage but reserves the right to comment once it has had sight of the CC's provisional conclusions in this regard.

Inability to monitor adherence to terms of tacit agreement

4.35 Even assuming that the Majors are able to reach a tacit agreement, it is difficult to see how they would be able to monitor adherence to the terms of such an agreement. The CC implies that there are two possible routes through which such transparency can be obtained:

(a) statistics released by the MPA; and

(b) interaction with customers.

4.36 In relation to the market share statistics released by the MPA, CEMEX notes that these statistics are produced with a time lag and aggregated and hence do not provide CEMEX with a real time understanding of its competitors' current behaviour. Therefore at any given point of time, it is not possible for CEMEX to understand whether its competitors are adhering to a hypothetical tacit agreement. An example of a MPA monthly and quarterly report are attached at **Annex 4**.

4.37 In relation to the reporting of gains or losses by interacting with customers, CEMEX notes that this is an extremely imprecise way of monitoring shares of external sales. Customers are driven by their own agenda and will often misreport the name of their former supplier, the supplier they wish to switch to, the quantities they bought from their former supplier and the terms on which they traded with other suppliers. This makes it impossible to precisely track competitor behaviour by interacting with customers. Other methods, such as observing customers premises to see which supplier is delivering to them, are even more imprecise (for example, it is not possible to know the volumes being delivered) and hence there is no precise way in which to understand whether any hypothetical tacit agreement is being adhered to.

[22] *UIS*, paragraph 84.

(g) The role of importers in the GB cement market

4.38 CEMEX believes that the CC has fundamentally misunderstood the role played by importers in the GB cement market. Cement importers impose a considerable constraint on GB producers' prices and hence ensure that any hypothetical coordination between GB cement producers is seriously undermined. CEMEX notes that it is yet to receive the CC's working paper on imports and as such reserves its right to comment further once this is published. In this section, CEMEX addresses the following issues:

(i) the CC's working paper on barriers to entry and expansion to the extent that it relates to entry by importers;

(ii) the absence of any cost disadvantage for cement importers;

(iii) overseas EU producers are incentivised by the EU ETS to export cement to GB;

(iv) cement importers' incentive to undercut prices leading to a reduction in GB producers' prices and growth in market share of importers;

(v) ability of importers to sell GB wide; and

(vi) inability of GB producers to undermine the viability of imported cement.

(i) Barriers to entry for cement importers

4.39 CEMEX notes that the CC has evaluated evidence on a number of issues when considering barriers to entering the GB cement market using imported cement. CEMEX notes that the CC has not reached a conclusion in relation to each issue analysed but has provisionally concluded that barriers to entry are higher for smaller suppliers than larger suppliers and that, like clinker importers, cement importers face a transport costs penalty compared to GB producers. In addition, the CC concludes that finding a source of cement independent of the existing participants in the UK market would be likely to be difficult. CEMEX strongly disagrees with this conclusion and sets out below its views on some of the evidence taken into account by the CC in reaching this conclusion.

4.40 ***Access to an import terminal*** – CEMEX wishes to note that it is not necessary to have access to an import terminal in order to import cement into the UK. It is possible to ship both bulk cement via road tanker and bagged cement via flatbed trucks to the UK. For example, CEMEX understands that in the past year Quinn, an Irish producer, has successfully imported and sold an estimated [✂] bagged cement via flatbed trucks and [✂] bulk cement via road tanker. In particular, CEMEX notes that Quinn supplies [✂] of bulk cement per annum to [✂] via road tanker. As noted previously, CEMEX [✂].

4.41 In relation to Titan Cement UK's ("Titan") claim that there were only a limited number of ports suitable for import terminals,[23] CEMEX notes that importers can import cement in ships with

[23] CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 107.

capacity as little as 3,000 tonnes, which do not require deep water terminals. In any case, CEMEX believes that there are a number of deep water locations around the UK and Titan is deliberately underestimating the availability of import terminals in GB. CEMEX's arguments in this regard are supported by Sherburn Stone's evidence that it had no difficulty finding a port when it started importing cement in 2007.[24]

4.42 ***Incumbent Reaction*** – CEMEX addresses the inability of GB producers to undermine the viability of imported cement in more detail in paragraphs **4.62 – 4.64** below. However, in relation to the evidence evaluated by the CC in relation to incumbent reaction being a barrier to entry for importers, CEMEX notes that the CC has only cited evidence by an anonymous source which speculates that a *possible* (i.e. not realised) reaction by incumbent suppliers (including impugning the entrant's reputation and lowering prices) was a barrier to entry.[25] In any case, as the anonymous source is now established as a "mid-tier cement importer" one assumes that the possible incumbent reaction was not a very effective barrier to entry.

4.43 ***Customer Reaction*** - CEMEX notes that the CC has only received speculative evidence in relation to possible customer reaction inasmuch as Titan has noted that a new entrant *may* face reluctance from customers to change to a new supplier.[26] CEMEX considers that the CC would be able to judge customer reaction better if it asked actual customers, rather than importers, for their views on switching to imported cement from a new supplier. Moreover, CEMEX notes that cement importers have gained market share in a declining market which is strong evidence of customers' willingness and ability to switch from Majors to importers.

4.44 ***Vertical integration of Majors*** – Titan notes that the cement market is less attractive to new entrants as vertical integration of the Majors has reduced the addressable market for independent cement producers/importers.[27] However, the CC notes that 50 percent of the bulk cement being purchased in the UK is by Majors.[28] This quantity includes purchases by AI which is not vertically integrated and could purchase from independents and other Majors. If one discounts purchases by AI, then the market available to new entrants is more than 50 percent of sales. CEMEX believes that a market of this size, approximating 4.5 million tonnes provides a very considerable incentive for independent cement producers/importers. This is clearly evidenced by the growing number of importers entering the GB market (see below).

4.45 ***Evidence of new entry*** – CEMEX wishes to note that in addition to the six new import terminals identified by the CC,[29] new terminals have been opened by Dudman in Montrose, Scotland and by Quinn Cement in Medway, Kent. This further illustrates that market conditions in GB are conducive to new entry by cement importers.

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24 CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 109.

25 CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 118.

26 CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 119.

27 CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 120.

28 CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 121.

29 CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 78.

4.46 The evidence of new, and flourishing entry, and the long list of independent cement suppliers in a shrinking market undermines the CC's provisional conclusion that finding a new source of cement independent of the existing participants in the UK cement market would be likely to be difficult. In addition, the CC's provisional conclusion that the barriers to establish a cement operation will be more significant for smaller operators than larger ones is undermined, in light of the low costs of establishing an import terminal and the even lower costs of transporting cement by road tanker, in the case of bulk cement, and flatbed trucks, in the case of bagged cement.

4.47 Finally, the arguments regarding cement importers' costs below contradicts the CC's provisional conclusions regarding transport cost penalties for new cement and clinker importers.

(ii) Absence of any cost disadvantage for cement importers

4.48 CEMEX rejects the CC's provisional conclusion in the UIS that GB cement producers have a substantial cost advantage at the margins and hence are not constrained by importers. For the reasons set out below, CEMEX believes that the CC should be considering the *total costs* of importers and *total costs* of GB producers in assessing whether a cost disadvantage exists for cement importers. CEMEX notes in this regard that the CC has already accepted that total costs for importers and cement producers may not be dissimilar.

4.49 CEMEX notes that in the imports putback paper the CC compares GB producers' average variable costs to the FOB price of imported cement and finds that on average, the FOB price is higher than GB producers' average variable cost. This result is hardly surprising since the CC's comparison is not like-for-like. It compares the <u>price</u> of one supplier with the <u>variable cost</u> of another.

4.50 The fixed costs of GB producers cannot simply be disregarded. As the CC emphasises, the cement industry is capital intensive and requires substantial upfront investments. This implies that in the long-run, the equilibrium price cannot be equal to average variable costs; otherwise firms could not cover their fixed costs. GB cement producers cannot persistently lower prices to a level that prevents them from generating an appropriate return on their capital invested.

4.51 In contrast, if overseas producers have spare capacity it makes sense to use this to supply GB at any price above average variable cost, in order to contribute to their own fixed costs. It may make more sense to export cement to GB than to expand domestic sales and drive down domestic prices to a level that no longer allows them to cover all their costs.

(iii) Overseas EU producers are incentivised by EU ETS to export cement to GB

4.52 CEMEX believes that the CC is wrong to reject, without sufficient analysis, CEMEX's argument that overseas EU cement producers are incentivised by the EU ETS to export cement to the UK, sometimes at a loss, in order to maintain their carbon credit allowances.

4.53 In summary, the EU ETS' partial cessation rules means that if cement producers' production falls below 50 per cent of their historical 2005 to 2008 baseline levels, they start to automatically lose allowances, without compensation. As soon as production drops below 50 percent then half the allowances are lost the following year, and if production drops to 25 percent then 75 percent of allowances are lost. Hence overseas EU producers, have a further incentive to sell at low prices in

GB if this helps them maintain their emission trading permits allowances. Consequently a producer that is operating at below 50 percent capacity may find it profitable to sell into the GB market at below average variable cost in order to meet the 50 percent threshold and maintain its valuable emission trading permits allowances.

4.54 CEMEX has experience of producers in countries such as Spain, Portugal and Ireland, which have significant spare capacity and are operating well below their 2005-2008 levels, aggressively targeting the GB market in order to maintain their carbon credit allowances. For example, Portland Valderrivas, Titan, Quinn, CRH and Lagan are all aggressively targeting the UK. Quinn and Lagan (Ireland) in particular have both made public statements in the last few months that they are looking to expand their export business in the UK.

4.55 The operation of the EU ETS is described in detail in paragraphs **11.1 – 11.21** below.

(iv) Cement importers' incentive to undercut prices

4.56 CEMEX notes the CC's view in the UIS that the higher (variable) costs faced by cement importers incentivizes them to price just below the price of GB produced cement. CEMEX strongly disagrees with the CC in this regard. The reality is that cement importers continually price significantly below CEMEX's prices, with the result that CEMEX has to lower its prices. Please see **Table 2** below which is a copy of CEMEX's internal record of customers that it has retained following the approach of an importer but in each case CEMEX [✂].[30] In some cases, CEMEX [✂], see **Table 3** below. CEMEX also refers the CC to the Confidential Annex to its response to the CC's working paper on market definition, [✂]. This is reproduced at **Annex 5**.

