Anticipated acquisition by Lafarge Cement UK of the West Thurrock Cement Terminal from Castle Cement Ltd

The OFT's decision on reference under section 33(1) given on 10 June 2005. Full text of decision published 27 June 2005.

Please note square brackets indicate information excised or replaced by a range at the request of the parties for reasons of commercial confidentiality

PARTIES

1. **Lafarge Cement UK (LCUK)** is the British cement arm of the Lafarge Group. LCUK is one of the major suppliers of cement in the United Kingdom, with a number of grey cement works and depots. In 2003, the Lafarge Group had UK turnover of [ ].

2. **Castle Cement Ltd (Castle)** is the UK arm of the global cement producer Heidelberg Cement Group. It owns a number of cement works and import terminals in the UK, including one in West Thurrock, Essex, which is the target of this transaction. In 2003, Castle's West Thurrock turnover was £[ ] (£[ ] from imports).

TRANSACTION

3. LCUK proposes to acquire Castle's West Thurrock import terminal (West Thurrock) for a purchase price of £[ ]. LCUK currently supplies cement to the South East region from its Northfleet cement works. This site is due to close in 2008 because the lease at the Northfleet Eastern Quarry is due to expire in April 2008 and cannot be extended. This acquisition is part of the restructuring programme to replace the capacity that will be lost following the closure.

4. The administrative deadline is 10 June 2005.

JURISDICTION

5. The parties argued that the transaction amounted to a sale of assets rather than of an enterprise. However, third party enquiries suggest that [ ] would continue to seek their supplies from West Thurrock after the merger. This suggests that what is being sold is an ongoing enterprise, and that two enterprises will cease to be distinct for the purposes of the Enterprise Act 2002 (the Act).

6. The parties overlap in the supply of grey cement in Great Britain (GB), and the share of supply test in section 23 of the Act is met.

7. The OFT thus believes that it is or may be the case 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

8. LCUK and West Thurrock's activities overlap in the supply of cement.[1] Cement consists of various binding materials which when mixed with water set to a hard mass.

Grey cement

9. There are two basic types of cement: white cement and grey cement. White cement is not produced in Great Britain due to a lack of suitable limestone. West Thurrock only imported [ ] of white cement in 2004 and LCUK does not supply white cement to third parties. There is no overlap[2] in and no third party concerns relating to supply of white cement and this sector is thus not considered further.[3]

10. There are different types of grey cement and it may be possible to refine the product scope to specific grades. On the demand-side, the parties argue that customers may purchase pre-blended cement or pure cement and make their own blends. Furthermore, previous EC cases considered different types of grey cement as largely interchangeable.[4] On the supply-side, the parties maintain that any cement manufacturer can produce pure cement and/or different grades of blended cement and that there is nothing fundamentally different between the manufacturing processes of each type.

Imported and domestically produced cement

11. The West Thurrock terminal has a dual function: it can be used as an import terminal (to receive seaborne cement imports for onward distribution to customers) and as a depot (to distribute cement manufactured elsewhere). Castle has used West Thurrock principally as a depot for cement sourced from its plants elsewhere in the UK. Castle maintains that West Thurrock as an import terminal is currently underutilised [ ][5]. LCUK does not import cement[6].

12. A distinction could be drawn between imported and domestically produced grey cement. The parties submit that imported grey cement competes directly with grey cement manufactured domestically and that from a customer perspective the

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[1] Castle imported 14Kt of alumina, used for casting in aluminium, [ ]. There is no overlap in this segment, and therefore it will not be considered further.
[2] LCUK has reminded the OFT that it did indicate it supplied some white cement. However, the overlap is small and does not raise any competition concerns.
[3] The European Commission identified white cement as a separate product segment because it is used for different purposes, it is produced in much more limited quantities and it is significantly more expensive than grey cement (*COMP/M.2317 – Lafarge / Blue Circle II*).
[4] *COMP/M.2317 – Lafarge / Blue Circle II.*
[5] West Thurrock has a throughput capacity of 600Kt per annum. In 2004, [ ] of imported cement passed through the terminal and currently [ ] are being made via West Thurrock.
[6] LCUK has reminded the OFT that it did not import any 'material' volumes of grey cement.

two sources are directly substitutable. Third party responses corroborate this view stating further that there is no appreciable quality difference between the two and that cement sold in Great Britain must meet EC standards. Prices of imported and domestic are also similar.

