

Draft Notice

Application for Notification

by

James Hardie and Coy Pty Limited

in relation to the manufacture and sale of
Fibre Cement Building Products

Registration nos:

N30710

Commissioners:

Fels
Broome
Asher
Cousins
Round
Hilton

File No: CN95/1

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Trade
Practices
Commission



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1 The notification

1.1. James Hardie and Coy Pty Limited (James Hardie) gave the Trade Practices Commission (the Commission) notice on 13 February 1995 under s. 93(1) of the *Trade Practices Act 1974* (the Act). The notice sets out particulars of conduct or proposed conduct relating to the manufacture and supply of fibre cement building products products (fibre cement).

1.2. In particular the conduct or proposed conduct relates to James Hardie supplying or refusing to supply fibre cement building products to CSR on condition or for the reason that CSR Limited (CSR) will not re-supply or has not agreed not to re-supply fibre cement products to distributors/resellers in any State or Territory in Australia except Western Australia and the Northern Territory (the conduct).

2 Background

2.1. The impact of the notified conduct or proposed conduct will be on the production and distribution of products used for the internal lining of commercial and domestic buildings. The most common products used in the eastern states for this purpose are fibre cement and plasterboard (internal lining products).

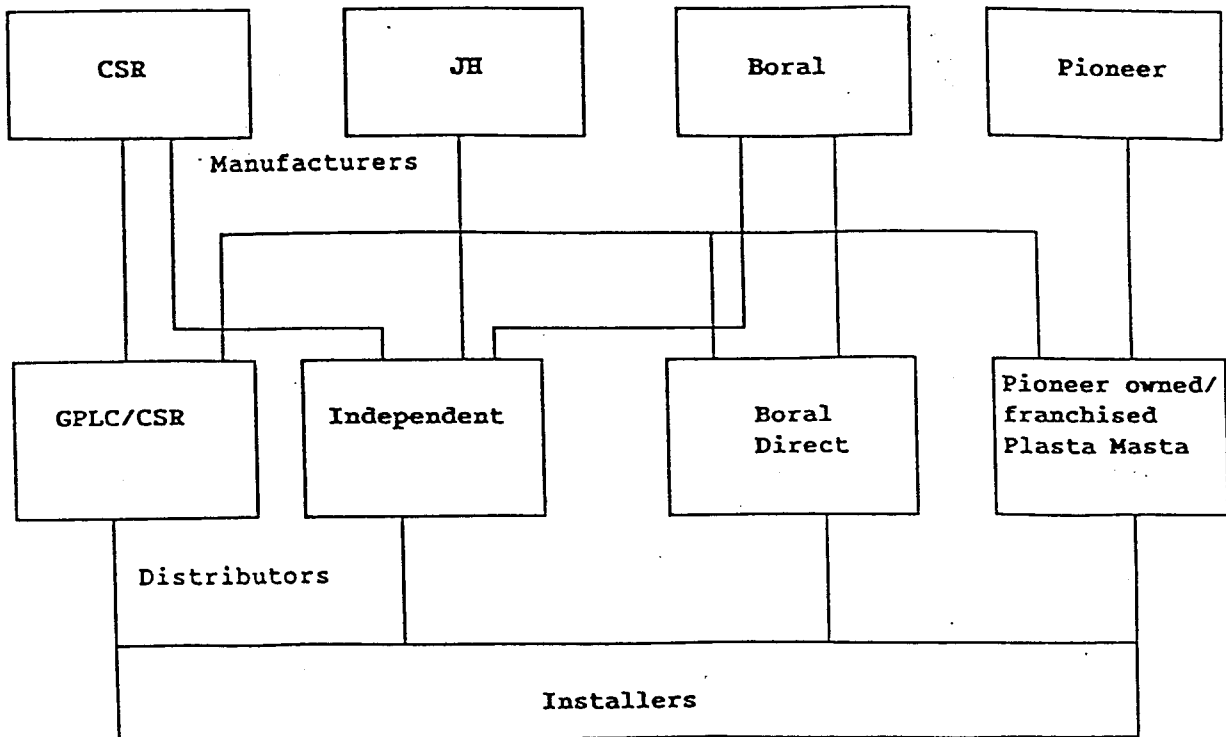
2.2. Currently James Hardie are the only manufacturers of fibre cement in a position to supply the eastern states. In October 1994 CSR indicated that it was going to open a fibre cement manufacturing plant in Sydney. Figures from the Australian Bureau of Statistics indicate that imports of fibre cement are not significant.