Table 2 – Price Erosion from Importers

Month	Customer	Location	Region	Approach	Tonnes (KT)	CX budgeted/ Original '12 price *	Defended Price	Price Erosion	Price Impact (£k)
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

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[30] The importers identified are [✂],[✂],[✂],[✂] and [✂].

[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

* CX original *12 price = budget price used prior to price increase and actual price used post increase

4.57 As a result of being [✂], CEMEX has [✂]. This is illustrated by **Table 3** below.

Table 3 - Recent significant customer gains from and losses to cement importers

PART A: LOSSES

Month	Customer	Location	Region	Tonnes (KT)	Lost to	Price When Lost
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

PART B: GAINS

Month	Customer	Location	Region	Tonnes (KT)	Gained From	Price to Regain
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

4.58 The practical reality of the impact of importers on the GB cement market is supported by economic theory. The CC's logic is that because importers' have a substantial variable cost disadvantage, they do not face incentives to price below the current price level as they are aware that GB producers would be able to price them out of the market. This logic assumes that the importers take part in tacit coordination between themselves and have no incentives to deviate. CEMEX considers that this logic is flawed and contradicts the well-established literature on incentives to coordinate. As shown by Vasconcelos, in a homogenous product market with cost-asymmetries,

the smallest and least efficient firms are the most difficult to induce to coordinate.[31] Kühn obtains essentially the same results in a differentiated product market.[32]

4.59 Economic theory therefore suggests that, even if the CC's assertion regarding the importers' cost disadvantage were correct, it would not imply that they have no incentives to undercut the price. On the contrary, the smaller share of the market of each individual importer, and the allegedly higher costs of importers, would imply that they have greater incentives to deviate from any collusive agreement.

4.60 The CC's logic is also inconsistent with the fact that imports by independents have been steadily increasing and there has been recent new entry by importers in the GB cement market as outlined in paragraphs **4.45-4.46** above. CEMEX notes that the CC is likely to have the most accurate market data with which to quantify the increasing share of the GB cement market held by cement importers. CEMEX estimates that cement importers held [✂] the GB cement market in 2011 which will only have increased since. This represents an increase of [✂] from 2001 when importers' market share was [✂].

(v) Ability of importers to sell GB wide

4.61 CEMEX notes that the CC has provisionally concluded that cement importers are generally able to sell cement only within a limited distance of the terminal through which it is imported.[33] Although neither the putback on cement imports, nor the UIS provides any analysis of the proportion of cement sold close to the terminal through which it is imported, in CEMEX's experience imported cement is sold throughout the country and, in particular, at locations over 150 miles away from an import terminal. Nowhere in GB is more than 70 miles from the sea and, because of the geographic spread of import operations across GB, CEMEX believes that at this time it is possible to purchase imported cement (bulk or bagged) anywhere in the UK. For example, CRH, an Irish cement manufacturer and importer, sells cement imported into Swansea across the Midlands.

(vi) Inability of GB producers to undermine the viability of imported cement

4.62 CEMEX notes that the CC has provisionally concluded that GB cement producers consider, and sometimes take, steps to undermine the viability of imported cement.[34] According to the putback paper on cement, GB producers allegedly take the following steps to undermine the viability of imported cement:

(a) applying pressure to cut off cement supplies to independent importers;

(b) purchasing of import terminals; and

(c) targeting lower priced cement selectively at customers of cement importers.

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31 H. Vasconcelos , *Tacit Collusion, Cost Asymmetries, and Mergers*, The RAND Journal of Economics, 36(1) (2005), pp. 3 - 62.

32 K.-U. Kühn, *The coordinated effects of mergers in differentiated product markets*, The John M. Olin Centre for Law & Economics Working Paper No. 34 (2004).

33 *UIS*, paragraph 86.

34 *UIS*, paragraph 86.

4.63 CEMEX notes that it has not seen any evidence on the first two points and therefore cannot comment fully at this stage. CEMEX notes however, that these steps are unlikely to be effective, or sustainable, given the substantial spare capacity available in Europe and the available capacity at the import terminals.

4.64 In relation to GB producers targeting lower priced cement selectively at cement importers, this is inconsistent with the CC's theory of harm on coordination between GB cement producers. Coordination is very difficult to sustain if the coordinating firms can and do target customers selectively (which in itself suggests that the importers impose a competitive constraint) but they are unable to inform each other about these selective price decreases. For example, suppose that one firm that is part of a putative tacitly collusive agreement targets certain customers with low prices with a view to undercut importers. It may be difficult for the other parties of that same agreement to distinguish the aforementioned 'defensive' (and possibly pre-emptive) action against importers from a more 'offensive' move by the firm aimed at increasing its market share. In particular, it may therefore be unclear for the other parties as to whether or not it is appropriate for them to retaliate.

Conclusion on role of importers in GB cement market

4.65 It is clear that importers play a very significant role in the GB cement market. Contrary to the provisional conclusions of the CC, cement importers do not face a cost disadvantage when competing with GB producers and, as a result, are able to significantly undercut GB producers and continue to grow market share, and generally erode cement prices across GB.

4.66 In addition EU cement producers from countries with significant spare capacity are incentivised by the EU ETS to aggressively target GB. Further, no evidence has been presented by the CC to demonstrate that importers are only able to constrain GB producers' prices close to import terminals or that it is possible for GB producers to take effective action to undermine the viability of imported cement.

4.67 The impact of importers across the GB cement market, and in particular, the growing market share of cement importers, significantly undermines the CC's theory of harm in relation to coordination in cement as it is not possible for any hypothetical coordinating group to tacitly agree to maintain a market share or share of production in a situation where the coordinating group's total market share is declining.

[2] Profitability in GB cement market

4.68 CEMEX notes that the CC has acknowledged that, unlike the other three Majors, even when profits are calculated on a historical cost accounting ("HCA") basis, CEMEX [✂].[35] In fact, in each of the years 2007 to 2011, [✂].

4.69 CEMEX intends to provide its comments in response to the CC's working papers on the approach to assessing profitability in the reference markets and preliminary profitability on an HCA basis shortly. This response will address the CC's proposed approach to profitability in detail. However, CEMEX makes a few preliminary observations below.

[35] *UIS*, paragraph 87.

4.70 The working papers published by the CC to date do not contain any meaningful conclusions inasmuch as the HCA working paper sets out CEMEX's ROCE for the years 2007 to 2011 but the approach to profitability paper indicates that the CC will calculate ROCE not on an HCA basis but on a current cost accounting or modern equivalent asset basis ("MEA"). Further, the CC is yet to publish either its working papers profit margins (CEMEX has only seen a putback of this paper) or its planned approach to the assessment of the level of cost of capital. It is therefore difficult to foresee whether, following its assessment of profitability of the Majors on an MEA basis, the CC will continue to find, by the benchmark that it sets, that three out of the four Majors have high ROCE in the cement market.

4.71 CEMEX believes that if ROCE is calculated on an MEA (rather than an HCA basis) basis, it will accurately reflect how the Majors value their cement manufacturing assets and is likely to indicate a consistently low ROCE in cement for all Majors, with an especially low ROCE for CEMEX.

4.72 Furthermore, in this regard, CEMEX notes that its forecasted return on capital for its Cement business, calculated [✂] (utilising gross book value), [✂] (on an HCA UK GAAP net book value basis). CEMEX has not calculated its return on capital measure for 2011 (on an IFRS basis) [✂]. On this basis, CEMEX submits that that CC's HCA approach significantly overestimates [✂] of capital measure [✂] and, in all probability, overestimates [✂] measure for other Majors in cement.

4.73 A finding of low levels of profitability for all Majors in cement would have significant implications for the CC's theory of harm regarding coordination in cement. A consistently low profitability in cement is consistent with a lack of coordination in the cement market and the CC would be required to show that GB cement producers continue to coordinate in spite of such coordination not leading to high profits.

4.74 Further, CEMEX believes that the CC has not properly taken account of the implications of CEMEX having a [✂] in cement manufacture compared to other Majors. The [✂] indicate that, to the extent that any coordination might exist in the cement market, this would not be advantageous for CEMEX and hence CEMEX has an incentive to compete aggressively and win business at the expense of other Majors. Further, CEMEX's [✂]. Some of these investments have allowed [✂]. This provides an incentive to increase output, allowing CEMEX to [✂].

4.75 Finally, given the unprecedented changes in the reference markets in the recent years analysed by the CC, the results of the CC's profitability analysis may not be a meaningful indicator of normal levels of profitability in the industry. The CC should give consideration to the fact that most of the period 2008-2010 has been characterised by a sharp decline in the UK construction sector, which may have led firms in this sector into varying degrees of financial distress. When demand is low, debt service payments are spread over smaller volumes. As a result, a firm may have to raise its unit margin to ensure it can cover its debt payments, which may lead to an inflated ROCE.

[3] Price Increase Announcement Letters

4.76 CEMEX welcomes the CC's conclusion in the UIS that price announcements do not act as a focal point for coordination.[36]

4.77 CEMEX notes, however, that the CC is concerned that price announcement letters may give an indication of the magnitude of any price increase. CEMEX disagrees with this provisional conclusion for the following reasons:

(a) CEMEX is unable to realise the full extent of price increases announced;

(b) there is no 'pattern' followed by Majors in making price announcements;

(c) the parallelism in dates of price announcements is explained by the demands of customers to have foreseeability of price changes and by exceptional costs increases; and

(d) CEMEX [✂], which, so far as it is aware, is not being followed by other Majors.

