

**Australian
Competition &
Consumer
Commission**

Determination

Application for Authorisation

Adelaide Brighton Limited

in relation to its proposed acquisition of
shares in Adelaide Brighton Cement Limited

Date: 30 April 1999

Authorisation no:
A90683

File no:

Commissioners:
Asher
Shogren
Bhojani

Summary

On Tuesday, 30 March 1999, Adelaide Brighton Limited (ABL) lodged an application with the Australian Competition and Consumer Commission (the Commission) seeking Authorisation under Section 88(9) of the Trade Practices Act 1974 (Cth) (the Act) to acquire the 49 per cent shareholding in Adelaide Brighton Cement Limited (ABCL) currently held by Australian Cement Holdings Pty Limited (ACH), a joint venture between CSR Limited (CSR) and Pioneer International Limited (Pioneer) (Authorisation number A90683).

Related to the above Authorisation application:

- ABL intends to enter into new cement supply contracts with ACH for the supply of cement in South Australia and Western Australia; and
- ABCL's subsidiary, Northern Cement (NC), intends to enter into new cement supply contracts with CSR and Pioneer for the supply of cement in the Northern Territory.

In addition to Authorisation A90683, ABL lodged at the same time on Tuesday, 30 March 1999, a second application seeking Authorisation (Authorisation number A90682) to acquire all the issued capital of Cockburn Cement Limited (CCL). The Authorisation application for CCL is the subject of a separate Authorisation determination but the two transactions are integral to each other. Authorisation application A90682 involves ABL acquiring all the issued capital of CCL for a consideration of \$230 million to be satisfied by the issue of 200 million ABL shares to Rugby Holdings Limited (RHL) at a price of \$1.15 per share. This will result in RHL controlling approximately 55 per cent of ABL.

In discussions with the Commission, ABL has indicated that the whole series of transactions will not proceed if any one of the transactions cannot, for whatever reason, be completed. In particular, ABL and Rugby have provided the Commission with undertakings pursuant to s.87B of the Act, undertaking not to proceed with the ABL acquisition of CCL unless the ABL acquisition of shares in ABCL and the RHL acquisition of shares in ABL are also completed contemporaneously.

An Authorisation application has not been made under s.45 of the Act for the supply agreements. However, the Commission must consider the effect of these supply agreements in the context of the wider package of transactions.

ABL is a listed public company, principally carrying on business as a cement producer. Its most significant interest is its 51 per cent shareholding in ABCL. ABL also owns 100 per cent of the NC clinker grinding plant in Darwin in the Northern Territory, 50 per cent of the Sunstate clinker grinding plant in Brisbane and 50 per cent of ICL. ABCL owns Geelong Cement at Fyansford in Victoria; cement manufacturing plants at Birkenhead and Angaston in South Australia; and the Swan lime kiln and clinker grinding plant in Kwinana in Western Australia.

Relevant provisions of the Act

Section 50 of the Act prohibits acquisitions that would have the effect, or likely effect, of substantially lessening competition in a substantial market.

ABL's application for Authorisation is pursuant to sub-section 88(9) of the Act. This section provides a statutory exemption from the operation of s.50 of the Act which might otherwise prevent the proposed acquisition. Sub-section 90(9) of the Act provides that the Commission shall not grant Authorisation unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place. The Commission considers public detriment as well as public benefit in its evaluation and gives considerable emphasis to any negative effect on competition arising from the acquisition.

The relevant market

Section 50 of the Act refers to a substantial lessening of competition in a market. An assessment of public benefit and detriment must be undertaken in the context of a market. Market definition is relevant in determining the effect of the acquisition on competition.

The Commission is of the view that the relevant product market for the Authorisation under consideration is cement and the Commission has focused on two key geographic markets namely a Western Australian market and a south-east Australian market. The Commission is of the view that the current functional market for cement covers quarrying, clinker manufacturing, grinding, and concrete manufacturing.

Assessment of the proposal

In considering the likely implications for the industry with and without the ABL acquisition of ABCL, the Commission acknowledges that the proposed acquisition is part of a wider restructuring proposal that is dependent on the ABL acquisition of ACH's 49 per cent shareholding in ABCL.

Therefore, the Commission considers that it must take into account the wider effects of the restructuring proposal when deciding whether or not to grant the Authorisation.

In its examination of the proposal, the ACCC has identified a number of public detriments. In particular:

- The supply agreements proposed between ACH and ABL may deter new entry and constrain competition to some degree in Western Australia, South Australia, and the Northern Territory. Nevertheless, the Commission accepts that the proposed supply agreements will have some pro-competitive effects.
- The merger of ABL and CCL in Western Australia significantly raises concentration in the WA cement market decreasing the number of competitors in the market from 3 to 2. However, the ACCC is confident that amendments to

BGC's clinker supply contract, which the ACCC has sought and obtained, will enable BGC to compete aggressively with the merged entity and any competitive detriment will be minimal.

- The south-west WA lime market will see the exit of Swan. The ACCC has received submissions stating concerns about this situation but it does not appear that the ABL acquisition of CCL will result in a substantial detriment in the lime market.
- The closure of the Geelong plant will result in the direct loss of jobs. While these losses are regrettable, the losses will be offset to some extent by employment growth in other areas. Also, it is likely that these jobs would be lost eventually even if this proposal does not proceed.

In addition to the detriments noted above the package of transactions will also result in significant public benefits including:

- The ABL acquisition of ACH's shares in ABCL, will result in significant public benefits. Most notably, the independence of ABL from ACH is likely to have a positive effect on competition in all Australian markets.
- The RHL acquisition of ABL will provide ABL with access to Rugby's international experience and financial strength, improving ABL's competitiveness in the Australian cement industry.
- ABL will achieve rationalisation benefits through the closure of the Geelong plant and rationalisation between CCL and ABL in Western Australia. In particular, the closure of the Geelong plant and the subsequent increase in production at ABL's Birkenhead plant will lower unit production costs improving ABL's competitiveness.

On balance, the ACCC is of the view that the public benefits flowing from the package of transactions are likely to outweigh the detriments. In particular, the existence of the 'poison pill' in the ABL/ACH shareholder agreement severely limits the scope for alternative restructuring proposals.

During its examination of the restructuring proposal, the ACCC has identified several concerns which the parties have been able to address through adjustments to the proposal and by offering undertakings which have been accepted by the Commission.