2.3. Fibre cement consists of panels and planks containing cellulose fibre, cement and ground sand. It is a durable, low maintenance building product which is used in both residential and commercial buildings. It is used for internal linings, particularly in wet areas such as bathrooms, kitchens and laundries. It is also used for ceilings and for external wall cladding, external decking, eaves, screens and fencing.

2.4. While CSR, Boral Plasterboard Pty Ltd (Boral) and Pioneer Plasterboard Pty Ltd (Pioneer) manufacture a wet area plasterboard, it is understood that fibre cement is preferred for wet areas. This preference is based on its water resistance.

2.5. CSR, Boral and Pioneer also manufacture plasterboard for dry areas. James Hardie does not manufacture any form of plasterboard. It is usual that for any particular job internal lining will be required for both dry and wet areas with plasterboard for dry areas being the largest component. The Commission understands that the proportion of internal linings for dry areas to internal linings for wet areas is approximately nine to one.

2.6. The internal linings board industry basically has three functional levels which are outlined in the following diagram:



2.7. The Commission understands that there is overcapacity in the supply of internal lining products

3 Summary of submissions

3.1. CSR

3.2. CSR lodged a submission with the Commission on 23 March 1995 and met with staff of the Commission to discuss the submission on 29 March 1995.

3.3. CSR states that, by its conduct, James Hardie is seeking to place barriers in the path of its entry into competition with James Hardie. Its conduct has been contrived to look like exclusive dealing and is a charade for a blatant use of its market power.

3.4. CSR asserts that there are fibre cement and internal lining board markets and provides information in relation to those markets.

3.5. In relation to fibre cement, CSR refutes the implication in James Hardie's submission which accompanies its notice, that imports are a viable alternative. It bases its view on figures supplied by the Australian Bureau of Statistics and contact with the two companies named in the application as importing product into Australia.

3.6. In relation to the internal lining boards market, CSR submits that there are markets along the eastern seaboard which are dependent on fibre cement. The markets, it submits, are the major metropolitan and regional centres.

3.7. CSR submits that there are three different functional levels: manufacturer, distributor and then the trade level. CSR has a network of 29 outlets operating at the distributor level which all sell both plasterboard and fibre cement.

3.8. CSR provided its estimates of market share figures for the internal lining board market at the distributor level for Sydney, Melbourne and Brisbane.

- In Sydney CSR has 41%; Boral 19%; Pioneer 22% and independents 18%;
- In Melbourne CSR has 33%; Boral 15%; Pioneer 20% and independents 32%;
- In Brisbane; CSR has 8%; Boral 19%; Pioneer 11% and independents 62%.

3.9. In the eastern states, for the manufacture of internal lining boards, CSR estimates that it has 35%, Boral 30%, Pioneer 20% and James Hardie 10%-15%.

3.10. CSR estimates that fibre cement for internal linings for wet areas has a market penetration of over 90% for shower recesses in Sydney and Brisbane and some 60% in Melbourne, Adelaide and Hobart.

3.11. CSR alleges that builders and plasterers wish to purchase all their internal lining board requirements from one outlet. Therefore, if CSR outlets are unable to supply James Hardie fibre cement for wet areas, they will go to other outlets. Thus the CSR outlet will not only lose its sales of fibre cement but also a substantial proportion of its sales of other internal lining boards.

3.12. CSR alleges that the conduct, which is the subject of the notification, is conduct which has the purpose, and will have the effect or likely effect, of substantially lessening competition, at both the:

- manufacturing/wholesale level of the fibre cement market, and
- distribution/trade level of the lining boards markets.

3.13. CSR provides several reasons which it alleges demonstrate that James Hardie has the requisite purpose. Finally CSR alleges that the notification regime in this matter has the effect of protecting conduct which would otherwise contravene s46 of the Act.

3.14. At the interview between CSR and Commission staff, CSR provided further information in relation to the internal lining board market.

