Anticipated acquisition by Lafarge Cement UK of Port Land Cement Company Limited

The OFT's decision on reference under section 33(1) given on 13 October 2005. Full text of decision published 21 October 2005.

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' or third parties' request.

PARTIES

1. **Lafarge Cement UK (LCUK)** is the British cement arm of the Lafarge Group, a major supplier of cement in Great Britain (GB). The group's consolidated UK turnover for 2003 was [ ].

2. **Port Land Cement Company Ltd (Port Land)** is an importer of cement based in the South East of England. It started importing cement from Turkey to GB in May 2003 and sells both bulk and packed grey cement. In the financial year ending 30 April 2004, Port Land generated a turnover of [ ].

TRANSACTION AND RATIONALE

3. LCUK is proposing to acquire the entire share capital of Port Land for a consideration of [ ]. LCUK currently supplies cement to the South East region from its Northfleet cement works but this is due to close in 2008. This acquisition is part of LCUK's restructuring programme to replace the capacity that will be lost following the closure.

4. A satisfactory submission was received on 1 September 2005 and the statutory deadline for the Office of Fair Trading (OFT) to make a decision on reference is 13 October 2005.

JURISDICTION

5. As a result of this transaction, LCUK and Port Land will cease to be distinct for the purposes of the Enterprise Act 2002 (the Act). The parties overlap in the supply of cement in Great Britain, and the share of supply test in section 23 of the Act is met. The OFT thus believes that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

Product scope

6. LCUK's and Port Land's activities overlap in the supply of cement. Cement consists of various binding materials which when mixed with water set to a hard mass. LCUK currently manufactures grey cement and imports small quantities of white cement. Port Land operates a cement import terminal and imports white and grey cement into GB; it is not active in any element of cement production.

Grey and white cement

7. There are basically two types of cement: white and grey. White cement is made from raw materials which are extremely low in impurities and it is used mainly for jobs where its attractive and decorative visual impact is preferred. It is not produced in Great Britain due to a lack of suitable limestone.

8. Although it is possible to segment grey cement according to specific grades, demand and supply side considerations suggest that the different grades of grey cement are largely interchangeable. This is consistent with the decisional practice of the European Commission in relation to this product.[1]

9. It appears that white and grey cement should be treated as separate product segments. Not only are white and grey cement used for different purposes, but also white cement is produced in much more limited quantities and is significantly more expensive than grey cement. This view is also consistent with the decisional practice of the European Commission's case law in relation to this product.[2]

Imported and domestically produced cement

10. A distinction could be drawn between imported and domestically produced grey cement. However, the parties submit that imported grey cement competes directly with grey cement manufactured domestically and that from a customer perspective the two sources are substitutable. Third party responses corroborate this view stating further that there is no appreciable quality difference between the two and that cement sold in GB must meet European standards. Prices of imported and domestic are also similar.

Bulk and bagged cement

11. Bulk cement is stored in large silos and can either be dispatched in specialist bulk road tankers or packed into bags prior to distribution and dispatched in ordinary vehicles. Packaging can take place either on-site at cement works or later in the supply chain process at a depot, depending on the available facilities. Imports of grey cement is

[1] *COMP/M.2317 – Lafarge / Blue Circle II.*
[2] *COMP/M.2317 – Lafarge / Blue Circle II.*

typically transported in bulk form on container ships; once reaching the import terminal, cement can be distributed to customers in bulk form or packed into bags at the import terminal. There is no technical difference between the two forms - the difference is primarily a question of volume and packaging. In addition, bagged cement is typically more expensive than bulk, largely reflecting the additional packaging costs.

12. On the demand side, comments from third parties indicate that bulk and bagged cement serve different customers and that there is limited substitutability. Bulk cement is used by ready-mixed concrete and concrete product manufacturers who have suitable equipment to handle the product, whereas bagged cement is typically supplied to building merchants or DIY outlets.

13. The parties argue that there is a high-degree of supply-side substitutability between bulk and bagged cement, but third party views have been mixed on this point. Responses indicate that if a supplier has the equipment in place to supply both physical forms they could switch relatively quickly. If this is not the case, switching from bulk to bagged supply would involve the installation of packaging facilities, which is not likely to happen in a timely manner in response to a 5-10 per cent price increase.

Conclusion

14. The above analysis suggests it is appropriate to examine white cement separately from grey cement. In addition, the supply of bulk grey cement and the supply of bagged grey cement are considered separately, although this distinction does not substantially affect the competitive analysis and therefore it is not necessary to conclude on whether they constitute two separate relevant markets. In all cases, no distinction is drawn on the basis of whether or not the cement in question is imported.

Geographic market

15. Evidence before the OFT suggests that cement suppliers compete at two geographical levels: at the regional level (where large cement producers compete with independent importers) and at the national level (where large cement producers compete primarily between themselves and are not constrained to any material degree by the independents). This is because regional importers supplying from a single depot are limited in terms of the economically viable distance over which they can supply cement; such distance is estimated to be within a radius of between 100 and 150 miles from the depot. The geographic scope of the market is largely determined by transportation costs, which have a linear relationship with delivery distance.

16. The location of Port Land’s import terminal (in Kent,) makes it particularly well suited to serve customers in the South East and Eastern regions of England. Although [ ] of Port Land’s sales are made to customers in the South East, the following factors indicate that conditions of competition in the supply of cement may be sufficiently homogeneous between the South East and Eastern regions of England to include the two areas in a single geographic frame.

17. First, considering as a proxy an area within a 125 mile radius from the Port Land import terminal (based on the mid point of the distances mentioned in paragraph 15 above), this exercise produces an area which is slightly larger than the Eastern and South East regions of England. Second, the average price of cement supplied to LCUK's customers in the two regions have been within [0-5 per cent] of each other over the past three years, and the average price charged by Port Land to its South East customers is the same as that charged to customers in the Eastern region.