(a) CEMEX is unable to realise the full extent of price increases announced

4.78 The CC's own analysis in its putback on price announcements in bulk cement indicates that there is a wide range in realised price increases for CEMEX, ranging from a price reduction equal to [✂] percent of the proposed price increase to a price increase equal to [✂] percent of the proposed increase for Portland Cement and increases of [✂] percent to [✂] percent of the proposed price increase for Rapid Cement (3 months after the date on which the price increase announcement became effective). Given the wide range of realised prices it is impossible for CEMEX, or any other Major, to obtain any meaningful indication of the magnitude of price rises when there is such a large variance in realised prices. The reality is, CEMEX is negotiating with individual customers every day and price announcements cannot provide any indication of how these negotiations are progressing. CEMEX is also aware of instances in which [✂].

(b) There is no 'pattern' followed by Majors in making price announcements

4.79 CEMEX notes that in the UIS, the CC has stated that one particular Major was always the first to announce price increases, with the other Majors generally following with the same or higher price increases.[37] CEMEX understands from the CC's working paper on price announcements in bulk cement that that the CC is alleging that there is a partial pattern to price increase announcements whereby Lafarge is the first to announce a price increase followed by Hanson, with Tarmac or CEMEX coming next.

4.80 CEMEX disagrees with the CC that there is any 'pattern' in relation to price announcements and this is clear from Table 1 of the CC's working paper on price announcements in bulk cement ("Table 1"). It can be seen from Table 1 that of the ten price announcements since January 2006, Lafarge has been the first to announce price increases only five times. Further, a more recent analysis shows that post-2010, Lafarge has been the first to announce price increases only once.

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36 *UIS*, paragraph 90.

37 *UIS*, paragraph 88.

4.81 Similarly, in relation to the second mover, Hanson has been the second to announce prices only four times out of the ten price increase announcements shown in Table 1. Again, a more recent analysis shows that post-2010, Hanson was the second mover in only one case.

4.82 On the basis of the above, CEMEX submits that the CC has been unable to demonstrate any consistent pattern in relation to the sequence in which Majors announce price increases. During discussions with CEMEX at the Hearing the CC itself acknowledged that since 2010 this supposed *partial pattern* "breaks down" and "doesn't wholly hold good."[38] CEMEX, which was the [✂] to announce its pricing strategy for January 2012 and [✂], makes its price announcement decisions unilaterally and is unconcerned with its order in the chain of announcements. For further commentary on the CC's analysis of price announcements in bulk cement, CEMEX refers the CC to its response to the CC's working paper on price announcements in bulk cement, which is at **Annex 6**.

(c) The parallelism in dates of price announcements is explained by the demands of customers to have foreseeability of price changes and by exceptional costs increases

4.83 CEMEX submits that any parallelism in the dates of price announcements by Majors is not the result of tacit coordination and is explained by two factors:

(a) customers prefer predictable price increases to unpredictable ones and, as the CC has noted, 1 January price increases are common in many industries. This explains the 1 January price increases (which account for seven of the ten price increases in Table 1); and

(b) any mid-year price increase is generally explained by a common increase in prices faced by each of the Majors. CEMEX notes that the only mid-year price increase common to all of the Majors, identified in Table 1, relates to August 2008. This mid-year price increase was the result of extremely high energy prices faced by each of the Majors, which they each sought to recover at the same time.

4.84 In general, at the time of sending out its price announcement letter, CEMEX is unaware if any other Major has issued a price announcement.

(d) CEMEX has [✂]***.***

4.85 [✂].

4.86 [✂]:

(a) [✂];

(b) [✂];

(c) [✂]; and

(d) [✂]

[38] As per Mr Malcolm Nicholson, *CC Notes of Hearing with CEMEX*, 7 December 2012, pp. 87 & 88.

4.87 [✂]

[4] Price parallelism in bulk cement

4.88 CEMEX has provided its preliminary comments in response to the CC's working paper on price parallelism in bulk cement on 4 January 2013. This is attached at **Annex 8**.

4.89 CEMEX considers that the CC has been unable to demonstrate that there exists price parallelism between the prices of GB cement Majors which is consistent with coordination.

4.90 As set out in CEMEX's preliminary comments, the CC's methodology to assess price parallelism between GB cement producers, and between GB cement producers and importers, is not sufficiently robust to conclude that there is a high degree of price parallelism in the GB cement market.

4.91 Even assuming that the CC had been able to demonstrate a degree of price parallelism in the GB cement market, the CC has not outlined how such price parallelism is a result of coordination. CEMEX makes five points in this regard.

4.92 First, it is not uncommon for there to be a degree of price parallelism between suppliers in commodity markets. As the CC has indicated, cement is a relatively homogenous product and the costs structure of each Major is broadly similar.[39] It is therefore to be expected that Majors will price at a similar level in order to recover these (fixed and variable) costs from customers.

4.93 Second, the CC has found that Tarmac's prices are not closely correlated to the other Majors.[40] The CC has failed to explain how CEMEX, Hanson and Lafarge have been able to maintain a coordinated price in a market characterised by the presence of a maverick, i.e. Tarmac.

4.94 CEMEX considers that the only reasonable explanation to be drawn in this regard is that Tarmac's cost structure differs from that of the other Majors and hence so do its prices. This reinforces the notion that any parallelism observed in the prices of CEMEX, Hanson and Lafarge are a result of their common cost structures and not coordination. This factor has been overlooked by the CC in its fixation on short-term variable costs as opposed to long-run costs (a more appropriate metric in this market).

4.95 Third, the CC has found that CEMEX, Hanson and Lafarge's prices are closely correlated to that of only two importers and not to those of a third importer.[41] CEMEX has already set out in paragraphs **4.56 – 4.60** above the disruptive effect importers have on GB cement prices and the CC's own (limited) analysis shows that 33 percent of importers' prices are not correlated to GB producers' prices. The CC has failed to explain how a coordinated price can be sustained in the face of significant price disruption from at least a large minority of importers and Tarmac.

4.96 Further, CEMEX believes that the CC's analysis overestimates the price parallelism between CEMEX, Hanson, Lafarge and importers. CEMEX notes that the CC has not carried out a price

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39 *UIS*, paragraphs 82 & 83.

40 CC, *Working Paper on Price Parallelism in bulk cement*, 28 November 2012, paragraph 15.

41 CC, *Working Paper on Price Parallelism in bulk cement*, 28 November 2012, paragraph 16.

correlation analysis between all importers and GB producers. CEMEX believes that if the CC were to carry out such an analysis it would find that importers often undercut GB producers and any parallelism observed between GB producers' and importers' prices is a result of GB producers having to substantially lower their prices in order to match prices quoted by importers.

4.97 Finally, CEMEX considers that the CC has been unable to demonstrate the manner in which a coordinated price has been maintained between CEMEX, Hanson and Lafarge. The CC has already accepted that it is unlikely that prices are a main focal point for coordination and that they are not transparent given that they are negotiated individually.[42] Having accepted that individually negotiated prices are not transparent, the CC has failed to provide an explanation as to how a coordinated price is (or could be) maintained. In the absence of a mechanism explaining how a non-transparent coordinated price could be maintained, the CC must accept that any price parallelism observed in the GB cement market is a result of factors other than coordination.

[5] Cross-sales in bulk cement

4.98 CEMEX provided its preliminary comments in response to the CC's working paper on cross-sales on 4 January 2013. This is attached at **Annex 9**.

4.99 CEMEX notes that the CC has not found (either in the UIS or in its working paper) that cross-sales presently facilitate coordination. The CC has only set out how cross-sales could, if market conditions change so that there is an increase in cement demand (and consequently there is a change in the Majors' behaviour) leading to an increase in cross sales, hypothetically facilitate coordination.

4.100 CEMEX notes that the CC, in the UIS, has indicated that cross-sales between Majors can facilitate coordination in several different ways, including:

(a) by increasing transparency between the price charged by other Majors;

(b) by providing scope for small scale repatriation to signal dissatisfaction with another Major's conduct;

(c) by providing scope for large scale repatriation to be used as a punishment mechanism; and

(d) a potential mechanism for side payments between members of any coordinating group.

4.101 CEMEX rejects the CC's provisional conclusion that cross-sales could be used to facilitate coordination between Majors. However, in the absence of any evidence presented by the CC showing that cross-sales actually facilitate coordination, it would be a purely academic exercise to address this hypothetical possibility. Hence this is not addressed further in this response and the remainder of this section sets out how, under present market conditions, it is not possible for CEMEX's cross-sales arrangements to facilitate cross-sales in the manner hypothesised by the CC.

[42] *UIS*, paragraph 90.

4.102 As a preliminary point, CEMEX notes that the CC has acknowledged that cross-sales between Majors have been decreasing significantly.[43] [✂] CEMEX transacts for the supply and purchase of cement [✂]. However, as the CC acknowledges in its working paper on cross-sales, cross-sales agreements are entered into for rational business reasons including: (a) making up for a shortfall of input in a particular location; (b) in order to save transport costs; and (c) in order to supply a Major's RMX operations. CEMEX considers that none of these rationales are anti-competitive in nature and, on the contrary, each of these rationales have important pro-competitive benefits.

4.103 Each of the CC's specific concerns regarding the manner in which cross-sales could hypothetically facilitate coordination is addressed below in the context of CEMEX's present cross-sales arrangements.

(a) Limited scope for cross sales increasing transparency for CEMEX or other Majors it transacts with

4.104 As noted above, [✂]. CEMEX also [✂] (but [✂] in the upstream cement market). CEMEX notes that it operates each of its business divisions as a standalone business unit and it is CEMEX's policy to try to ensure that prices charged [✂] and CEMEX to each other are market prices. (However, as [✂] to CEMEX.)

4.105 In addition, CEMEX's price increase letters are sent by its individual business divisions and only relate to one product. Furthermore CEMEX's [✂] was only sent to stand alone RMX customers [✂].

4.106 Based on the above it is CEMEX's view that its present cross-sales agreements do not facilitate coordination.

(b) & (c) No scope for small or large scale repatriation

4.107 CEMEX notes that the CC has not presented any evidence showing either small or large scale repatriation by any Major in order to signal dissatisfaction with the other Majors' behaviour or to punish deviation from any tacit agreement.

4.108 In relation to cement, [✂] CEMEX transacts with, [✂]. CEMEX is not aware of any instance of repatriating volumes [✂].