These amendments and undertakings are as follows:

1. ABL and Rugby have signed s.87B undertakings which require that the ABL acquisition of CCL will not be concluded without the ABL acquisition of ABCL and the RHL acquisition of ABL taking place contemporaneously. These undertakings ensure that the transactions are linked and that the ACCC may take into account wider public benefits when Authorising the ABL acquisition of ABCL.
2. ABL has signed an undertaking to make adjustments to BGC's current contract for clinker supply to ensure that BGC will be able to compete effectively with the merged ABL/CCL.

3. The new Western Australian cement supply contract between ABL and ACH has been adjusted in order to increase the influence of imports on pricing in Western Australia.

The ACCC considers that these undertakings and amendments will overcome major competition concerns.

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1. Introduction

Treatment of confidential information

1.1. In the course of its inquiries, the Commission was provided with confidential information from a range of parties. In several places in this Determination, the Commission has drawn on that information in order to assist it in its consideration of the application. This version of the Determination is a public document, so where confidential material is cited, the relevant paragraphs and tables are marked with the words '*Confidential material see endnote i*' and the relevant information is contained in a separate document which is not publicly available.

The proposed acquisition

1.2. On Tuesday, 30 March 1999, Adelaide Brighton Limited (ABL) lodged an application with the Australian Competition and Consumer Commission (the Commission) seeking Authorisation under s.88(9) of the Trade Practices Act 1974 (Cth) (the Act) to acquire the 49 per cent shareholding in Adelaide Brighton Cement Limited (ABCL) currently held by Australian Cement Holdings Pty Limited (ACH), a joint venture between CSR Limited (CSR) and Pioneer International Limited (Pioneer) (Authorisation number A90683).

1.3. On 29 April 1999, the Commission declared the two applications by ABL for Authorisation of the acquisitions of CCL and shares in ABCL to be 'complex' under s.90(11A) of the Act.

Related transactions

1.4. As part of the sale agreement, ABL intends to enter into long term supply agreements with ACH, Pioneer and CSR. These consist of:

- ABL entering into new cement supply contracts with ACH for the supply of cement in South Australia and Western Australia to ACH for resupply to CSR and Pioneer (replacing ABCL's existing contracts with CSR and Pioneer); and
- ABL's subsidiary, Northern Cement (NC), entering into new cement supply contracts with CSR and Pioneer for the supply of cement in the Northern Territory.¹

1.5. An Authorisation application has not been made under s.45 of the Act for the supply agreements but in making its decision on the likely competitive outcome of the proposed transaction the Commission must take into account all relevant circumstances.

1.6. In particular, the Commission believes it is necessary to examine two key aspects of the agreements. These are the longevity of the contracts as they will last

¹ ABL Submission, 30 March 1999, para.1.3.

until the year 2008² and the fact that they tie up a large proportion of both the supply and demand for cement within a number of geographic regions.

1.7. As noted above, the parties have informed the Commission that it is essential for the long term supply agreements to be in place for the transaction to proceed. ACH argues that these supply agreements are needed because:

- ABL needs the certainty of substantial volumes of cement sales to provide a commercial underpinning for the buy-back of shares in ABCL held by the ACH joint venture and the acquisition of Cockburn;
- the Rugby Group needs the certainty of substantial volumes of cement sales to provide a commercial underpinning for its acquisition of shares in ABL (the source of ABL's buy-back funds); and
- Pioneer and CSR need the contracts to contain 'best price' terms to ensure that they continue to offer downstream customers competitively priced concrete and concrete products.³

1.8. In addition to Authorisation A90683, ABL lodged at the same time on Tuesday, 30 March 1999, a second application seeking Authorisation (Authorisation number A90682) to acquire all the issued capital of Cockburn Cement Limited (CCL). The Authorisation application for CCL is the subject of a separate Authorisation determination but the two transactions are integral to each other. Authorisation application A90682 involves ABL acquiring all the issued capital of CCL for a consideration of \$230 million and the consideration for this acquisition will be satisfied by the issue of 200 million ABL shares to Rugby Holdings Limited (RHL) at a price of \$1.15 per share.⁴ This will result in Rugby controlling 55 per cent of ABL.

1.9. In discussions with the Commission, ABL has indicated that the whole series of transactions will not proceed if any one of the transactions cannot, for whatever reason, be completed. In particular, ABL and Rugby have provided the Commission with undertakings pursuant to Section 87B of the Act, undertaking not to proceed with the ABL acquisition of CCL unless the ABL acquisition of shares in ABCL and the Rugby acquisition of shares in ABL are also completed contemporaneously.

The applicant

ABL⁵

1.10. ABL is a listed public company, principally carrying on business as a cement producer. Its most significant interest is its 51 per cent shareholding in ABCL which is the principal vehicle for ABL's core business, the production and distribution of cement. In Addition to ABCL, ABL's major investments are:

² ABL Submission, 30 March 1999, para.2.10.

³ ACH Submission, 16 April 1999, p.1.

⁴ ABL Submission, 30 March 1999, para.2.9.

⁵ ABL Submission, 30 March 1999, para.2.2-2.3.

- 50 per cent interest in the Sunstate clinker grinding plant in Brisbane (BCSC holds the remaining 50 per cent);
- 100 per cent ownership of the NC clinker grinding plant in Darwin; and
- 50 per cent interest in Independent Cement and Lime (ICL).

1.11. ABCL is an unlisted company owned 51 per cent by ABL and 49 per cent by ACH. Its major operations are cement manufacturing plants at:

- Birkenhead and Angaston in South Australia;
- Geelong in Victoria; and
- the Swan lime kiln and clinker grinding plant in Kwinana (Perth), Western Australia.

The target

1.12. As described above, ABCL is an unlisted company owned 51 per cent by ABL and 49 per cent by ACH. Its major operations are cement manufacturing plants at:

- Birkenhead and Angaston in South Australia;
- Geelong in Victoria; and
- the Swan clinker grinding plant in Kwinana (Perth), Western Australia.⁶

1.13. Note that the existing shareholder's agreement between ABL and ACH in relation to ABCL allows ACH to increase its shareholding in ABCL to 50 per cent if the control of ABL alters. This poison pill means that Rugby would not commercially wish to merge with ABL and gain control, as through the process the merged entity would lose control of ABCL (ABL's primary cement business)⁷

Background to the Authorisation applications

1.14. On Tuesday, 30 March 1999, ABL lodged with the Commission two applications for Authorisation to enter into arrangements whereby ABL acquires all the issued capital of CCL; and the 49 per cent shareholding in ABCL held by ACH. Prior to lodging the application for Authorisation ABL had conducted informal discussions with the Commission over an extended period of time.