- The total market for fibre cement is approximately 37 million square metres with the approximate value of \$276m, of which approximately \$80m is wet area internal linings.
- CSR plans to supply about 11 million square metres of fibre cement. CSR estimates that there is currently about 15% excess capacity in the supply of fibre cement.
- CSR estimates that since Pioneer started manufacturing plasterboard, supply has increased 20%-25%. The market was at capacity before Pioneer commenced supply.
- Pricing at the distribution level is very competitive. If contractors had to go to separate outlets for plasterboard and fibre cement they would have to pay for two lots of delivery.
- CSR stated that it chose to manufacture fibre cement because it appeared that there were good margins in the industry and that by manufacturing fibre cement it could obtain a competitive advantage on the distribution side of its business.
- CSR estimates that it will about twelve months before it would start supplying fibre cement.

Distributors and plasterers

3.15. A number of distributors and plasterers were contacted, the majority of whom supplied information on a confidential basis.

3.16. Both distributors and plasterers generally agreed that the inability to supply or acquire both fibre cement and plasterboard from one outlet would adversely affect their businesses. In particular, plasterers who used contract transporters were concerned that if they had to pay for two deliveries it would make them uncompetitive with plasterers who only had to pay for one delivery.

3.17. A number indicated that builders would specify that they wanted fibre cement to be used in the wet areas.

3.18. Both distributors and plasterers indicated that the markets in which they operate are very competitive.

3.19. The plasterers indicated that there were a number of factors that influence which distributor they use, including price, service provided (for example opening time) and location.

James Hardie

3.20. In response to CSR's submission James Hardie made a submission dated 12 April 1995.

3.21. James Hardie's submission begins with an overview of the market and then discusses whether the conduct substantially lessens competition.

3.22. James Hardie states on the demand side fibre cement form part of two broader product markets, external cladding products market and internal lining products market. In respect of the internal linings board market and in particular for wet areas there are products which are comparable with fibre cement.

3.23. James Hardie submits that on the supply side there is no distinction between external and internal applications. All manufacturers given the right price incentives could shift from the production of one to the other.

3.24. James Hardie also refers to a Commission decision under the former clearance procedures where it used a broad market definition in relation to an acquisition of asbestos cement products, which have now been replaced with fibre cement products.

3.25. As to the geographical and functional levels of the market, James Hardie submits that there is a national market at the manufacturing/wholesale level. Cost of transport is not so significant as to carve out separate markets. At the distribution trade level the market is serviced by 4,734 outlets for James Hardie's fibre cement of which only 32 are CSR owned distributors. The major hardware stores are the largest customers of James Hardie's fibre cement products.

3.26. In relation to the temporal dimension of the market, James Hardie states that the buildings product market is dynamic and evolving.

3.27. James Hardie rejects CSR's assertion that it is a monopolist. James Hardie states that there is clear evidence that it regards itself as being constrained by its competitors and distributors. James Hardie supplied a graph which shows the movement in the price of fibre cement products and its close substitutes and states that from that it is evident that there is a very close correlation between the movement of fibre cement and plasterboard.

3.28. James Hardie alleges that the Buckeridge Group of Companies (BCG) will be a strong competitor. James Hardie alleges that only 50% of BCG's capacity is required for its own supply. It claims that the delineation of the market based on transport costs is baseless. James Hardie states that it transports products from the

eastern states to Western Australia, except where there is a particularly strong demand in Western Australia, then it manufactures those products at its plant in Western Australia. James Hardie also states that fibre cement products and substitutes, such as western red cedar, are increasingly global markets. James Hardie attached a brochure circulated by the Australian agent Eternit, the world's largest producer of fibre cement products. James Hardie believes there is a very significant potential for imports.

3.29. James Hardie than state that because of the market structure its conduct can not be said to have substantially lessened competition in any of the identified markets. It draws the Commission attention to the following matters.

- The identified markets are characterised by a large number of manufacturers and suppliers
- The barriers to entry in establishing a plant for the production of building products are neither significant or insurmountable.
- The building products market is characterised by extreme product differentiation, sales promotion and a keenly competitive broadly-based distribution system.
- James Hardie is the only building product manufacturer which is not vertically integrated.
- James Hardie does not seek to dissuade CSR from its plans to manufacture fibre cement products.
- James Hardie neither intends nor does it believe it would be able to frustrate CSR from temporarily obtaining its fibre cement products from other sources.

3.30. James Hardie states that the Act is concerned with the competitive process rather than the competitiveness of individual competitors.

3.31 James Hardie states that CSR's contention about the effect the conduct will have on its plasterboard sales because of customers transferring to outlets where they can purchase the full range of products does not have any base in fact or law.