Bulk and bagged cement

13. 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. Equally, imports of grey cement are 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. Technically, there is no variation in the different forms. The difference is primarily a question of volume and packaging; in addition, bagged cement is typically more expensive than bulk.

14. On the demand-side, comments from third parties indicate that bulk and bagged cement serve different customers and that there is limited demand-side substitution. Bulk cement is used by ready-mixed concrete and precast manufacturers who have suitable equipment (silos, mixers) to handle the equipment. Bagged cement is supplied to building merchants or DIY outlets.

15. On the supply-side, the parties argue that there is a high-degree of supply-side substitutability, 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 a packaging machine and a palletiser. Switching from bagged to bulk appears to be more costly as it would involve the installation of specialist machinery and the purchase of specialised vehicles.

Conclusion

16. It does not seem appropriate for the purposes of this analysis to distinguish between imported cement and cement produced in the UK, nor is necessary to conclude on whether different types of cement should be considered separately. The above analysis points towards taking, as a starting point for examining this case, all different types of grey cement under the scope of grey cement collectively, regardless of whether it is produced domestically or abroad. The analysis also points to taking the supply of bulk grey cement and the supply of bagged grey cement separately.

Geographic scope

17. Within the supply of grey cement sector, it appears that the geographic scope is determined by transportation costs.

18. Although some third parties responses indicated that the distribution process of bagged cement differs slightly from bulk and that bulk cement could be somewhat cheaper to transport than bagged, the balance of evidence on this topic appears inconclusive. As issues regarding the definition of geographic scope are the same

for each physical form of cement, it seems reasonable to consider both together.

19. It appears that cement suppliers compete on two dimensions: on a regional and national level.

20. Competition between large cement producers and independent importers is more likely to take place at a regional level. Regional importers supplying customers from a single import terminal are limited in terms of the economically viable distance that they can travel. The parties submit that data on West Thurrock's customer base indicates that 80 per cent of its annual sales are to customers in the South East, with customers on average being located 53 miles (range 2 - 430 miles) from the terminal.

21. Nonetheless, West Thurrock does supply the West Midlands, East Anglia, the East Midlands, the South West and also Northern England, Scotland and South Wales. It is also possible that chains of substitution could expand the geographic scope.

22. On the demand side, it appears that the geographic scope is immaterial to the majority of customers who get cement delivered. On the other hand, location is an issue for customers who collect cement.

23. On the supply side, cement is typically transported between 0-175 miles. There appears to be a number of national players that can expand distribution through either a network of depots or travelling longer distances, but it is unclear how easily and quickly smaller players could expand distribution to constrain the merged entity.

24. Based on the information available, it is difficult to conclude definitively on the relevant geographic frame of reference. Nevertheless, it appears that competition between large cement producers does take place at a national level, and that many customers require and negotiate national distribution contracts.

25. In view of the foregoing, it seems appropriate to consider competition at both the regional (i.e., the South East) level and national (i.e. GB) level.

HORIZONTAL ISSUES

National issues

26. At a Great Britain level, the merger is unlikely to cause competition concerns. The transaction does not appear to alter the national distribution networks of the parties. Comments from third parties maintain that West Thurrock appears to be redundant and Castle submits that it is underutilised. The parties combined share of supply for bulk cement is [40-50 per cent] (increment [less than 1 per cent]) and for bagged cement is [45-55 per cent] (increment [less than 1 per cent])[7].

27. In the absence of third party concerns and low accretions to national share of supply, it is considered that there is no realistic prospect of a significant lessening of competition at the national level.

[7] See Table 1.

Regional issues

28. The figures on Table 2 show that, post-merger, the parties' combined share of supply for bulk and bagged cement supplied to the South East is [55-65 per cent] (increment [less than 5 per cent]) and [55-65 per cent] (increment [less than 5 per cent]), respectively. Castle will remain in the market after the transaction as an independent supplier.

29. LCUK argues that West Thurrock should not be considered as a stand alone source of supply since the transaction does not involve the transfer of any sales in respect of grey cement. It submits that West Thurrock represents one element of Castle's overall supply chain and customers choose a particular supplier to meet their grey cement requirements rather than an individual plant or depot. Following the closure of LCUK's Northfleet terminal and the sale of West Thurrock from Castle to LCUK, both parties maintain that they will re-route their supplies to existing customers.