1.15. On Wednesday 31 March 1999, the Commission wrote to market participants and other interested persons and bodies to notify them of the application and to seek their views. In particular the Commission wrote to all other clinker and cement

⁶ ABL Submission, 30 March 1999, para.2.3.

⁷ ABL Submission, 30 March 1999, para.5.37.

manufacturers, to a broad range of pre-mixed concrete companies, to the Australian Workers Union, to the Western Australian quick-lime manufacturers, the key lime users and to a range of industry bodies. The Commission received submissions from in excess of 30 interested parties.

1.16. Over the following three weeks, the Commission conducted market inquiries and spoke to the applicant, ACH and to a range of key players in the industry.

2. Relevant provisions of the Act

Prohibition against anti-competitive mergers

2.1. ABL lodged this application for Authorisation (A90683) pursuant to subsection 88(9) of the Act. An Authorisation granted pursuant to s.88(9) provides a statutory exemption from the operation of s.50 of the Act, which may otherwise prevent the proposed acquisition.

2.2. Subsection 50(1) of the Act provides:

A corporation must not directly or indirectly:

- a) acquire shares in the capital of a body corporate; or
- b) acquire any assets of a person;

if the acquisition would have the effect, or be likely to have the effect, of substantially lessening competition in a market.

2.3. Section 50(3) sets out factors which must be taken into account by the Court when assessing whether an acquisition is likely to have the effect of substantially lessening competition. Section 50(3) provides that the following non-exhaustive list of factors must be taken into account in the evaluation of the effect or likely effect of particular acquisitions:

- a) the actual and potential level of import competition in the market;
- b) the height of barriers to entry to the market;
- c) the level of concentration in the market;
- d) the degree of countervailing power in the market;
- e) the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;
- f) the extent to which substitutes are available in the market or are likely to be available in the market;
- g) the dynamic characteristics of the market, including growth, innovation and product differentiation;
- h) the likelihood that the acquisition would result in the removal from the market of a vigorous and effective competitor; and
- i) the nature and extent of vertical integration in the market.

2.4. Sub-sections 50(4) and (5) provide a mechanism for Authorisation of existing contracts for the acquisition of shares or assets provided the contract is conditional on Authorisation being granted.

2.5. Where an acquisition is found to breach s.50, the Federal Court can order divestiture of shares or assets acquired in contravention of s.50 (s.81(1)) or set aside the transaction (s.81(1A)) and, in addition, impose pecuniary penalties on the acquirer, or any other party who is knowingly concerned in the contravention, of up to \$10 million.

If an acquisition has not proceeded and the Federal Court is satisfied that it breaches the Act, it can restrain the parties from proceeding with that acquisition (s.80(1)).

Authorisation of potentially anti-competitive mergers

2.6. The Act contains a process whereby certain conduct, including acquisitions, which may breach the restrictive trade practices provisions in Part IV of the Act, can be authorised if there is sufficient public benefit in allowing the conduct.

2.7. The current application is made under sub-section 88(9) of the Act which provides that:

...the Commission may, upon application by a person –

- a) grant an Authorisation to the person to acquire shares in the capital of a body corporate or to acquire assets of a person...

2.8. The Commission shall only grant authorisation if the applicant satisfies the relevant test in sub-section 90(9) of the Act.

2.9. Sub-section 90(9) provides that the Commission shall not grant Authorisation unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to take place. In making its Determination the Commission gives consideration to both the claimed public benefits and any public detriment, particularly any negative effect on competition, that the proposed acquisition is likely to have.

2.10. Sub-section 90(9A) provides that in determining what amounts to a benefit to the public for the purposes of subsection (9):

- a) the Commission must regard the following as benefits to the public (in addition to any other benefits to the public that may exist apart from this paragraph):
 - (i) a significant increase in the real value of exports;
 - (ii) a significant substitution of domestic products for imported goods; and
- b) without limiting the matters that may be taken into account, the Commission must take into account all other relevant matters that relate to the international competitiveness of any Australian industry.

2.11. Should the Commission be satisfied as to the requisite degree of public benefit attributable to the proposed acquisition in all the circumstances, including in particular, the effect of the proposed acquisition on competition, the Commission may grant Authorisation or grant Authorisation subject to conditions. If this is not the case, the Commission may refuse Authorisation or alternatively, in refusing Authorisation, indicate to the applicant how the application could be constructed to change the balance of detriment and public benefit so that Authorisation may be granted.

Conditional Authorisation and enforceable undertakings

2.12. It is open to the Commission, in granting an Authorisation, to do so on certain conditions. Such conditions could include a condition that certain relevant

undertakings are provided to the Commission by the parties to the application. Pursuant to s.87B of the Act, the Commission is able to accept written undertakings. Section 87B of the Act provides for enforcement in the Federal Court of written undertakings accepted by the Commission in connection with a matter in relation to which the Commission has a power or function under the Act. Where the Commission believes that a term of such an undertaking has been breached it may apply to the court for:

- an order directing compliance; and/or
- an order to pay the Commonwealth up to the amount of any financial benefit that can be reasonably attributed, directly or indirectly, to the breach; and/or
- any order the Court considers appropriate to compensate a third party for loss or damage resulting from the breach; and/or
- any other order the Court considers appropriate.

3. The Australian Cement Industry

3.1. This section presents background to the Australian cement industry. It focuses on both clinker and cement manufacture. It should be noted that clinker and cement are very closely linked as cement is essentially ground clinker with certain additives.

The Cement Manufacturing Process

3.2. Clinker manufacture consists of a mixing stage and a burning stage. The products and percentage shares used in the mixing process are listed in Table 1 below. These materials were traditionally mixed by a process known as the wet process in which the products were ground and mixed in water. The problem with the wet process is that it requires considerably more energy at the burning phase due to the high quantity of water. Technological advances have resulted in all new plants using a dry process where the grinding and mixing of materials takes place in a dry environment to produce a raw meal.⁸

3.3. There are four stages to the burning process - evaporation and preheating, calcining, clinkering and cooling:

Evaporation and preheating remove moisture and raise the temperature of the raw mix preparatory to calcining. Calcining takes place at 800-900°C and breaks the calcium carbonate down into calcium oxide and carbon dioxide which is evolved in the process. Clinkering completes the calcination stage and fuses the calcined raw mix into hard nodules resembling small grey stones. Kiln temperatures in the burning zone range from 1350-1450°C, and retention times in this zone are four to six seconds.⁹

Table 1 Proportions of materials used for clinker manufacture

Materials	(per cent)
Limestone, lime sand and coral	79
Sand	5
Gypsum	4
Shale	3
Slag	2
Clay	1
Iron material	1
Other	4
Total	100

Source: Aquatech *The Cement Industry in 1998*, p.18

3.4. After the cooling phase the clinker is ground either at the same establishment or it is transported to a grinding facility where the clinker is ground to form a fine powder. Small quantities of gypsum are added at the grinding process. Supplementary

⁸ ABL Submission, 30 March 1999, para.6.2.