- The Federal Court has rejected the notion that the Act is concerned with either the convenience of distributors or their customers.
- CSR has provided no evidence that consumers generally purchase all their building products from one retail outlet. James Hardie states that it is more likely that consumers adopt the common practice of comparing price and service available from several outlets.
- CSR could obtain fibre cement products from wholesalers.
- James Hardie submits that even if the convenience of customers was relevant, customers are well served by a highly competitive market at the retail level.
- James Hardie urges the Commission to be very sceptical of CSR's claim that its plasterboard business is so threatened that it will not go ahead with its fibre cement plant.

3.32. James Hardie states that its purpose was not the proscribed purpose and the conduct was taken for the following sound commercial reasons

- James Hardie has a legitimate commercial concern about CSR's support for its product.
- James Hardie submits that it should be under no obligation to continue to supply a distributor who is actively preparing to compete with it.
- James Hardie rejects CSR's assertion that there is no issue of product differentiation. It believes that it has a range of products which have considerable support from customers and which are known in the market to be products of high quality and reliability with a well established track record. To be required to continue to supply CSR will undermine James Hardie's marketing strategy to distinguish its product from other fibre cement products by allowing James Hardie to piggyback on James Hardie's reputation.
- CSR has used its vertical integration to leverage its own competitive product into market segments where fibre cement has been traditionally used. This, it states is not the conduct of a loyal distributor.
- James Hardie advertising material was removed from a CSR distributor. James Hardie states that it is justifiably concerned that CSR is not actively promoting sales of its fibre cement products.
- James Hardie states that whether or not installers prefer to receive the full range from one distributor is irrelevant to the competitive process.
- The conduct does not extend to Western Australia the Northern Territory because CSR has indicated that it does not intend to supply there and therefore it could be assumed that CSR will actively promote its products in these locations.

3.33. James Hardie states, in relation to its submission to the Department of Planning that it was within its rights but chose not to exercise its right to lodge an appeal with the Land and Environment Court.

4 Statutory test

4.1. The notice by James Hardie was given in accordance with s. 93(1) of the *Trade Practices Act* 1974. The Act provides that the Commission may at any time issue a notice if it is satisfied that that the conduct or proposed conduct meets the test in s. 93(3).

4.2. Subsection 93(3) provides that the Commission may at any time give notice that it is satisfied that the conduct or the proposed conduct has or would have the purpose or has or is likely to have, or would have or be likely to have the effect of substantially lessening competition within the meaning of s. 47 of the Act and that in all the circumstances -

- the conduct or has not resulted or is not likely to result or the proposed conduct would not result or be likely to result in a benefit to the public; or
- any benefit to the public would not outweigh the detriment to the public constituted by any lessening of competition that has resulted from the conduct or would result from the proposed conduct.

5 Trade Practices Commission evaluation

5.1. The Commission's evaluation of the conduct notified under s. 93(1) is in accordance with the test set out in section 4.

Market definition

Product market

5.2. The Commission is of the view that the product market is the internal lining board market an essential component of which are fibre cement products. The Commission's view is based on its inquiries of both distributors and plasterers, which support CSR's contention, that an important factor affecting their businesses is the ability to be able to sell or acquire both fibre cement and plasterboard in one lot.

5.3. The Commission is also of the view, based on these inquiries, and the market share figures supplied by CSR, that, while there may be substitutes for fibre cement products in wet areas, James Hardie's products are sufficiently differentiated to provide James Hardie with a significant advantage when compared with other wet area lining products. It is clear that James Hardie is making further efforts to differentiate its product. The Commission also notes that, while James Hardie's submission, dated 12 April 1995, argues in one part that there are a number of substitutes for its products, it also takes issue with CSR that there is no product differentiation and states:

that it has a range of fibre cement products which have considerable support from customers and which are known in the market to be products of high quality and reliability with an established track record.

5.4. James Hardie submits that there are alternatives to fibre cement products and plasterboard products for wet areas, such as modular showers. These products are likely however to only compete on the fringes with the main stream products and therefore are not thought likely by the Commission to be substitutes in the major portion of the market. For example it is probable that the majority of houses being built still use conventional internal lining boards for wet areas.

5.5. The Commission accepts that there is product differentiation and innovation however it does not necessarily accept, and no evidence was provided, as to how this was constraining or effecting James Hardie's operations.

5.6. The Commission is of the view that:

- the internal lining board market includes both plasterboard products and fibre cement products;
- within that market both products have distinct uses; and
- there is an advantage to the purchaser in being able to buy the products together.