4.109 Even assuming that CEMEX was part of a coordinating group, CEMEX [✂]

(d) Cross-sales are not a potential mechanism for side payments between members of any coordinating group

4.110 CEMEX notes that the CC has presented no evidence to demonstrate that cross-sales can be used as side payments between Majors to maintain the stability of the coordinating group. Hence CEMEX is unable to comment on this issue at this stage.

<u>[6] CEMEX Internal Documents</u>

[43] *UIS*, paragraph 94.

4.111 CEMEX's comments on the internal documents seen by the CC will be contained in its response to the CC's enhanced putback on CEMEX's UK and non-UK internal documents.

4.112 CEMEX however, wishes to note for the purposes of this section that the CEMEX internal documents cited as evidence of tacit coordination by the CC are:

(a) largely historical and relate to 2005/2006 when the dynamics of the UK cement market were very different and bear little relation to the present realities of the market;

(b) drafts for discussion prepared by external consultants and not approved by CEMEX; and/or

(c) taken out of context by the CC.

4.113 For the reasons above, CEMEX does not believe that any of the internal CEMEX documents cited by the CC is evidence of any present coordination. CEMEX does not discount the possibility that there are documents in the CC's possession which the CC may consider demonstrate present coordination but CEMEX has not seen these documents and hence cannot comment on them.

Conclusion on coordination between cement producers

4.114 As set out by the CC in its Merger Guidelines and repeated under Theory of Harm 2 of its Statement of Issues, dated 8 March 2012, each of the following conditions must be present in order for a finding of coordination in the UK cement market to be possible:

(a) competitors must be able to come to an understanding regarding the terms on which they seek to co-ordinate;

(b) competitors must be able to monitor their rivals' adherence to the terms of coordination;

(c) competitors must be incentivised not to deviate and/or punishment mechanisms be put in place to deter them from doing so; and

(d) outsiders to the agreement must not be able to undermine a collusive outcome.

4.115 In CEMEX's view the CC has failed to adduce evidence sufficient to demonstrate the presence of any one of the above conditions in the UK cement market. In concluding its remarks on the CC's UIS, CEMEX's briefly addresses each of these points below:

(a) ***competitors must be able to come to an understanding regarding the terms on which they seek to co-ordinate.***

4.116 In its UIS, the CC has stated that the focal points for coordination are likely to be one or more of shares of production, shares of sales and/or wins/losses of customers.[44]

4.117 CEMEX has highlighted in this response the difficulties inherent in any attempt to agree on any of these metrics particularly given the uncertainties surrounding the selection of the relevant metric and the need to coordinate redistribution of market shares between the majors as volumes are lost to both independents and importers, which continue to increase their market shares.

[44] *UIS*, paragraph 84.

(b) ***competitors must be able to monitor their rivals' adherence to the terms of coordination.***

4.118 CEMEX notes that the CC has provisionally concluded that there is sufficient transparency in the UK cement market to allow the monitoring of wins/losses of cement customers, based principally on the data released by the MPA and competitors' interactions with customers.[45] In CEMEX's experience, neither of these methods offers the degree of precision necessary to monitor coordination effectively, especially given the level of detail required to assess market shares and customer wins/losses. The statistics produced by the MPA are both aggregated and released with a time lag, which undermines any attempt to gain from them a real time understanding of a competitor's current behaviour. Further, in relation to the collection of data through interaction with customers, this is an extremely imprecise and unreliable way of monitoring shares of external sales, with customers often incentivised to misreport or fabricate data.

(c) ***competitors must be incentivised not to deviate and/or punishment mechanisms be put in place to deter them from doing so.***

4.119 Even if an explicit or tacit agreement could be reached and monitored, it would not be sustainable without an effective and credible mechanism to punish parties should they deviate from any tacit agreement. The CC has referred to the ability of competitors to utilise spare capacity in the cement market to punish instances of deviation from an alleged tacit understanding, by (i) targeting the cement customers of the deviator and (ii) repatriating cement volumes. Aside from the operational difficulties, and the expense and the lag time inherent in any effort to utilise spare capacity, CEMEX makes the following points:

(i) In relation to (i) above, the CC has put forward no evidence to adduce this is the case; and

(ii) In relation to (ii), whilst the CC has referred to cross sales between majors as providing a potential punishment mechanism via the repatriation of volumes,[46] given that the CC has not provided any supporting evidence for this consideration, CEMEX has not addressed the issue in detail. However, as the CC acknowledges in its working paper on cross-sales in bulk cement, cross-sales agreements are entered into for rational business reasons. As CEMEX has set out in its response to that paper (attached at **Annex 9**), cross sales between majors have been decreasing dramatically and [✂]. From CEMEX's perspective, [✂]

(d) ***outsiders to the agreement must not be able to undermine a collusive outcome*.**

4.120 CEMEX agrees with the CC that there are significant barriers to entry into the GB cement market in terms of the capital cost of constructing a new cement plant. However, CEMEX believes that the CC has significantly overstated the barriers to entry in relation to (a) the construction of a new grinding mill and (b) the import of cement into the UK. Whilst CEMEX is yet to receive the CC's working paper on cement imports, it believes that the CC has fundamentally misunderstood the

[45] *UIS*, paragraph 85.

[46] *UIS*, paragraph 94.

role played by importers in the GB cement market. On this point, CEMEX refers the CC to its comments in sections **4.38 - 4.67** above. In particular, CEMEX highlights the evidence of new entry by importers (including the construction of eight new import terminals); the absence of any cost disadvantages when one considers importers' lower fixed costs; the active incentive to export to GB provided by the EU ETS and to undercut UK prices so as to recover variable costs; and the inability of GB producers to undermine the viability of imported cement.

4.121 Finally, even if (contrary to CEMEX's view) the CC considered that these were historically the features of the GB cement market which were conducive to coordination, the entry of Mittal into the market makes it extremely unlikely that any such coordination can be maintained going forward. In particular, Mittal is a completely new entrant, both to the cement industry in general and the GB cement market in particular and has no existing relationships with either. Furthermore, it has a different set of assets and a different vertical structure to that of Tarmac and other majors and has every incentive to compete to grow its market share (see further Section 10 below).

5 AGGREGATES

5.1 CEMEX considers that the CC has not been able to demonstrate any adverse effect on competition in the aggregates market in terms of either unilateral market power or coordinated effects.

5.2 As a preliminary point, CEMEX notes that it does not agree with all of the CC's provisional conclusions in relation to market definition in aggregates. CEMEX's views on market definition in aggregates are set out in detail in its response to the CC's working paper on market definition, which is at **Annex 10**. In summary, CEMEX concurs with the CC's provisional conclusion that there is a single product market for all construction aggregates.[47] However, CEMEX does not support the CC's qualifications to this general proposition and in particular notes that secondary and recycled aggregates are used by RMX producers and impose a significant competitive constraint on CEMEX's pricing of aggregates.

5.3 CEMEX addresses each of the CC's theories of harm in relation to aggregates below.

6 UNILATERAL MARKET POWER IN AGGREGATES

6.1 CEMEX rejects the CC's provisional conclusion that there *may* be unilateral market power in certain local aggregates markets.[48] In particular, CEMEX rejects the proposition that CEMEX itself may have unilateral pricing power in any local aggregates market. This is for the reasons set out below.

[1] Intense competition in local aggregates markets

6.2 CEMEX believes that the CC's own PCA/EEA analysis demonstrates that there is intense competition in local aggregates markets, with over 90 percent of local aggregates markets having 5 or more suppliers.[49]

6.3 CEMEX also notes that the CC found that in 8 percent of job sites, the largest company held a market share of 50 percent or more.[50] As the CC has not identified the specific markets in relation to which it has made these findings, CEMEX is unable to comment on the conditions of competition in these specific local markets. However, as far as CEMEX is aware, it does not hold a market share of 50 percent or more in any local aggregates market, nor does it hold any market share below 50 percent such that it is unilaterally able to exercise pricing power in any such market. CEMEX further notes that the CC found that in 18 percent of job sites the four largest companies had a market share of more that 90 percent.[51] As the CC has not identified the specific markets in relation to which it has made these findings, CEMEX is unable to comment on the

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47 *UIS*, paragraph 14.

48 *UIS*, paragraph 39.

49 CC, *Aggregates price-concentration analysis and entry and exit analysis: first results*, 11 January 2013 (referred to hereafter as the PCA/EEA analysis), slide 11.

50 PCA/EEA analysis, slide 11.

51 PCA/EEA analysis, slide 11.

conditions of competition in these specific local markets. However, being a supplier in a relatively concentrated market does not readily imply that the supplier has (significant) unilateral market power. It is widely recognised that, in reality, most firms – even small ones – have a degree of market power when measured using, for example, the Lerner index, which indicates the percentage elevation of price over (short-term) marginal cost. However, this clearly does not in general raise any antitrust concerns within the relevant competition authorities, particularly in industries with high fixed costs which need to be covered by prices in the medium term.

6.4 In addition, as has been remarked on previous occasions (see for example CEMEX's preliminary response to the CC's working paper on price parallelism attached at **Annex 8**), the pricing of firms with large fixed costs is guided to a considerable extent by the need to recover long-run average costs. Accordingly, a more appropriate concept to measure market power would be a Lerner index based on long-run marginal cost or long-run average incremental cost (LRAIC), which incorporates some of the costs (e.g., capital expenditures) that are fixed in the short run.

6.5 Finally, the CC's PCA/EEA analysis found that the effect of entry and exit on the change in prices set by aggregates plants was mostly statistically insignificant.[52] CEMEX does not agree that the conclusion arising from these findings is that there is any unilateral market power in any local aggregates market. On the contrary, the CC's findings are entirely consistent with, and suggestive of, highly competitive local markets. This is addressed in detail in CEMEX's response to the CC's PCA/EEA analysis, at **Annex 11.**

[2] Barriers to entry and expansion in local aggregates markets

6.6 CEMEX's preliminary views on barriers to entry and expansion in aggregates market are contained in its response to CC's working paper on barriers to entry and expansion, submitted on 4 January 2013 (at **Annex 12**).