⁹ Aquatech *The Cement Industry in 1998*, p.104.

Cementitious Materials (SCMs) are also added either at the grinding stage or once the product is ground. The key SCMs are ground granulated blast furnace slag (GGBFS) which is a by-product of iron manufacturing and fly ash which is generated from the combustion of pulverised coal in thermal power stations.¹⁰

3.5. SCMs are used both to reduce the cost of concrete and to improve the binding properties in certain concretes.

Industry participants¹¹

Manufacturers

Adelaide Brighton Limited (ABL)

3.6. ABL is a listed public company, principally carrying on business as a cement producer. Its most significant interest is its 51 per cent shareholding in ABCL which is the principal vehicle for ABL's core business, the production and distribution of cement. In addition to ABCL, ABL's major investments are:

- 50 per cent interest in the Sunstate clinker grinding plant in Brisbane (BCSC holds the remaining 50 per cent);
- 100 per cent ownership of the NC clinker grinding plant in Darwin; and
- 50 per cent interest in ICL (the Barro Group owns the remaining interest).

Australian Cement Holdings Pty Limited (ACH)

3.7. ACH is an unlisted company owned 50 per cent by Pioneer and 50 per cent by CSR. It currently holds 49 per cent of the shares in ABCL and also has the following:

- cement manufacturing plants located at Kandos in New South Wales and at Railton in Tasmania (Goliath); and
- a 78 per cent interest in Melcann Holdings Limited (Melcann) which is a distributor of bagged cement in Victoria, New South Wales and Adelaide.

Adelaide Brighton Cement Limited (ABCL)

3.8. ABCL is an unlisted company owned 51 per cent by ABL and 49 per cent by ACH. Its major operations are cement manufacturing plants at:

- Birkenhead and Angaston in South Australia;
- Geelong in Victoria; and
- the Swan clinker grinding plant in Kwinana (Perth), Western Australia.

Blue Circle Southern Cement (BCSC)

3.9. BCSC is a wholly owned subsidiary of Boral Limited. It operates the following cement manufacturing plants:

- Waurm Ponds, Victoria;
- Berrima and Maldon, New South Wales;

¹⁰ Aquatech *The Cement Industry in 1998*, pp.19-20.

¹¹ All descriptions of market participants are from ABL's submission, 30 March 1999, at para.6.6-6.13.

- clinker grinding plant in Kooragang, New South Wales; and
- 50 per cent interest in the Sunstate clinker grinding plant in Brisbane, Queensland (50 per cent owned by ABL).

Queensland Cement Limited (QCL)

3.10. QCL is a wholly owned subsidiary of Holderbank Financiere Glaris, Switzerland. It operates the following plants:

- a clinker production plant (with limited cement production capacity) at Gladstone, Queensland;
- a small clinker and lime plant at Rockhampton, Queensland; and
- a clinker grinding plant at Bulwer Island, Brisbane.

Sunstate Cement Limited (Sunstate)

3.11. Sunstate is jointly owned (50 per cent each) by ABL and BCSC. It operates a clinker grinding facility in Brisbane. That plant was commissioned in 1985 after the company was established as a distributor of cement in 1982. Sunstate sells both bulk and bagged cement into south east Queensland and northern New South Wales. Sunstate's major customer is BCSC's owner, Boral.

Cockburn Cement Limited (CCL)

3.12. CCL is a wholly owned subsidiary of Rugby. It was originally formed in the mid 1950s to engage in cement production and distribution. It currently operates a cement manufacturing plant at Munster, Western Australia. In the early 1970s, CCL expanded into lime production and since then, all major investment by CCL has been dedicated to its lime business. CCL currently operates three quicklime kilns – one at Dongara and two at Munster, all are in Western Australia. CCL has the ability to switch its clinker kilns to lime production at little cost.

BGC (Australia) Pty Limited (BGC)

3.13. BGC is a private company which operates a clinker grinding plant at Canning Vale, a suburb of Perth. BGC is vertically integrated in the building industry, being involved in house building, land and property development, as well as product manufacture. About 60 per cent of the cement produced by BGC is supplied to its own pre-mixed concrete, concrete tile, light weight brick and fibre cement operations.

Independent Cement and Lime Pty Limited (ICL)

3.14. ICL commenced operations in 1988 with a facility at Port Melbourne designed to take cement powder imported from Ube Industries in Japan. Imports were received from Ube before ICL switched the majority of its sourcing to Adelaide Brighton Cement. ICL is currently owned 50 per cent by the Barro Group and 50 per cent by Adelaide Brighton Limited.¹²

¹² Notes from ACCC meeting with the Barro Group, 12 April 1999, p.2, and Aquatech *The Cement Industry in 1998*, para.2.3.7.

The Barro Group Pty Limited (the Barro Group)

3.15. The Barro Group operates concrete and quarry businesses in Victoria and Queensland and resells building materials and products, manufactures and distributes concrete roof tiles, and sells new and recapped tyres. The Barro Group also has a 19.9 per cent share in ABL and a 50 per cent share in ICL.¹³

Clinker manufacturing capacity and grinding capacity

3.16. It needs to be recognised that clinker manufacture and cement manufacture represent separate stages of the manufacturing process. All clinker manufacturing plants also have grinding facilities (although QCL's Gladstone plant only has minor grinding capacity). It is, however, important to note that not all clinker is ground at the plant where it was manufactured as substantial quantities of clinker are shipped to separate grinding plants. Table 2 provides a comparative overview of the location and quantity of clinker manufacture in Australia in 1988 and in 1998. Map 2.2 highlights the location of clinker manufacturing plants and clinker grinding plants in Australia.

3.17. It is estimated that Australia has about 8.1 million tonnes of cement manufacturing capacity with an additional 3.3 million tonnes of grinding capacity located separately from manufacturing facilities.¹⁴ Future expected demand is dealt with below, but one can observe that there is a degree of excess capacity in the Australian cement industry which will increase if the anticipated drop in demand eventuates.