5.7. While there are some products which attempt to substitute for fibre cement there is a consistent demand for fibre cement products which is only marginally reduced by substitutes for fibre cement. There does not appear to be any other product that is likely to take away a significant part of that market.

Geographic market

5.8. In terms of the geographic market, the Commission takes the view on the basis of the information so far available there is an eastern states market at the manufacturing level. Although James Hardie states that the market should not be delineated on the basis of transport costs, there is no information to indicate that there are currently significant movements of fibre cement products from one coast of Australia to another.

5.9. If this were to change and fibre cement products for internal lining were to be transported in significant quantities from WA, it would be open to James Hardie to argue that the geographic market had changed.

5.10. At the distribution level the geographic market is likely to be metropolitan and regional levels. Distributors in Melbourne do not compete with distributors from Sydney. It may also be that within the larger metropolitan areas that distributors do not compete with all other distributors in the area because of the distance between them.

Functional level

5.11. The Commission accepts that there are two functional levels of the internal lining board market at which the notified conduct has an impact. These levels are the manufacture of fibre cement products and the distribution of internal lining board markets.

5.12. The Commission is satisfied that James Hardie is currently the only genuine supplier of fibre cement products for the eastern states at the manufacturing level. The fact that the Buckeridge Group of Companies appears to be considering entering the market, and that the import potential for fibre cement is being explored, does not in itself establish that actual entry is imminent. CSR stated, and James Hardie did not challenge, that there is an over capacity of approximately 15% of external and internal fibre cement. This is also likely to affect entry into the market.

5.13. At the distribution level there are specialist lining distributors, specialist builders distributors, who would supply a range of building products, and hardware stores.

5.14. At the distribution level, the Commission accepts the market share figures provided by CSR for Sydney, Melbourne and Brisbane.

5.15. The Commission, based on its inquiries of distributors and plasterers, is of the view that the market at the distribution level is extremely competitive. Consequently any adverse change in any of the factors that influence the service distributors offer is likely to have a heightened effect on their ability to compete.

Assessment of conduct

5.16. Based on the above analysis, the Commission is persuaded that the markets which should be considered when assessing the effect or likely effect or the purpose of the conduct are:

- the manufacturing level of the fibre cement market; and
- the distribution level of the internal lining board market in at least Sydney and Melbourne.

Effect or likely effect of the conduct

at the manufacturing level of the fibre cement market

5.17. The Commission accepts that when considering the impact on competition of particular conduct it should be concerned with the competitive process rather than the individual competitor. In this case however, at the manufacturing level, they can not be distinguished. James Hardie is the only current genuine manufacturer in the eastern states and CSR is the only committed alternative supplier. Therefore any conduct that affects CSR's ability to become an effective alternative supplier also affects the competitive process.

5.18. It is the Commission's view, given the competitive nature of the distribution market, and the significance of the requirement to be able to purchase both plasterboard and fibre cement from one outlet, that withdrawing supply of fibre cement from CSR would have a significant effect on the business of CSR distributors and independent distributors tied to CSR. In the period of about twelve months between when the conduct takes effect and when CSR is in a position to supply fibre cement, plasterers would switch to non-CSR distributors. This switch will not only immediately decrease the demand for CSR's plasterboard products but will also be likely to decrease the demand for CSR's fibre cement products at the time the plant opens. In other words the conduct will have the immediate effect of decreasing CSR's ability to compete in the plasterboard segment of the lining board market. This in turn will affect its ability to be a competitive supplier immediately in the plasterboard market and, when it commences supply, to be a competitive supplier in the fibre cement market. It may be that the risk to CSR's plasterboard business is such that it could cause CSR to re-consider proceeding with its plans for the manufacture of fibre cement. As James Hardie is currently the only supplier of fibre cement products in the eastern states, its conduct which lessens the demand for a potential rival's product, is likely to have the effect of substantially lessening competition in the market for the manufacture of fibre cement.

at the distribution level of the internal lining board market

5.19. Again the Commission notes that it is the effect on the competitive process that is to be considered not the effect on an individual's ability to compete. As stated above the Commission is of the view that this level of the market is very competitive. Apart from CSR, there are two other vertically integrated distributors

and a number of independents. Their market shares vary (see paragraph 3.8). For the Commission to ascertain the effect on competition of the conduct, in a market with these characteristics, is not possible on the information currently available to it. The Commission however thinks that it is unnecessary to make a firm conclusion as to whether or not the conduct has the effect or is likely to have the effect of substantially lessening competition at the distribution level of the internal lining board market.

has or would have the purpose

at the manufacturing level

5.20. In reaching its decision in relation to the purpose of the conduct at the manufacturing level, the Commission is of the view that James Hardie perceived that its position as sole supplier was at risk. In response it embarked on a strategy to counter that risk.