6.7 CEMEX agrees with the CC's findings that neither the availability of resources, the capital cost nor economies of scale constitute significant barriers to entry for aggregates producers. In addition, CEMEX notes that [✂], new entrants are easily able to enter local aggregates markets by securing funding to acquire these assets.[53]

6.8 However, in relation to barriers to entering the aggregates market through secondary and recycled aggregates, CEMEX strongly disagrees with the CC's finding that the concept of new entry is not particularly meaningful for these segments of the market.[54] It is meaningful to consider new entry and expansion of existing operations in relation to any product which is capable of imposing a significant constraint on the producers of primary aggregates. This is particularly true when considering local aggregates markets, where each market may be affected by the transfer of secondary and/or recycled aggregates from an adjacent local market. For example, the ability of

[52] PCA/EEA analysis, slide 7.

[53] In this context, CEMEX also notes and endorses Hanson's comments repeated by the CC at paragraph 31 of its working paper on the competition aspects of regulation and government policy. Hanson notes that in some cases smaller operators might be treated more favourably than larger firms by the Minerals Planning Authority believing smaller operators were local players which were more committed to the local area.

[54] CC, *Working Paper on Barriers to Entry and Expansion*, 23 November 2012, paragraph 73.

merchant hauliers to bring additional secondary and recycled aggregates into local markets from other areas regularly acts as a constraint on the prices of primary aggregates. CEMEX provides examples of the competitive effects of such 'new entry' in paragraph 6.10 below.

6.9 CEMEX also considers the CC, in its provisional conclusions in the UIS, to have significantly overstated the limitations both on the availability of recycled aggregates and their substitutability with primary aggregates. As the CC acknowledges in its working paper on market definition, primary and secondary or recycled aggregates are part of a single product market for all construction aggregates, with secondary and recycled aggregates accounting for a significant proportion of the market. CEMEX is able to provide numerous examples of instances where recycled aggregates have been substituted for primary aggregates in certain applications. This is particularly noteworthy in relation to certain applications requiring premium materials such as single-sized or graded aggregates, where the use of primary aggregates has traditionally taken precedence. Such examples include the following:

(a) aggregates for use in pipe bedding and drainage in groundwork, large volumes for which are provided by soil washing plants producing recycled aggregates which are levy exempt, ensuring a competitive advantage over primary aggregates through lower fixed costs;

(b) aggregates for use in volumetrics, where a number of operators including [✂] have switched to cheaper recycled aggregates; and

(c) significant quantities of recycled aggregates have been used in place of primary aggregates on the construction of the main hub of the Nottingham Tram Project.

It is therefore logical and consistent with CEMEX's experience to conclude that the competitive conditions relating to primary aggregates are necessarily affected by the production of secondary and recycled aggregates, making the absence of barriers to entering the market via secondary and recycled aggregates immediately relevant.

6.10 CEMEX disagrees with the reasoning behind the CC's intention not to consider barriers to entry in relation to merchant hauliers. Contrary to the CC's assertion, owing to the ability of merchant hauliers to transport aggregates over greater distances by arbitraging between prices in different localities their activity will often increase the total volume of aggregates in a given catchment area. Hence even though merchant hauliers do not increase the total volume of aggregates nationally, they do introduce the possibility of new (and extremely competitive) entry into local aggregates markets and are [✂]. For example, merchant hauliers transport recycled aggregates out of London as far as Colchester, with CEMEX [✂]. This contradicts the CC's preliminary conclusions in its working paper on barriers to entry and expansion, in that, given their substitutability and the ability to transfer recycled aggregates between markets, the amount of secondary aggregates in a given locality may well vary in response to the competitive conditions for primary aggregates. Likewise, in relation to primary aggregates, [✂]. CEMEX [✂]. As such, the ever-present and growing threat of 'new entry' via merchant hauliers transporting aggregates between adjacent markets acts as a constant constraint on competitive conditions across localities.

6.11 CC also underestimates the role of merchant hauliers in the aggregates market in the way that they can form a virtual quarry offering to their clients. [✂]. Thus, although merchant hauliers are a major customer of aggregates producers, [✂]. As an individual quarry cannot individually supply all the needs of its clients [✂], which offer a one stop shopping experience for their clients. Further, merchant hauliers have [✂] as they are aware of several local quarries which can supply materials of similar quality. This results in low prices and margins for quarry owners, despite investing the majority of the capital in the value chain.

[3] Profitability in aggregates

6.12 CEMEX agrees with the CC's conclusions that [✂].[55] This is consistent with CEMEX's experience of [✂] in the aggregates industry generally.

6.13 CEMEX submits that, while there may be regional variations in profitability, it is highly unlikely that, if the CC were to carry out a profitability analysis of local aggregates markets, it would find that CEMEX [✂] in any local market. This further demonstrates the absence of unilateral market power being exercised by CEMEX in any local aggregates market.

6.14 CEMEX notes that the CC's analysis has found that margins on internal sales are higher than its margins on external sales for other Majors.[56] CEMEX notes that in its putback on margins, the CC has acknowledged that it is unable to ascertain the difference between CEMEX's internal and external margins due to data limitations. While CEMEX is unaware of the policy of other Majors, as explained to the CC at the Hearing, [✂]. CEMEX also emphasises to the CC the importance of comparing products of equivalent grading, quality and end use in any comparison of internal and external margins.

[4] Aggregates local market case studies

6.15 CEMEX notes that the CC has carried out case studies in relation to two aggregates markets in South Wales and East Anglia. The CC has concluded on the basis of its case studies that the presence of independent aggregates producers results in downward pricing pressure.[57] Further, the CC concludes that on the basis of the documents available to it and the interviews it has conducted, there is no suggestion that unilateral market power is a problem in these areas.[58]

6.16 CEMEX submits that the South Wales and East Anglia local aggregates markets studied by the CC are broadly representative of local aggregates markets and, if the CC were to carry out further local markets case studies, it would find an absence of unilateral market power in each case.

Conclusion on unilateral market power in GB local aggregates markets

6.17 The CC has indicated in the UIS that its provisional view is that any concerns relating to unilateral market power in aggregates is confined to a limited number of local markets.[59] However, in the

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55 *UIS*, paragraph 35.

56 *UIS*, paragraph 36.

57 *UIS*, paragraph 38.

58 *UIS*, paragraph 38.

59 *UIS*, paragraph 26.

absence of any indication from the CC as to which local markets may have a problem of unilateral market power, it is not possible for CEMEX to substantively comment, in any meaningful way, on the CC's provisional conclusions. However, CEMEX submits that in the absence of the CC carrying out any further case studies of local aggregates markets (which the CC has indicated it will not do) the CC is required to reach a decision based primarily on the case studies it has conducted and these demonstrate that unilateral market power is not a problem in local aggregates markets.

7 COORDINATION BETWEEN PRODUCERS OF AGGREGATES

7.1 CEMEX notes that the CC has only very limited concerns in relation to coordination in GB aggregates markets.

7.2 CEMEX agrees with the following observations of the CC regarding the GB aggregates market:

(a) the local nature of GB aggregates markets means that there is a geographical differentiation between aggregates produced at different locations. In addition, there are a number of non-Major aggregates producers which supply a fragmented customer base which purchases on a project by project basis through bilateral negotiations. This means that prices, customer relationships and total aggregates output are not particularly transparent for individual aggregates suppliers;

(b) competitive conditions may vary from one local aggregates market to another and this may make it difficult for suppliers to maintain a single model of coordination across the country;

(c) the local markets studied by the CC show that both Major and non-Major aggregates suppliers are competing with each other in these areas to gain market share and/or to persuade customers to switch; and

(d) the Majors have relatively modest returns on capital in the GB aggregates market.

7.3 CEMEX submits that in view of the above factors, not only is it unlikely that there is any coordination in GB aggregates markets, but it is virtually impossible for the conditions of coordination (reaching a tacit understanding, monitoring the tacit understanding and punishing deviators from the tacit understanding) to exist in such circumstances.

7.4 However, CEMEX understands that, notwithstanding its limited concerns, the CC's current view is that it has identified some aspects of the supply of aggregates which may increase the theoretical possibility of coordination in at least some local aggregates markets. In the absence of the CC identifying which local aggregates market it is specifically concerned with, it is difficult for CEMEX to comment fully on this issue. Hence CEMEX makes only a limited number of points in this regard.

[1] Aspects of market structure and product

Concentration

7.5 The UIS notes that there is concentration in the supply of aggregates with five Majors collectively supplying 74 percent of aggregates markets in GB.[60]

7.6 As aggregates markets are local, it is difficult to understand the relevance of the national share of supply in aggregates in considering whether there is coordination in local aggregates markets. CEMEX submits that a degree of concentration at a national level is not indicative of, existing or potential, coordination in aggregates markets in GB.

7.7 The CC has also identified that in 45 percent of catchment areas the Majors collectively hold a market share of 75 percent or more.[61] CEMEX accepts that a high degree of concentration may make a local market susceptible to coordination. However, a degree of concentration (or even a high degree of concentration were that to be found) by itself is not an indicator of existing coordination in the absence of other indicators and the CC has not identified any other features of the specific local markets, which make them conducive to coordination. CEMEX submits that in the absence of any other factors, even a high degree of concentration cannot, by itself, lead the CC to conclude that coordination is present in any particular local aggregates market.

7.8 In addition, the CC has not identified in which catchment areas there is a high degree of concentration and where such concentration may lead to coordination. Hence it is not possible for CEMEX to comment in an informed manner on this aspect of the CC's case.

Structural Links

7.9 CEMEX notes that the CC has indicated that structural links between aggregates producers, in the form of common membership in the MPA and participation in JVs may make aggregates markets conducive to coordination.[62]

7.10 CEMEX refers the CC to paragraphs **4.15 - 4.16** of this response in relation to the role of the MPA and the reasons why common membership in the MPA is not indicative of coordination.

7.11 As regards participation in aggregates JVs, CEMEX, like a number of other producers is a member of a number of aggregates JVs (these are set out at **Annex 2)**. However, the CC has not presented any evidence regarding how these JVs are used to facilitate coordination or which JVs are of particular concern. In addition, CEMEX notes that a number of its aggregates JVs are with non-Major aggregates producers, which the CC have not included as part of any coordinating group.