Capacity at Birkenhead

3.18. One of the key public benefits claimed by ABL are the efficiencies arising from the closure of the Geelong plant and increasing capacity utilisation at Birkenhead. ABCL's Birkenhead is one of the largest and most efficient cement manufacturing plants in Australia. ABL states that 'the Birkenhead plant will primarily produce cement and clinker for customers in: South Australia; Victoria, through ICL; Queensland through Sunstate Cement; and Western Australia (top up amounts only).'¹⁵ The Geelong plant currently produces 489,000 tonnes for sale within Victoria¹⁶ which is to be replaced by interstate production. ABL submits that this demand will be met by the Birkenhead plant which will create additional capacity through:

- a) reducing export tonnages (currently 200,000-250,000 tonnes);
- b) reducing tonnages supplied to Western Australia (150,000-200,000 tonnes), with that production being transferred to the Munster plant, and

¹³ The Barro Group Submission, 14 April, p.1.

¹⁴ ANZ Investment Bank Equities Research *The Australian and New Zealand cement industry: Between a rock and a very hard place*, September 1998, p.1.

¹⁵ ABL Submission, 30 March 1999, para.5.6.

¹⁶ ABL Submission, 30 March 1999, Table 7.

- c) achieving additional output by selling more cement (which includes gypsum and mineral additives) and less clinker.¹⁷

3.19. The Commission accepts that the Birkenhead plant will run at near capacity following the closure of the Geelong plant.

Table 2 Clinker capacity by plant and process, 1988 and 1998

Plant location	1988			1998		
	Clinker capacity ('000 tonnes)	Operating kilns	Process	Clinker capacity ('000 tonnes)	Operating kilns	Process
NSW						
Berrima	1150	2	wet and dry	1400	1 ^a	wet and dry
Portland	120	1	wet	Closed	-	-
Maldon	Standby	n.a.	wet	300	1 ^b	wet
Kandos	400	2	dry	450	2	dry
VIC						
Waurn Ponds	450	1	dry	500	1	dry
Geelong	800	3	wet	650	2 ^c	wet
Gippsland	110	2	semi-dry	Closed	-	-
QLD						
Darra	270	1	wet	Closed	-	-
Gladstone	550	1	semi-wet	1600	1	dry/precalciner
Townsville	280	2	wet	Closed	-	-
Rockhampton	140	1	wet	140	1 ^e	wet
SA						
Angaston	250	2	wet + semi-dry	250	2 ^d	wet + semi-dry
Birkenhead	860	3	wet and dry	1300	1	dry/precalciner
WA						
Burswood	260	3	wet	Closed	-	-
Munster	310	3	wet	600	4	wet
TAS						
Railton	690	1	dry	1100	1	dry/precalciner

Aquatech *The Cement Industry in 1998*, p.9

(a) Includes a wet process kiln at Berrima of 400 ktpa which will be on standby once the dry process upgrade is completed in early 1998.

(b) Used for speciality cements.

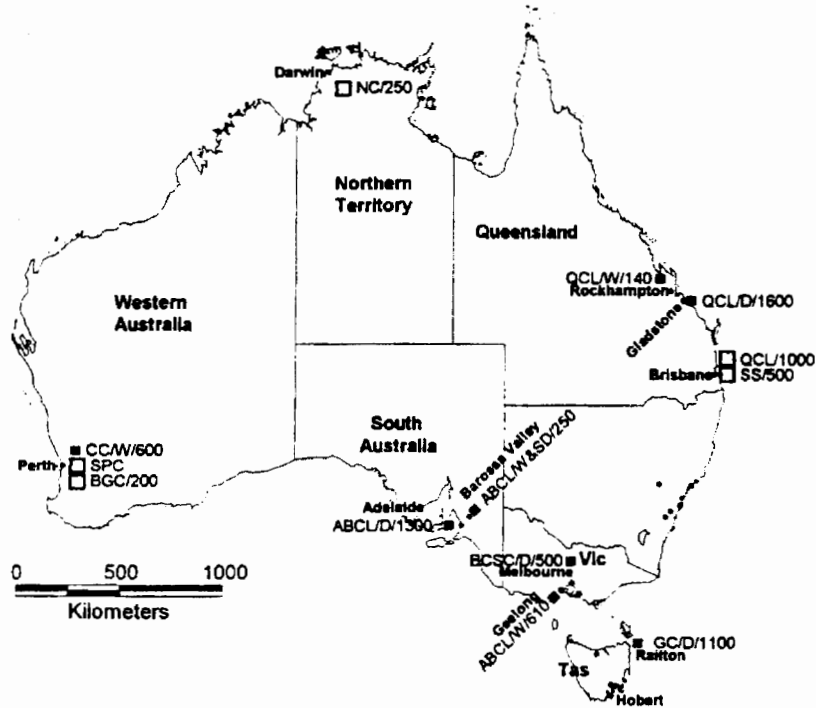
(c) A third wet process kiln is not operated.

(d) Used for speciality cements.

(e) Currently used for lime production

¹⁷ ABL Letter, 22 April 1999, p.2.

Map 2.2: Cement plant locations, Australia, 1998



KEY

- Cement plants
- Clinker-grinding plants

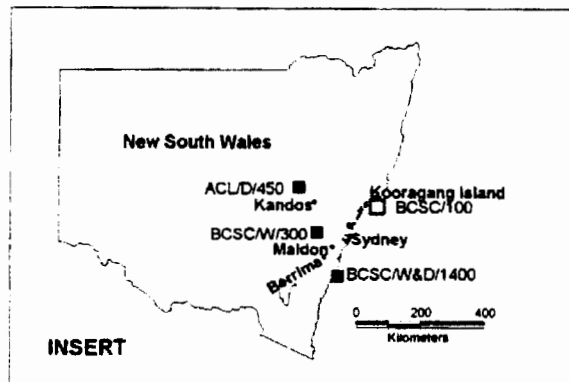
COMPANY CODES

- ABCL Adelaide Brighton Cement Limited
- ACL Australian Cement Limited
- BCSC Blue Circle Southern Cement
- BGC Buckeridge Group of Companies
- CC Cockburn Cement
- GC Goliath Cement
- NC Northern Cement
- QCL Queensland Cement Limited
- SPC Swan Portland Cement
- SS Sunstate Cement

PRODUCTION CODES

- D Dry
- SD Semi-dry
- SW Semi-wet
- W Wet

NOTE: Tonnages are expressed in ('000) of tonnes



Source: Aquatech *The Cement Industry in 1998* p.6

Market shares

3.20. The following Table shows the market shares for each Australian producer of cement. The market shares are based on Table 7 in ABL's Submission.