30. In order to analyse this issue, the post-merger competitive interaction between the parties needs to be considered in respect of: (i) whether Castle has enough capacity to substitute imported cement from other sites to the South East region as well as enough storage and distribution capacity to utilise alternative plants or depots to replace West Thurrock's depot functionality; (ii) whether Castle is logistically able to supply customers of West Thurrock from other sites; and (iii) whether West Thurrock's customers can switch suppliers.

31. Castle submits that it will continue to have sufficient capacity to remain an effective actual and potential competitor to LCUK. West Thurrock has a throughput capacity of approximately 600Kt per annum, [ ]. The low throughput is confirmed by a number of third parties who maintain that West Thurrock has remained dormant over the last few years.

32. Castle submits that its import terminals are underutilised and that it can respond to an increase in demand.

33. Turning to the storage and distribution capacity of alternative sites to replace West Thurrock's depot functionality, the parties maintain that Castle could supply directly from its Ketton cement works or transfer activities to its Kings Cross depot. Furthermore, they maintain that Castle could set up a depot at relatively little cost. Post-merger, it appears plausible that Castle has the capacity to meet West Thurrock's supply, but the logistics of supply raises further questions.

34. Logistically, transferring Castle's supply from its West Thurrock terminal to other sites may be difficult and this may result in an accretion to LCUK's share of supply. Castle maintains that customers place their orders centrally rather than with an individual plant, depot or terminal and that Castle decides the best source of supply for those customers. This however is only applicable to those customers who get cement delivered in contrast to those that collect from the supplier. In 2004, approximately [ ] ([ ] per cent of West Thurrock's throughput) was delivered.

35. [ ]

36. For customers who currently collect from West Thurrock, out of the [ ] currently collected, [ ] is collected by LCUK itself. Castle maintains that customers may switch to delivered cement or collect from another site.

37. Customers have more than one choice of cement supplier in the South East. As shown in Table 2, Cemex/RMC supplies approximately [15-25 per cent] of bulk and [15-25 per cent] of bagged cement in the region. Furthermore, Tarmac and a number independent importers (e.g., Derby[8], Dragon, Dudman, Paragon, Port Land and Southern) remain. Respondents indicate that they are price sensitive and face relatively low switching costs. Switching costs may vary depending on the customer and the sector in which it operates.

38. To conclude, the resulting increments to the share of supply appear to over represent the competitive impact of the transaction. Assuming that customers who currently collect their purchases remain at West Thurrock [ ], the increment to LCUK is [*de minimis*]. It is not possible to subdivide the tonnage by bulk or bagged cement, but even if the [ ]Kt is allocated to each group, the increment to bulk and bagged segment is less than 0.5 per cent.

Co-ordinated effects

39. Cement is a homogenous product with relatively few major players in the industry. The OFT has therefore considered whether transaction may increase the likelihood that post-merger the parties may tacitly (or explicitly) coordinate their behaviour to raise price, curtail output or engage in market sharing. In order for this to be successful or to become more likely, the OFT considers whether the participants have the ability and incentive to align behaviour, and whether collusion is sustainable.

40. In this case, the merger does not appear to change the ability of the parties to align their behaviour. After the merger, Castle will maintain distributional facilities in the South East region. Moreover, there is limited accretion to share of supply, suggesting a minimal impact on incentives to collude.

Entry and expansion

41. The parties submit that barriers to entry are relatively low and estimate that the cost of setting up a new depot is typically between £2 million and £3 million. This is sustained by evidence provided by LCUK that illustrates cost projections for building a typical 12Kt bulk storage and distribution depot. Furthermore, the parties indicated a number of examples of new cement depots set up in 2003/2004 in the South East.

42. It is more costly to construct an import terminal than to build a depot. LCUK's internal documentation shows that at the present time it would cost in the region of £[ ] to build an equivalent site to West Thurrock terminal. Third party estimates vary considerably, with lower estimates starting at approximately £2 million, going up to £25 million. Site construction may vary considerably on the scale of operation required.

[8] Derby ceased trading in October 2004.