Barriers to Entry

7.12 CEMEX refers the CC to paragraphs 2 to 4 of its response to the CC's working paper on barriers to entry and expansion in local aggregates markets (at **Annex 12**). In addition, CEMEX notes that the CC has stated that barriers to entry are only a concern if other conditions for coordination are met in particular local markets.[63] As the CC has not identified any particular local markets which meet

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60 *UIS*, paragraph 71.

61 *UIS*, paragraph 71.

62 *UIS*, paragraph 71.

63 *UIS*, paragraph 71.

the other conditions of coordination, CEMEX assumes that there are no local aggregates markets in which barriers to entry could enhance the ability of a coordinating group to coordinate.

[2] Market Outcomes

Profitability

7.13 CEMEX notes that the CC has provisionally concluded that the profitability of Majors in aggregates is not particularly suggestive of widespread coordination.[64] CEMEX agrees with the CC in this regard.

7.14 CEMEX notes, however, that the CC has qualified its conclusions on profitability in aggregates by stating that a GB-wide analysis may disguise the fact that profits may be higher in certain areas than others.[65] However, the CC has not identified which areas have a high profitability in aggregates for all Majors so as to indicate coordination in that particular area. Hence CEMEX is unable to comment further on this issue.

Margins

7.15 CEMEX notes that the CC has indicated in the UIS that margins on internal sales are higher than margins on external sales and that the CC intends to investigate this further.[66] This evidence does not seem to be suggestive of coordination. CEMEX notes that in its putback on margins, the CC has acknowledged that it is unable to ascertain the difference between CEMEX's internal and external margins due to data limitations. While CEMEX is unaware of the policy of other Majors, as explained to the CC at the Hearing, [✂].[67]

PCA and EEA analysis

7.16 CEMEX notes that the CC's PCA/EEA analysis found that the effect of entry and exit on the change in prices set by aggregates plants was mostly statistically insignificant.[68] CEMEX does not agree that the conclusion arising from these findings is that there is any coordination in any local aggregates market. On the contrary, the CC's findings are entirely consistent with, and suggestive of, highly competitive local markets. This is addressed in detail in CEMEX's response to the CC's PCA/EEA analysis, at **Annex 11**.

[3] Conduct

Price Announcements

7.17 CEMEX notes that the CC has indicated that there is a parallelism in dates of aggregates price announcement letters.[69] However, as the CC acknowledged, this parallelism can be explained to a large degree by the similar annual price review (i.e. January) process followed by all Majors

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64 *UIS*, paragraph 75.

65 *UIS*, paragraph 75.

66 *UIS*, paragraph 36.

67 CC, *Notes of Hearing with CEMEX*, 7 December 2012, p. 37.

68 PCA/EEA analysis, slide 7.

69 CC, *Working Paper on Price Increase Announcement Letters in Aggregates*, 30 November 2012, paragraph 52.

(reflecting customers' desire for advance information on pricing for the new year) as well as the impact of changes in common regulatory costs (such as changes to the aggregates levy in April).[70] There are only **two** price announcements which are not explained by the two factors above. While CEMEX cannot explain the reasons why other Majors chose to issue price announcement letters at this time, CEMEX sets out below its reasons for sending out price announcement letters on these specific dates.

Date of Price Announcement	**CEMEX's Reasons for Price Announcement**
1 June 2010	[✂]
1 July 2011	[✂]

7.18 As is evident from the above, CEMEX had its own independent and objective reasons for issuing price announcement letters on each of the dates identified by the CC. CEMEX therefore rejects the suggestion that parallelism in the dates of price announcements is indicative of coordination in any local aggregates market.

7.19 CEMEX also notes that the CC has indicated that there is no single overall pattern to the Majors' announcements but there may be a trend that Aggregates Industries and Tarmac are often the first to announce price increases, with other Majors announcing slightly higher price increases.[71] CEMEX makes the following points in this regard:

(a) of the 15 price increases analysed by the CC in its working paper on price increase announcement letters in aggregates, Tarmac *or* Aggregates Industries have been the first to announce price increase on only seven occasions. Of these occasions, Tarmac has been the first mover on four occasions and AI has been the first mover on 3 occasions. In the context of a market with only five Major players nationally, it is not unusual for an individual Major to be the first mover 20 or 25 percent of the time and this cannot be indicative of coordination. In addition, CEMEX notes that Tarmac has followed Aggregates Industries as second mover on only three occasions. Again, this is not unusual in a market with only five major players and cannot be indicative of coordination;

(b) CEMEX does not have access to the price increases announced by other Majors and is unable to comment on the CC's observation that other Majors announced price increases slightly higher than Aggregates Industries or Tarmac. However, CEMEX observes that

[70] CEMEX notes that a similar annual price review is undertaken by certain larger independents.

[71] CC, *Working Paper on Price Increase Announcement Letters in Aggregates*, 30 November 2012, paragraph 52.

the CC has noted that there are instances of late announcing Majors undercutting.[72] This observation, together with the fact that there is no statistically anomalous pattern in price announcements, indicates that price announcement letters cannot be (and have not been) used to facilitate coordination; and

(c) finally, CEMEX notes that there is a wide range in realised price increases for CEMEX. Given the wide range of realised prices it is impossible for CEMEX, or any other Major, to obtain any meaningful indication of the magnitude of price rises when there is such a large variance in realised prices. The reality is that CEMEX is negotiating with individual aggregates customers every day and price announcements cannot provide any indication of how these negotiations are progressing. In addition to customers significantly negotiating down the price rises announced, as well as reopening negotiations later in the year to further reduce any increases realised in the first instance, CEMEX is also aware of [✂]. For example, CEMEX [✂].

Local aggregates market case studies

7.20 CEMEX notes that the CC has carried out case studies in relation to two aggregates markets in South Wales and East Anglia. The CC has concluded on the basis of its case studies that there is competition for customers between both Major and non-Major aggregates suppliers.[73] This indicates an absence of coordination in these local markets.

7.21 CEMEX submits that the South Wales and East Anglia local aggregates markets studied by the CC are broadly representative of local aggregates markets and, if the CC were to carry out further local markets case studies, it would find normal conditions of competition existing in each case.

7.22 CEMEX also notes that the CC reached its conclusion on these local aggregates markets in spite of finding that the Majors' internal documents indicate that there are multiple contacts between Majors across local aggregates markets, together with site-sharing and cross supply agreements.[74] Further, the CC found that there is a degree of transparency in relation to competitors' prices due to interaction with customers.[75] CEMEX submits that the CC's findings indicate that, even in markets with "negative" features identified by the CC, healthy competition can exist and the mere existence of such features does not indicate a market conducive to coordination.

Conclusion on coordination in GB local aggregates markets

7.23 CEMEX agrees with the CC's provisional conclusion that there are, at worst, limited reasons to be concerned with coordination in local aggregates markets.

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72 CC, *Working Paper on Price Increase Announcement Letters in Aggregates*, 30 November 2012, paragraph 24.

73 *UIS*, paragraph 79.

74 *UIS*, paragraph 79.

75 *UIS*, paragraph 79.

7.24 The CC has not identified any particular local aggregates markets in which coordination may be a problem. Further, CEMEX submits that the observations made above clearly indicate that it is highly unlikely that there are any local aggregates markets in which Majors are coordinating.

7.25 Finally, the CC's own PCA and EEA analysis and its aggregates local market case studies are entirely consistent with, and suggestive of, highly competitive local markets.

8 COMPETITIVE CONDITIONS IN RMX

8.1 Whilst CEMEX agrees with the CC's analysis and conclusions in relation to the relevant product market, the absence of any significant barriers to new entry and that unilateral market power in the supply of RMX is unlikely, it would like to briefly address the following points raised by the CC in its UIS:

(a) that RMX from volumetric trucks is less of a substitute for RMX from fixed plants in the construction of larger projects;

(b) that site plants are suitable only for very large projects; and

(c) that competitive conditions may be different for customers seeking very large volumes.

8.2 As set out by CEMEX in its response to the CC's working paper on market definition (attached at **Annex 10)** there exists no practical reason preventing volumetric trucks from competing for larger, more technically demanding projects. CEMEX refers the CC to the examples it has provided at paragraph 18 of its market definition response as examples of volumetric operators winning large and complex orders. Further, CEMEX notes [✂] is currently advertising the provision of RMX through more sophisticated volumetric trucks capable of offering quality assured concrete on a large scale.

8.3 CEMEX wishes to reiterate to the CC that there is a growing tendency for smaller jobs to be serviced by fixed site plants. CEMEX is aware (as a result of being asked to quote for the same) that fixed site plants are being used for smaller jobs in [✂] notes that not only are these orders fulfilled by competitors, but also by customers self-supplying by taking advantage of increasingly available low-cost RMX equipment. As technology advances and concrete plants become smaller, cheaper and more manageable, this trend is likely to continue.

8.4 In relation to point (c) above, whilst the CC has not fully explained its thinking in this regard, nor presented any evidence which would raise any competitive concerns, CEMEX would point out that in its experience, due to the volumes involved, there is invariably intense competition for larger projects both from majors and increasingly from independents. CEMEX would also note that orders for larger volumes tend to be subject to additional downward pressures on prices given the increase in customer buyer power that comes with larger orders.

9 VERTICAL INTEGRATION AND EXCLUSIONARY BEHAVIOUR

9.1 CEMEX notes that the CC has indicated in the UIS that is not intending to investigate further the possibilities of unilateral or coordinated foreclosure arising as a result of the vertically integrated structure of GB Majors.[76]

9.2 However, CEMEX notes that the CC has indicated that it still has concerns regarding two possible effects of the vertically integrated nature of GB Majors. First, the CC has indicated that it is concerned that the vertically integrated structure of GB Majors may increase the barriers to entry for new RMX producers and for new cement producers or importers seeking to sell cement in GB.[77] Secondly, the CC has indicated that it is concerned that the vertically integrated nature of GB Majors may facilitate coordination in the GB cement market.[78]

9.3 With regard to the CC's concern that vertical integration increases the barriers to entry in the GB cement and RMX markets, this point has been addressed by CEMEX in its response to the CC's working paper on barriers to entry submitted on 4 January 2013 and CEMEX refers the CC to paragraph 6.5 of that response (attached at **Annex 12**).