Table 3 Market shares for Australian cement manufacturers (per cent)

	SA & NT	VIC	NSW	QLD	WA	TAS	Australia
ABCL	83.4	37.1	2.1	35.0	27.1	1.5	26.5
ACH		28.0	42.9			87.1	22.5
BCSC	1.7	34.9	53.9			11.4	26.5
QCL	14.8		1.1	65.0			16.1
CCL					59.1		6.7
Imports					13.8		1.5

Source: ABL Submission, Table 7

International trade

Imports

3.21. There has been considerable speculation over the impact of the Asian crisis on imports to Australia. The *Aquatech* report estimates that Malaysia, Thailand, Indonesia, Vietnam and the Philippines may have an excess capacity of up to 50 million tonnes over the next few years.¹⁸ This is in stark contrast to the situation that existed only a few years ago when countries such as Malaysia and Thailand had export restrictions on cement. Australia's closest Asian neighbour, Indonesia, currently has an estimated surplus capacity of 26 million tonne per annum.¹⁹

3.22. In its submission, ABL has placed substantial emphasis on the extent of actual and potential import competition in the market. ABL states:

The prospect of import competition is an important constraint in the cement industry. The actual level of imports has not exceeded 10% of the market, reaching a peak in 1995 of 512,000 tonnes (or approximately 8% of the Australian consumption). Although imports do not constitute a significant proportion of the market, ABL submits that their influence is substantial.²⁰

3.23. The Commission accepts that there currently is a significant quantity of cement that could be exported to Australia. The Commission is, however, not satisfied that Australia is likely to encounter significant import penetration due to the barriers to entry into this market and the extensive vertical integration that exists in the pre-mixed concrete market. The Deutsche Bank Report stated:

¹⁸ *Aquatech The Cement Industry in 1998*, para.5.7.

¹⁹ Deutsche Bank Research *Australian Cement Industry: Cement imports – are they likely?* 22 September 1998, p.13.

²⁰ ABL Submission, 30 March 1999, para.8.8.

With the added transport and terminal infrastructure costs of bringing in imports, we estimate that the larger more efficient dry process plants are capable of competing effectively with imports even at the current depressed Indonesian pricing levels, unless wholesale dumping occurs at prices below the cost of production.²¹

3.24. It should also be noted that if any product is to be imported into Australia it is likely to be clinker rather than cement due to the greater ease by which this product can be shipped. Table 4 highlights the quantity of clinker imported into the Western Australian market over the last five years.

Table 4 Clinker Imports into Western Australia (tonnes)

Year	Yearly Qty	Importer	Source	Quantity
1994	101,000	CCL	Japanese	91,000
		BGC	Ssangyong (S. Korea)	10,000
1995	63,000	CCL	Japanese	63,000
1996	90,000	ABL	Mitsubishi	20,000
		CCL	Japanese	48,000
		BGC	Mitsubishi	22,000
1997	83,000	CCL	Japanese	42,000
		BGC	Mitsubishi	41,000
1998	108,000	ABL	Mitsubishi	12,000
		CCL	Japanese	40,000
		BGC	Mitsubishi	56,000

Source: ABL Submission Table 10

3.25. Anecdotal evidence was submitted to the Commission suggesting that market outcomes are being distorted in favour of imports due to excessive domestic cabotage charges. Swan submitted that it 'would not be able to move its product from Perth to Esperance by a ship because this would be more expensive than bringing product from Indonesia to Esperance.'²²

3.26. Nevertheless the Commission accepts that the threat of imports may have an influence on clinker and cement pricing decisions in Australia that is disproportionate to the quantity of imports actually flowing into the country. This issue is explored further below.

Exports

3.27. Export opportunities are low for Australian clinker and cement manufacturers. This is especially the case in the aftermath of the Asian economic crises which has seen a downward trend in previously existing export markets such as Malaysia, Singapore and Indonesia. ABL stated that the Asian financial crisis will limit the ability of ABCL

²¹ Deutsche Bank Research *Australian Cement Industry*, p.18.

²² Notes from ACCC meeting with Swan Cement, 9 April 1999, para.26.

to export cement.²³ Even when demand picks up in Asia it is unlikely that Australian cement companies will be able to capture significant export markets due to the large production capacity that has become operational in most Asian countries over the last two years. Aquatech estimates that in 1997-98 in Indonesia, Malaysia, Thailand and the Philippines an additional 29.2 million tonnes annual capacity has become operational.²⁴

3.28. Nevertheless, it is the case that ABCL currently exports a small proportion of its production from its Birkenhead facility. ABCL has pursued exports in order to increase the capacity utilisation of its plant to lower unit production costs. ABL states, 'Export sales have been difficult to achieve and those sales that have been made have been at low prices, typically at less than full production cost'.²⁵

Horizontal and vertical arrangements

3.29. A key effect of the proposed ABL acquisition of ABCL is the removal of the tie between ACH and ABL. The fact that ABL's principal asset, ABCL, has a 49 per cent shareholding by ACH limits the extent of independent competition between the two companies. ABL writes in its submission that 'ACH has significant strategic control over ABCL's business through its 49% shareholding'.²⁶ More importantly ABL notes that '[u]ntil now, ABCL's strategic direction has been influenced, to some extent, by the location of ACH's other cement plants'.²⁷

3.30. It should also be noted that there is a high degree of joint activity within the cement industry as a whole. For instance BCSC and ABL are linked through their joint venture in Sunstate and ACH is currently linked in one way or another with all the major Australian manufacturers except for CCL. Consequently, severing one of these key ownership ties is likely to have a beneficial effect on competition.

3.31. In addition to the high level of horizontal ties in the cement market there is also a high degree of vertical linkage in relation to concrete production. ABL notes that 'as much as 70% of all cement is sold to pre-mixed concrete producers'.²⁸ The pre-mixed concrete producers are dominated by Boral, CSR and Pioneer. ABL estimates that Boral, CSR and Pioneer represent approximately 60 per cent of Australia's cement demand.²⁹

3.32. In addition to the structural ties between the major cement companies there is also a degree of co-operation through borrow and loan distribution arrangements. Borrow and loan arrangements are effectively a swap of cement between cement

²³ ABL Submission, 30 March 1999, para.12.26.

²⁴ Aquatech *The Cement Industry in 1998*, Tables 5.4, 5.5, 5.6 and 5.7.

²⁵ ABL Submission, 30 March 1999, para.3.9.

²⁶ ABL Submission, 30 March 1999, para.5.20.