5.21. The Commission considers that the letter sent by James Hardie to CSR dated 13 February 1995, which advises CSR of the conduct, is significant. The letter prima facie indicates that James Hardie was motivated by a concern that CSR's decision to manufacture fibre cement would adversely effect its competitive position in that market.

5.22. CSR advised the Commission that James Hardie approached CSR last year with an offer of improved terms for the distribution of its fibre cement products. CSR allege that the reason for this offer was to persuade CSR not to proceed with the decision to open the fibre cement plant. James Hardie have supplied, confidentially, a different reason for the conduct. The Commission notes that the approach to provide better terms was made only after CSR had announced that it would be opening a fibre cement plant. This tends to lend some credence to CSR's assertion. James Hardie's reason does not, in the Commission's view, necessarily contradict CSR's version.

5.23. The Commission considers that the decision by James Hardie to take action in relation to the opening of CSR's plant by lodging a formal objection to the development application, was part of James Hardie's strategy to frustrate CSR's entry into the market to manufacture fibre cement. The Commission however also notes that James Hardie did not proceed as far with this strategy as it was able as it chose not to take the appeal process as far as it could.

5.24. James Hardie is alleged by CSR to have offered and concluded terms with Boral and Pioneer that are more favourable than those enjoyed by CSR. CSR did not indicate if it believed those terms to be comparable to the ones offered to it by James Hardie and turned down. Again the Commission is of the view that this action suggests that James Hardie are threatened by CSR's decision to manufacture fibre cement. By offering Boral and Pioneer, James Hardie are attempting to lock in these two companies prior to CSR's entry to the market. This is part of the strategy the purpose of which was to raise a considerable barrier to entry which attempts to make it difficult for CSR to enter the market for the manufacture of fibre cement.

5.25. CSR allege that James Hardie has been publicising its decision to refuse to supply CSR. This action is obviously aimed at frustrating CSR's operations in the distribution market.

5.26. In considering James Hardie's purpose, the Commission also notes, as described above that the distribution market is very competitive and that it is important to be able to supply a full range of products. The more difficult it is for CSR to operate in the distribution market the more difficult it will be for it to operate competitively in the market for the manufacture of fibre cement.

5.27. The Commission acknowledges that James Hardie's conduct is motivated by a commercial imperative. However this does not preclude that a substantial purpose of the conduct was to frustrate CSR's ability to compete to such a degree that it could be characterised as substantially lessening competition.

5.28. The Commission is satisfied that the conduct when viewed in the context of:

- the letter dated 13 February 1995 from James Hardie to CSR advising CSR of the conduct;
- James Hardie's actions as outlined in paragraphs 5.22 to 5.25 inclusive; and
- the circumstances in which CSR operates in the distribution market;

has or would have the purpose of substantially lessening competition.

at the distribution level of the market for internal lining boards.

5.29. The Commission notes and is confident that competition at the distribution level is strong and is also confident that it is important to be able to provide a full product range. However on the information available to it at the moment it is not prepared to draw a conclusion as to whether the conduct has or would have the purpose of substantially lessening conduct at the distribution level of the market for internal lining boards.

6 Conclusion

6.1. The Commission is satisfied that the conduct has or would have the purpose and would be likely to have the effect of substantially lessening competition in the the market for the manufacturing of fibre cement products.

6.2. James Hardie did not advance any public benefit arguments in support of its conduct. The Commission is also unaware of any public benefits in support of the conduct.

6.3. The Commission is therefore satisfied that the conduct is not likely to result in a benefit to the public.

7 Draft Notice

7.1. For the reasons outlined in section 5, subject to any request for a conference pursuant to s 93A(4), the Commission proposes to issue a notice under s 93(3) of the Act that it is satisfied that the conduct, the subject of the notification N30710, has or would have the purpose or would be likely to have the effect of substantially lessening competition and that it is not likely to result in a benefit to the public.