9.4 With regard to the CC's concern that vertical integration facilitates coordination in the cement market, CEMEX notes that the CC has listed four possible ways in which coordination may be facilitated through a vertically integrated structure.[79] CEMEX has addressed each of these points elsewhere in this response (and in its response to the CC's working papers) and hence makes no further submissions in this regard. However, CEMEX wishes to reemphasize that although the CEMEX UK board has regard to the UK business as a whole when making key strategic decisions, as the CC has noted in its working paper on market background, CEMEX largely operates its aggregates, cement and RMX operations as separate [✂] businesses [✂]. To that extent, CEMEX may operate as a [✂] business than other GB Majors.

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76 *UIS*, paragraph 113.

77 *UIS*, paragraphs 114 – 116.

78 *UIS*, paragraph 117.

79 *UIS*, paragraph 117.

10 EFFECT OF THE ACQUSITION OF THE DIVESTED ASSETS BY MITTAL ON THE MIR

10.1 CEMEX believes that any findings made by the CC in relation to the historic conditions of competition in the market is of limited relevance in light of the purchase of the assets, divested under the terms of the CC's decision in *Anglo/Lafarge*, by Lakshmi Mittal.

10.2 In particular, CEMEX believes that, to the extent that the CC finds that historically there was any coordination in the GB cement market, the ability of GB cement producers to coordinate is significantly undermined by the entry of the Mittal controlled producer (the "Mittal Producer"). CEMEX wishes to emphasise that the Mittal Producer has not simply "stepped into the shoes of Tarmac" but imposes a considerably greater constraint on CEMEX, Hanson and Lafarge's alleged ability to coordinate. This is for the reasons set out below.

[1] The Mittal Producer is not part of any existing coordinating group and increases the external constraint on any coordinating group

10.3 CEMEX notes that the Mittal Producer, unlike Tarmac, is a new player in the GB cement market, which does not have any existing customer relationships or commercial relationships with other GB producers. This makes it very difficult for the Mittal Producer to enter into, understand the terms of, or maintain any tacit understanding with other GB cement producers.

10.4 To the extent that any tacit understanding between GB producers exists, this could only have been reached by observing, monitoring and reacting appropriately to competitor behaviour over a period of a number of years. It will therefore be virtually impossible for a new player to immediately join a coordinating group. Hence it is in the interests of the Mittal Producer to seek to compete aggressively and increase market share.

10.5 CEMEX notes in this regard that the *Anglo/Lafarge* merger decision states the following (at paragraph 8.133), "*Assuming that the acquirer of the proposed divestiture package did not form part of any potential coordinating group, then it might be expected that, compared with the situation before the proposed JV…the size of any competitive fringe could increase in the short term, if the acquirer of the proposed divestiture package produced at or near the capacity of the Hope plant. This would tend to increase the extent of external constraints on any coordinating group…*"

10.6 As the Mittal Producer is not part of any existing coordinating group, it is CEMEX's belief that it serves to significantly increase the extent of the external constraint on any coordinating group.

[2] The Mittal Producer has significantly different incentives to those of Tarmac and other Majors

10.7 CEMEX believes that, given the composition of the Divested Assets, the Mittal Producer is a cement producer with significantly different characteristics and incentives to compete than Tarmac.

10.8 CEMEX notes in this regard that the *Anglo/Lafarge* merger decision states (at paragraph 8.148), "*the proposed divestiture would replace Tarmac with a competitor with different characteristics from Tarmac in terms of key competitive variables such as size of plant, prospects for future expansion and, to some degree, the extent of its vertical integration. Some of these factors — in particular the size of the cement plant — might increase, relative to Tarmac, the external constraint*

posed by the new competitor on any coordinating group." CEMEX agrees with the CC's conclusions here.

10.9 CEMEX also believes that there is considerable uncertainty over how the Mittal Producer will behave in the market, which significantly undermines any ability which GB producers' might be said to have to coordinate.

10.10 In this regard, CEMEX notes that the *Anglo/Lafarge* merger decision states (at paragraph 8.133), "*assuming that the acquirer of the proposed divestiture package did not form part of any potential coordinating group, then it might be expected that, compared with the situation before the proposed JV…there would be some uncertainty about how the new company would seek to develop its business over a longer time horizon."*

10.11 As the CC is aware, for any coordinating group to operate effectively, it requires a considerable level of certainty that all the key market participants understand, and will adhere to, the tacit agreement in place. A coordinating group cannot operate effectively if there is uncertainty over the behaviour of a maverick. CEMEX submits that the uncertainty over how the Mittal Producer will behave makes it a significant maverick and hence makes coordination virtually impossible.

10.12 The uncertainty over how the Mittal Producer will behave is partly based on the composition of the Divested Assets it has acquired. The Mittal Producer, unlike Tarmac, operates the Hope plant rather than Tarmac's Tunstead plant. The Hope plant has a significantly higher capacity than the Tunstead plant and this means that the Mittal Producer, unlike Tarmac, is "long in cement" with an incentive to acquire external customers.

10.13 CEMEX notes that the *Anglo/Lafarge* merger decision states (at paragraph 8.113) that "*the Hope plant has never been operated on a stand-alone basis and any purchaser of the divestiture package will not have a track record of operating a similar facility within the UK. The strategy of the new competitor may therefore, to some degree, be more uncertain than might otherwise be the case. The extent of such uncertainty may be affected by the identity of the purchaser of the divested business*."

10.14 The *Anglo/Lafarge* merger decision also states (at paragraph 8.113) that "*the acquirer of the divestiture package would operate a larger cement plant than Tarmac has done to date, such that any uncertainty about its strategic behaviour might potentially affect a larger share of the market"*

10.15 CEMEX believes that a purchaser such as Mittal, with no existing relationships in the GB cement sector, imposes the form of constraint envisaged by the CC in the *Anglo/Lafarge* merger decision. [✂]

10.16 [✂]. This further increases the incentive for the Mittal Producer to run the Hope plant close to capacity, reduce prices and win market share.

[3] The Mittal Producer is backed by significant financial resources

10.17 It is important to note that the Divested Assets are being acquired by Lakshmi Mittal, the richest man in Britain whose personal wealth is estimated at $16 billion.[80] It can therefore be expected that the Mittal Producer has substantial financial resources at its disposal, which it will use to invest and grow its business. This provides both the ability and an additional incentive for the Mittal Producer to compete aggressively and increase its market share.

[4] There is no danger that the Mittal Producer will increase coordination in the GB cement market

10.18 CEMEX notes that, in paragraph 8.139 of the *Anglo/Lafarge* merger decision, the CC has set out a list of possible reasons why the design of the divestiture package might hypothetically increase coordination in the GB cement market, compared to the pre-JV scenario. However, the CC has, in each case, also explained why the risk of this happening is substantially reduced by the specific design of the divestiture package.

10.19 CEMEX agrees with the CC regarding the minimal risk of the divestiture package increasing coordination and notes that the risks identified by the CC are further reduced by having the Mittal Producer as the purchaser of the divested assets as Mittal does not have any existing relationships in the GB cement market.

Conclusion on the effect of the acquisition of the Divested Assets by Mittal

10.20 CEMEX believes that the entry of the Mittal Producer has fundamentally altered the competitive dynamics of the cement market in GB. The Mittal Producer is a completely new entrant, both to the cement industry in general and the GB cement market, in particular. It has no existing relationships within the industry in general or with the Majors. In addition, it has a different set of assets and a different vertical structure to that of Tarmac and other Majors and has every incentive to compete and grow its market share.

10.21 In the presence of a maverick such as the Mittal Producer, it is not clear to CEMEX how, to the extent that the CC finds that historically there was any coordination in the GB cement market, such coordination can be maintained. Hence CEMEX considers that it is of the utmost importance that the CC take into account the impact of the entry of the Mittal Producer in reaching its findings and considering remedies (if any).

[80] Forbes, available at: http://www.forbes.com/profile/lakshmi-mittal/.

11 POLICY AND REGUALTION

11.1 For the purposes of this response CEMEX makes a limited number of points, primarily in relation to the EU ETS which it believes that the CC should take into account in its assessment.

[1] Barriers to entry for new entrants

11.2 The CC has correctly identified that CEMEX had submitted to the CC that provided that the New Entrant Reserve had sufficient carbon allowances available, new entrants to the EU ETS would not be prejudiced in any way in respect of entry into the market. This statement is not at odds with Tarmac's submission that a new entrant would only be able to apply for carbon allowances once it had built and commenced operations at its new plant. Although the cost of building a plant could obviously be considered to be a barrier to entry, this is not a barrier created by the EU ETS. In fact, the lack of restrictions on new entrants is clearly demonstrated by the fact that at the end of Phase II carbon allowances for new entrants had not been exhausted.

[2] Overall impact of the EU ETS

11.3 Although CEMEX has stated in its previous submissions that the EU ETS "drives efficiencies in the sector, and encourages, rather than distorts competition", the CC should be clear that this statement referred to Phase II of the EU ETS, in which the number of allowances allocated to the cement sector has meant that GB cement producers have not had to pass on any costs of the EU ETS to customers. However, in Phase III it is unlikely that the allocation of free allowances will be sufficient to cover all emissions and therefore GB cement producers (including CEMEX) are likely to need to buy additional allowances. This is a cost which producers outside the EU will not have to bear and which, along with other benefits such as cheaper electricity, will provide them with a significant competitive advantage over producers in the EU who are subject to the EU ETS.

[3] The EU ETS partial cessation rule increases the incentives for non-GB producers to export cement to the UK

11.4 As the CC is aware, the EU ETS partial cessation rule applies where one sub-installation, which contributes at least 30 percent of the installation's final annual amount of emissions allowances allocated, or contributes to more than 50,000 allowances, reduces its activity by at least 50 percent of its historic activity level ("HAL").

11.5 If activity levels are reduced between 50 and 75 percent of HAL, then the amount of free carbon allowances the installation will receive will reduce by half the following year. If activity levels are reduced between 75 and 90 percent of HAL, then the amount of free carbon allowances the installation will receive will reduce by 75 percent the following year. If activity levels are reduced by 90 percent (or more) of HAL, then the installation will receive no carbon allowances the following year.