²⁷ ABL Submission, 30 March 1999, para.5.22.

²⁸ ABL Submission, 30 March 1999, para.6.22.

²⁹ ABL Submission, 30 March 1999, para.6.25.

suppliers, each existing in different markets. These arrangements save costs for both companies by limiting the transport of the cement to other markets. ABL submits that these represent an alternative method of market entry. ABL states:

An alternative method of market entry and interstate trade is through borrow and loan arrangements. The purpose of borrow and loan arrangements is to eliminate the cost of transporting cement, while at the same time allowing cement producers to contract sales in States where they have no production capacity. Accordingly, borrow and loan arrangements facilitate efficient interstate trade, market entry and competition throughout Australia.³⁰

3.33. The Commission questions the level of genuine competition that these borrow and loan arrangements are able to generate as it would appear that they are only suitable for the existing cement majors (*Confidential material see endnote ii*). This view is supported by the Barro Group's submission which states 'Barro has never been approached by a cement producer that did not also have facilities in the same state.'³¹

3.34. The Commission's view of these borrow and loan arrangements is that they are only likely to be used by the majors in order to satisfy internal demand rather than generating third party business.

Supply contracts

3.35. ACH's 49 per cent shareholding in ABL will be acquired by means of a capital reduction. The terms of that acquisition are:

- payment of cash consideration of approximately \$82.9 million (subject to adjustment);
- ABL will enter into new cement supply contracts with ACH for the supply to ACH (for resupply to CSR and Pioneer) of its requirements in South Australia and 75% of its requirements in Western Australia until the end of 2008. These contracts will replace ABCL's existing contracts with CSR and Pioneer which are due to expire by the end of 2002;
- ABL's subsidiary, Northern Cement, will enter into new cement supply contracts with CSR and Pioneer for the supply of their requirements of cement in the Northern Territory, until the end of 2008; and
- ABCL's existing cement supply contract with ACH, which expires on December 2002, will remain in place.³²

3.36. ABL submits that these new supply contract will strengthen ABL's cement business in the following ways:

First, the new supply contracts with ACH, CSR and Pioneer will provide security for a substantial proportion of ABCL's sales volume. The present contracts with ACH, CSR and Pioneer expire during 2002. ACH has indicated that it will not renew its contract and there is no certainty of continuity of purchasing by CSR and Pioneer. The new contracts have been negotiated as part of ABL's acquisition of ACH's 49% interest in ABCL. The new contracts will apply until 2008 and

³⁰ ABL Submission, 30 March 1999, para.7.27.

³¹ The Barro Group Submission, 14 April 1999, p.3.

³² ABL Submission, 30 March 1999, para.2.10.

involve higher aggregate volumes than presently contracted. ABL believes that these new contracts will substantially underpin sales volumes for ABL.³³

3.37. These supply contracts do, however, raise certain concerns as they tie up a substantial proportion of the demand in South Australia, Western Australia and the Northern Territory for the next decade. CSR and Pioneer combined represent 36.6 per cent of total cement demand in South Australia, 46.7 per cent of the total cement demand in Western Australia and 62.5 per cent of total cement demand in the Northern Territory.³⁴

3.38. The Commission recognises that these supply contracts may assist ABL in optimising its capacity utilisation and give ABL a degree of certainty over future sales.

Prices

3.39. It is difficult to ascertain actual prices for clinker or for bagged or bulk cement. This is because the list price is merely the starting point for price negotiations with bulk purchasers being able to obtain significantly better rates than smaller purchasers. Further, the use of rebates appears to be widely used which further complicates any attempt to determine the real price of cement. The Barro Group noted that 'since rebates vary customer by customer, it is difficult to provide an estimate of the average rebate.'³⁵

3.40. Material presented to the Commission during its market inquiries suggests that there are significant variations in the price of cement throughout Australia. In particular, the Commission has been told that prices in the eastern States are higher than in Western Australia, while prices in the Northern Territory are higher again.

Profitability

3.41. ABL states in its submission that it:

believes it is evident that cement producers are deriving below normal profits in their industry. Indeed it is these low returns which have made the financial position of ABL vulnerable, and led ABL to vigorously explore restructuring options within the cement industry over the last 2 years.³⁶

3.42. The Commission notes that there has been a decline in profits in the cement industry but Table 5 below indicates that the returns for Australian cement companies have been reasonably strong throughout the 1990s with the exception of CCL.

³³ ABL Submission, 30 March 1999, para.5.24.

³⁴ Based on ABL Submission, 30 March 1999, Table 2.

³⁵ The Barro Group Submission, 14 April 1999, p.4.

³⁶ ABL Submission, 30 March 1999, para.8.35.

Table 5 Profitability of Australian cement industry

		FY94	FY95	FY96	FY97
Sales (\$m)	QCL ²	310.7	281.3	266.5	271.6
	CCL ¹	178.7	160.7	149.8	141.1
	ACH ²	340.5	339.5	310.4	318.2
	BCSC	250	257.0	245.0	260.9
	ABCL	225.0	252.8	211.8	228.9
	Total	1304.9	1301.2	1183.5	1220.7
EBIT (\$m)	QCL ²	59.6	48.4	48.1	46.2
	CCL ¹	3.7	-2.3	-8.6	2.2
	ACH ²	51.7	64.3	63.7	64.1
	BCSC	44.5	50.7	41.6	48.2
	ABCL	37.6	35.2	24.2	32.0
	Total	197.3	195.3	169.1	182.6
EBIT margin (per cent)	QCL ²	19.2	17.2	18.1	17.0
	CCL ¹	2.1	-1.4	-5.7	1.6
	ACH ²	15.2	18.9	20.5	17.0
	BCSC	17.8	19.0	17.0	18.5
	ABCL	16.8	13.9	11.4	14.0
	Total	16.1	14.9	14.3	15.0
ROA	QCL ²	14.6	12.4	11.4	7.7
	CCL ¹	3.4	-2.2	-9.1	2.7
	ACH ²	8.5	10.9	10.8	9.0
	BCSC	na	na	na	na
	ABCL	9.7	9.1	8.7	8.3
	Total	10.0	9.7	8.7	8.1

Source: Deutsche Bank Research *Australian Cement Industry* p.12

- Notes
1. Excludes quick lime operations.
 2. Includes ancillary activities to cement production.