18. The OFT has therefore analysed the effects of the proposed transaction on the basis of a combined South East and Eastern regions. In addition, notwithstanding its conclusions above, it has also considered whether its findings would be any different if the relevant geographic frame of reference were taken to be either GB or the South East region.

HORIZONTAL ISSUES

White cement

19. Port Land supplies only very limited quantities of white cement: in 2004 it supplied a total of [CONFIDENTIAL] of white cement in packed form. This represents [less than 1 per cent] of the total GB supply of packed white cement ([ ]). The accretion to LCUK's current share of supply in this segment ([40-45 per cent]) is therefore too small to give rise to any possible competition concerns and so this sector is not considered further.

Grey cement

National issues

20. At a GB level, Port Land's share of supply of bulk grey cement is [less than 1 per cent], and there are four other independent importers with a greater market presence. The merger would increase LCUK's share of supply [by less than 1 per cent] from [its existing share of 45-50 per cent]. For packed grey cement, Port Land's share of supply is [less than 5 per cent] and there are two other independent importers with a higher market share, as well as two large domestic producers, in addition to LCUK. The merger would increase LCUK's share of supply [by less than 5 per cent] from [its existing share of 50-55 per cent].

21. In view of these very low accretions to the shares of supply, there does not appear to be a realistic prospect of a significant lessening of competition as a result of the merger at the national level.

Regional issues

22. In the South East and Eastern region, the merged entity would have a combined share of supply of [45-50 per cent] in bulk cement and [52-57 per cent] in packed cement. The increments would be of [0-5 per cent], respectively. The merged entity will

continue to face competition from two national suppliers (Heidelberg/Castle and Cemex/RMC) and from a number of smaller independent importers.

23. Taking the South East region in isolation, the merged entity would have a share of supply of [60-65 per cent] (bulk) and [60-65 per cent] (packed), with a [0-5 per cent] (bulk) and [0-5 per cent] (packed) increments. Port Land is the largest independent importer in this region, and is the only importer with a market share greater than 1 per cent in packed cement.

24. The grey cement markets in the South East and in the combined South East and Eastern region are already highly concentrated and in these circumstances the increases in the HHI which will result from this merger provide preliminary grounds for concern (greater than 100 in the South East and Eastern region for bulk and packed cement, and 318 for packed grey cement in the South East). [ ]

25. On the other hand, other competitors (both national and regional players) in these areas also appear to have a considerable amount of spare capacity which could be brought on line within a very short period of time and at little cost. [ ]

26. Furthermore, it appears from the OFT's investigation that switching is relatively easy and costless, in particular for smaller customers (which make up most of Port Land's customer base).

27. On this basis, the OFT has concluded that, following the merger, even small customers' ability to switch in the event of a price rise to other suppliers who are active in the area will not be adversely affected.

Co-ordinated effects

28. Cement is a concentrated industry, with a history of cartelisation. In principle, a reduction in the number of players makes the prospect of coordination more likely, in particular when the target of the acquisition is a regional independent importer who could be important in destabilising oligopolistic behaviour by incumbent suppliers. However, post-merger a number of independent importers will continue to be active in the relevant region and [ ]. In these circumstances, it is not considered that this transaction will increase the risk of coordination.

Barriers to entry

29. The parties submit that barriers to entry for importers wishing to supply grey cement in GB are low. In particular, they submit that the initial capital investment required is not very high,[3] and that the timeframe required to setup an import terminal is not

[3] Roughly £100,000 to £400,000 where facilities already exist, and between £600,000 to £1 million for a new terminal building with flat storage and warehouses.

excessive,[4] even though the time frame and investments necessary in order to gain a 5 per cent market share at national level would be much greater. There have been recent new entrants in the South East and Eastern regions, such as Southern Cement, Dudman Cement and Port Land itself, although not all have been successful (Derby Cement, which started importing cement in 2002, ceased trading in 2004).

30. The balance of evidence suggests that barriers to entry are low; however, as there remains sufficient existing and, by way of expansion, potential competition to allay competition concerns post merger, it is not necessary to conclude definitively on this point.

Buyer power

31. The parties submit that both small and large customers face low switching costs and a choice of cement supplier which enables them to exercise buyer power by switching or credibly threatening to switch suppliers. Third party responses indicate that large customers can negotiate prices at national level and obtain favourable volume discounts, and that customers are generally price sensitive and face low switching costs.

32. However, given the lack of competition concerns arising from this merger, no conclusion is necessary on issue of countervailing buyer power.

VERTICAL ISSUES

33. This transaction does not raise any vertical issues.

THIRD PARTY VIEWS

34. Third parties were generally unconcerned about the merger, except for one small customer who worried that the acquisition would lead to a loss of choice (since it is too small to be supplied by the major competitors) and consequently to higher prices.

ASSESSMENT

35. This transaction leads to the loss of Port Land, an independent cement importer in the South East of England. Although its shares of supply are negligible (the highest being [0-5 per cent]), this may understate the constraint it represents (especially in relation to smaller customers) given the highly concentrated nature of the industry and Port Land's ability to increase its capacity.

36. On the other hand, the merged entity will continue to face competition from two national competitors as well as from a number of smaller independent suppliers which are active in the South East and East of England. Moreover, there is evidence that

[4] Between six and twelve months.

both groups of suppliers have spare capacity which could be brought on line quickly and cheaply. Switching costs are low and customers tend to be price sensitive. In these circumstances, the OFT has discounted the possibility that this transaction may result in either unilateral or co-ordinated anti-competitive effects since customers will continue to be able to switch to alternative suppliers in the event of a price rise.

37. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

38. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.