43. There is evidence of entry in the independent terminal business, but only from independent importers. New entrants include Dudman Cement, Paragon, Southern Cement, Derby Cement and Port Land. Comments from third parties suggest that a new entrant would be unable to achieve a 5 per cent share of supply. Nevertheless, entry may constrain the parties to some degree.

VERTICAL ISSUES

44. There is no evidence to suggest that significant vertical issues arise in this case.

BUYER POWER

45. Comments from third parties indicate that the majority of larger customers negotiate annual nationwide contracts. When purchasing large volumes, customers may be able to have some degree of buyer power. It is unlikely that smaller customers will be able to exert any buyer power. However, given the lack of competition concerns arising from this merger, no conclusion is necessary on issue of countervailing buyer power.

THIRD PARTY VIEWS

46. Third parties did not express any concerns about the transaction.

ASSESSMENT

47. The transaction qualifies on the share of supply test under the Enterprise Act 2002. For the purpose of this decision, the appropriate frames of reference are taken to be the supply of bulk and bagged grey cement at both the national (Great Britain) and regional (South East of England) level.

48. At a national level, in the absence of third party concerns and low increments to national share of supply, it is considered that there is no realistic prospect of a significant lessening of competition.

49. At a regional level, although this is a concentrated sector, the increment in the share of supply appears to over represent the impact of the transaction because Castle remains a competitor post-merger. Assuming that customers who currently collect remain at West Thurrock and [ ], the increment to the bulk and bagged cement segments is less than 0.5 per cent. Furthermore, customers have more than one choice of cement supply in the South East, and appear to be price sensitive and face relatively low switching costs.

50. 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

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

TABLE 1 GREAT BRITAIN SHARES OF SUPPLY OF GREY CEMENT IN 2004				
Company	**Bulk**		**Bagged**	
	Total third party sales (Kt)	per cent Share of total third party sales	Total third party sales (Kt)	per cent Share of total third party sales
LCUK	3,500-4,000	40-50	1,000-1,500	45-55
West Thurrock terminal	0-100	0-5	0-100	0-5
Combined	*3,500-4,000*	*40-50*	*1,000-1,500*	*45-55*
Castle (Other)	2,000-2,500	25-35	500-1,000	20-30
Cemex/RMC	1,000-1,500	15-25	0-500	10-20
Anglo American/Tarmac	0-500	0-5	0-100	0-5
Channel (Importer)	0-100	0-5	0-100	0-5
CMS (Importer)	0-100	0-5	0-100	0-5
Derby (Importer)	0-100	0-5	0-100	0-5
Dragon (Importer)	0-500	0-5	0-100	0-5
Dudman (Importer)	0-100	0-5	0-100	0-5
Morrissey (Importer)	0-100	0-5	0-100	0-5
Paragon/Aggregate Industries (Importer)	0-100	0-5	0-100	0-5
Port Land (Importer)	0-100	0-5	0-100	0-5
Quinn (Importer)	0-100	0-5	0-100	0-5
Southern (Importer)	0-100	0-5	0-100	0-5
Titan (Importer)	0-500	0-5	0-100	0-5
Total	**8,000-8,500**	**100**	**2,500-3,000**	**100**

TABLE 2 SOUTH EAST SHARES OF SUPPLY OF GREY CEMENT IN 2004				
Company	**Bulk**		**Bagged**	
	Total third party sales (Kt)	per cent Share of total third party sales	Total third party sales (Kt)	per cent Share of total third party sales
LCUK	1,000-1,500	55-65	0-500	55-65
West Thurrock terminal	0-100	0-5	0-100	0-5
Combined	*1,000-1,500*	*55-65*	*0-500*	*55-65*
Castle (Other)	0-500	10-20	0-500	10-20
Cemex/RMC	0-500	15-25	0-500	15-25
Anglo American / Tarmac	0-100	0-5	0-100	0-5
CMS	0-100	0-5	0-100	0-5
Derby	0-100	0-5	0-100	0-5
Dragon	0-100	0-5	0-100	0-5
Dudman	0-100	0-5	0-100	0-5
Morrissey	0-100	0-5	0-100	0-5
Paragon / Aggregate Industries	0-100	0-5	0-100	0-5
Port Land	0-100	0-5	0-100	0-5
Southern	0-100	0-5	0-100	0-5
Total	**1,500-2,000**	**100**	**500-1,000**	**100**