Future expected demand

3.43. ABL is of the view that future cement demand in Australia is likely to fall. ABL states:

demand is estimated to increase to approximately 7.4 million tonnes in 1999, and then decrease to approximately 6.7 million tonnes in 2002.³⁷

3.44. The Commission notes that the ANZ Investment Bank Equities research report reached a similar conclusion:

The level of cement production in Australia is expected to continue to rise over the next two years in the lead up to the Olympics, peaking at about 7.5m tonnes in the year to June 2000. Following the build up to the Olympics, cement demand is expected to fall 12%, to about 6.6m tonnes in the year to June 2002.³⁸

3.45. The Commission notes that it is predicted that the level of demand for cement may drop over the next three years.

³⁷ Minter Ellison Lawyers, letter dated 22 April 1999, p.1.

³⁸ ANZ Investment Bank Equities Research *The Australian and New Zealand cement industry*, p.15.

4. The Relevant market(s)

4.1. Section 50 of the Act refers to a substantial lessening of competition in a market. Section 50(6) limits the application of s.50 to a substantial market.

4.2. For the purposes of Authorisation the Commission is not required to express an opinion as to whether the proposed acquisition would breach s.50 of the Act. However, the assessment of the competitive effect of the proposed acquisition, the public benefits and public detriment, must take place within the concept of a market.

4.3. Section 4E of the Act provides that a market for goods or services includes other goods or services that are substitutable for, or otherwise competitive with, the first goods or services. The courts have established that both demand and supply side substitution is pertinent in determining the relevant market. The relevant market can be identified by determining the smallest area over which a profit maximising monopolist could impose a small but significant and non-transitory increase in prices (SSNIP), or equivalent exercise of market power.

4.4. The Commission's market evaluation consists of four dimensions, namely product, geographic, functional and time. The Commission's Merger guidelines highlight that the starting point for delineating the relevant market is the merged firm.³⁹

4.5. *(Confidential material see endnote iii).*

Product

4.6. The Merger guidelines indicates that the Commission will have regard to the following types of information in delineating the relevant product market:

- End use of the product and potential substitutes.
- Physical and technical characteristics of the product and potential substitutes.
- Costs of switching purchases between the product and potential substitutes.
- Views and past behaviour of buyers regarding the likelihood of substitution between products.
- Costs of switching production and distribution systems from another product line to a product which is closely substitutable with the relevant product.
- Views, business records and past behaviour of suppliers regarding the impact of price and marketing decisions by the suppliers of potential substitute products on their own pricing and marketing decisions.

³⁹ Australian Competition & Consumer Commission *Merger Guidelines: A guide to the Commission's administration of the merger provisions (ss 50, 50A) of the Trade Practices Act* as revised July 1996 at p.31 hereafter Merger Guidelines.

- Relative price levels and price movements of the product compared to potential substitutes.⁴⁰

4.7. With reference to the issues listed above the Commission is of the view that cement and lime clearly form part of different product markets despite the high lime content in cement.

4.8. In reaching this view the Commission notes ABL's view that:

There is some supply substitutability between lime and cement (clinker) production. Cockburn's older (rotary) plants operate dual-purpose kilns which can be switched from producing clinker to lime and back again. However, the newer, more fuel-efficient technology (pre-heater kilns) does not have this capability.⁴¹

4.9. The limited level of supply side substitution does not extend to the modern kilns that are currently replacing the older wet process kilns. Further, there is practically no demand side substitution between lime and cement. Consequently lime and cement should be treated as forming part of separate product markets. This view was also supported by QCL which stated that there are 'separate cement and lime markets due to the reason that the customers for the two products are entirely different and the end-users are different.'⁴²

4.10. In respect of cement, ABL argues in its submission that clinker, cement, bagged cement and bulk cement all form part of the same product market.⁴³ ABL submitted that:

A cement producer manufactures cement by mixing, burning and grinding materials until the ultimate product comes out of bulk storage and is...pumped into a bulk tank, container or hopper (which can be transported by either rail or road) or to a bagging machine... In addition, at the margin, there is the opportunity to transfer production between bulk and bagged cement if the economics of this are appropriate. As a result, the price of bagged cement is largely determined by the pricing of bulk cement...The ability of cement producers to switch production between bagged and bulk cement is not unlimited. Demand for bagged cement and bulk cement largely dictate the production mix on a day-to-day basis. Producers will increase the amount of bagged cement produced, relative to the amount of bulk cement produced, in response to increased demand for bagged cement. However, that demand affects price and, therefore, producers predisposition to meeting demand.⁴⁴

4.11. Market inquiries indicate that for most end users there is limited demand side substitutability between cement and clinker. As noted above the Barro Group submitted that 'clinker and cement are not substitutable for one another. Manufacturing cement from clinker requires a grinding facility, which would involve an expenditure of between \$30 and \$60 million.'⁴⁵ QCL was also of the view that there

⁴⁰ Merger Guidelines, p.36.

⁴¹ ABL Submission, 30 march 1999, para.9.3.

⁴² QCL Submission, 9 April 1999, p.1.

⁴³ ABL Submission, para.7.2.

⁴⁴ ABL Submission, 30 March 1999, para.7.3.

⁴⁵ The Barro Group Submission, 14 April 1999, p.2.

are separate product markets as 'clinker is a "semi-manufactured" product that requires further processing.'⁴⁶

4.12. However, the Commission notes that from a competition analysis point of view the relevant product market is cement with the differentiation between clinker and various forms of cement going to the functional market definition rather than to defining the product market.

Geographic

4.13. Delineation of the relevant geographic market involves the identification of the area or areas over which the merged firm and its rivals currently supply, or could supply, the relevant product and to which consumers can practically turn.⁴⁷ In establishing the relevant geographic dimension of the market, the Commission will have regard to the following types of information:

- The convenience to customers of accessing alternative sources of supply.
- The costs of switching to alternative sources of supply.
- Views and past behaviour of buyers regarding the likelihood of switching between geographic sources of supply.
- The cost of transportation or access to the alternative sources of supply.
- The perishability of the product.
- Any regulatory or other practical constraints on suppliers selling to the customers of the merging firms.
- The costs of extending or switching production and distribution systems to supply the customers of the merging firms.
- Views, business records and past behaviour of suppliers regarding the impact of price and marketing decisions in one geographic area on supply from another geographic area.
- The relative levels and price movements of different geographic sources of supply.⁴⁸

4.14. QCL submitted that the relevant geographic market is a national market which is part of a larger market.⁴⁹ This is essentially the same as ABL's geographic market

⁴⁶ QCL Submission, 9 April 1999, p.1.

⁴⁷ Merger Guidelines, p.36.

⁴⁸ Merger Guidelines, p.36.

⁴⁹ QCL Submission, 9 April 1999, p.1.