11.6 In addition, if the HAL increases back up to 50 percent then the level of free allocation is restored. Similarly, if the HAL increases back up to the 25 percent to 50 percent range, half the free allocation is restored.

11.7 CEMEX has submitted to the CC that, given the value of the free carbon emissions allowances, a cement producer in a country such as Spain or Ireland, which has undergone a significant building boom and bust, will be incentivised to produce cement for import to the UK in order to maintain the level of its free carbon allowances. CEMEX notes, however, that the CC, in the UIS, has indicated that this effect of the EU ETS may be overstated as: (a) it applies equally to all cement producers; (b) it applies only when production is near the threshold of 50 percent of HAL; and (c) it applies only to producers whose geographic location makes them suitable for exporting to GB. CEMEX addresses each of these points in turn.

(a) **Application to Cement Producers**

11.8 First, CEMEX accepts that the partial cessation rule applies to all cement producers. However, the point CEMEX is making is that the rule has a particularly significant effect on cement producers in countries such as Spain, Portugal and Ireland, which have undergone significant building booms (and hence had high HALs) but which are now experiencing a severe downturn in activity. This has resulted in a number of cement producers in these countries being at risk of operating at below 50, 75 or 90 percent of HAL. Hence, producers in these countries, when compared to GB producers, are particularly incentivised to produce cement for export to GB in order to meet the 10, 25 or 50 percent HAL threshold in order not to lose their free allocations of emissions allowances.

11.9 Furthermore, as discussed at the Hearing, producers have a greater incentive to sell marginal output in an overseas market (which may reduce prices in those markets), rather than sell it on their own domestic market. [81]

(b) **Effect of the thresholds**

11.10 Second, the CC suggested at the Hearing, that the effect of the partial cessation rule encouraging cement imports into GB applies only when production is near the threshold of 50 percent of HAL. [82] As a technical point, this is incorrect. The partial cessation rule will encourage imports into GB when production is near the 10 percent or 25 percent threshold as well. In this regard, CEMEX notes that it is likely that a number of cement producers in continental Europe are close enough to one of the 10, 25 or 50 percent thresholds to make it profitable for them to produce cement for export to GB, with a view to selling to GB customers at marginal cost or even (before taking account of EU ETS allowances) at a loss. Furthermore, different cement producers will be close to these thresholds at different times which means that this incentive encouraging imports is an on-going feature of the market.

11.11 In this regard, CEMEX notes that Lafarge has provided an illustration of the financial impact of the partial cessation rule on a cement producer's production incentives. CEMEX has not seen the confidential figures provided by Lafarge, but sets out below its own calculation, [✂].

11.12 [✂]

[81] CC, *Notes of Hearing with CEMEX*, 7 December 2012, p. 121 onwards.

[82] CC, *Notes of Hearing with CEMEX*, 7 December 2012, p. 121 onwards.

11.13 It is clear from the above illustration that that for a producer operating an average cement plant, it would be profitable to produce up to double the cement than it is able to sell domestically in order to retain its carbon allowances. This provides a very strong incentive to continental cement producers to export cement to the GB market, even (before taking account of EU ETS allowances) at a loss.

11.14 Third, CEMEX is aware that certain cement producers in Ireland are exporting cement to the UK, and selling it at a loss (for example, [✂]). CEMEX believes that this is being done in order to maintain levels of free allocations of emissions allowances.

11.15 Fourth, CEMEX notes that in Phase III of EU ETS the EU is seeking to introduce measures that would raise or, at the very least maintain, the price of carbon allowances. In particular, the EU is proposing to postpone the auction of 900 million allowances from 2013-2015 until the end of Phase III with the aim of supporting the price of allowances through restrictions on their supply. These measures indicate that the carbon price will be maintained, or will increase, in the medium term, providing an even greater incentive to non-GB cement producers to export cement into the UK in order to maintain their carbon allowances.

(c) **Geographic location**

11.16 Finally, CEMEX accepts that the partial cessation rule encourages exports only from producers at geographic locations which makes them suitable for exporting to GB. However, CEMEX notes that all existing exporters, almost by definition, are within a suitable distance to import to GB. Hence this does not reduce the number of importers on which the partial cessation rule has an effect. In addition, CEMEX's argument relating to the effect of the partial cessation rule relates primarily to cement producers in countries such as Portugal, Spain and Ireland, all countries which are suitably close to the UK and countries from which cement is currently imported to GB.

[4] GB cement producers will be further incentivised to export to the UK with the introduction of the UK Carbon Floor Price

11.17 CEMEX notes that the CC has not addressed in the UIS CEMEX's argument in paragraph 8.13 of its Initial Response that the introduction of the carbon floor price in the UK in April 2013 will strengthen the position of cement manufacturers exporting to GB. The UK Government has now announced that the target carbon price will start at about £16t/CO_2 in 2013, rising to £30t/CO_2 in 2020. This equates to a carbon price floor support rate of £4.94 t/CO_2 in 2012-13 which is only likely to increase with time. GB producers will inevitably seek to pass on the additional costs of the carbon floor price, making them less competitive when compared to cement importers from both within and outside the EU. The potential effects of the carbon price floor are so stark that the independent think tank CIVITAS published a report in December 2012 on the effects of carbon-reduction targets on energy intensive industries.[83] This report describe the carbon price floor as "*a good example of an ill-designed unilateral policy that simultaneously undermines competitiveness and institutionalises carbon leakage*". The carbon price floor therefore increases the cost of producing cement in GB and is a point which requires careful consideration.

[83] See http://www.civitas.org.uk/economy/IdeasFEG2.pdf.

[5] GB cement producers are disadvantaged by the UK Government not taking the option to compensate GB cement producers as provided for in the EU ETS

11.18 CEMEX notes that the CC has not addressed in the UIS, CEMEX's argument in paragraph 8.14 of its Initial Response that the UK Government is unlikely to adopt the option in Article 10a(6) of the EU ETS Directive that allows for the compensation of cement producers who are subject to increases in electricity prices due to EU ETS. The UK Government published a public consultation in October 2012 which proposed measures for a £250 million compensation scheme for energy intensive industries. This scheme is designed to compensate such industries from the indirect costs created by the EU ETS and the carbon price floor mechanism (and in particular to compensate for the increases in energy costs caused by these schemes). The UK consultation makes it clear that such compensation will only be available for those sectors which are set out in European Commission Communication 2012/C158/04. These sectors do not include the production of cement and therefore it appears unlikely that GB manufacturers of cement, such as CEMEX, will be able to take advantage of such compensation. This puts GB cement producers at a competitive disadvantage to manufacturers in countries such as France, Germany and Spain, who benefit from more benign electricity price regimes. This increases the incentives of cement manufacturers in these countries to import cement into GB and is another point which requires careful consideration.

11.19 The competitive disadvantage that GB energy intensive industries will be subject to as a result of the proposed compensation scheme is picked up in the House of Commons Environmental Audit Committee Report on the Energy Intensive Industries Compensation Scheme published on 4 January 2013 ("EAC Report").[84] The EAC Report finds that in respect of the methodologies for calculating compensation and the sectors that are eligible for compensation:

"*The compensation scheme being proposed by the Government has been closely modelled on the calculations and eligibility criteria issued by the European Commission, to ease the State Aid approval process for the scheme. In some areas, however, the Government has applied elements of the Commission's calculation in a potentially more stringent way than some other countries might be doing. The Government should review the operation of the compensation scheme after its first year, to ensure that it remains reasonable in view of the costs actually being incurred by energy intensive industries and does not put UK businesses at a competitive disadvantage*." (paragraph 53)

11.20 The EAC Report goes on to recommend that:

"*The Government should monitor development of compensation schemes for indirect energy and climate change policy costs in other EU member states for signs of competitive disadvantage. It should review the case for a UK compensation scheme beyond 2014-15 using such data, taking account of aggregate subsidies and disbursements in other countries beyond those linked to the EU Emissions Trading Scheme"* (recommendation 11).

[84] See http://www.publications.parliament.uk/pa/cm201213/cmselect/cmenvaud/669/669.pdf.

11.21 This recommendation is echoed by the CIVITAS report referred to in paragraph 11.17 above which recommends that:

"*The Government should scale back UK carbon costs where they exceed European levels and ensure that any exemptions to European directives are applied to the maximum extent allowed under law*".

[6] GB cement producers operate at a significant cost disadvantage

11.22 CEMEX notes that the CC has not addressed in the UIS, CEMEX's argument in paragraph 8.15 of its Initial Response that GB cement operations in any event operate at a significant competitive disadvantage across a number of key measures including price, incentives, tax relief and rebates and other exemptions compared to other countries, which encourages imports. The UK has some of the most expensive wholesale commodity prices in Europe, with it being estimated that carbon costs alone for the GB cement industry will be EUR 65 million in 2013 (or over 10 percent of the industry's revenue). In addition, there are other costs associated with producing cement in GB, which significantly increases regulatory costs for GB cement producers.

11.23 The high costs of cement manufacture in the UK put GB cement producers at a competitive disadvantage to manufacturers in continental Europe, which face fewer regulatory costs. This point is succinctly made by the CIVITAS report referred to at paragraph 11.17 above which states that "*It is accepted across the political spectrum that a manufacturing revival is needed to put the UK economy on a course of sustainable growth. For this to happen, the UK Government needs to ensure that UK based energy intensive industries have an internationally competitive cost base. They currently do not*." This increases the incentives of cement manufacturers in these countries to import cement into GB and is a further point which requires careful consideration.

Conclusion on Policy and Regulation

11.24 It is clear from the above, and a number of points made by CEMEX at the Hearing, that a number of features of government policy and regulation give both non EU producers, and EU producers outside GB, a cost advantage compared to GB cement producers. While CEMEX would welcome recommendations from the CC to amend these features, and reduce these distortions of competition, its primary point is that these features facilitate and encourage imports of cement into GB in a manner which is wholly incompatible with any theory of coordination in the GB cement market.