



Australian  
Competition &  
Consumer  
Commission

# Draft Notice

in respect of a notification lodged by

**James Hardie Australia Pty Ltd**

for its new distribution policy for the  
supply and re-supply of fibre cement products

**Date: 5 April 2006**

**Notification no. N31496**

**Public Register no. C2006/72**

**Commissioners: Samuel  
Sylvan  
King  
Martin  
McNeill  
Smith  
Willett**

# 1. The Notification

## Introduction

- 1.1. On 23 December 2005 James Hardie Australia Pty Ltd (James Hardie) lodged exclusive dealing notification N31496 with the Australian Competition and Consumer Commission (ACCC) under section 93(1) of the *Trade Practices Act 1974* (the Act).
- 1.2. The ACCC is the Australian Government agency responsible for administering the Act. A key objective of the Act is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service
- 1.3. The notification lodged by James Hardie concerns its proposed new distribution policy for the supply and re-supply of fibre cement products manufactured by James Hardie.
- 1.4. James Hardie lodged the notification as implementation of its new distribution policy may constitute exclusive dealing within the meaning of section 47(2) of the Act. Broadly speaking, exclusive dealing involves one person who trades with another, imposing restrictions on the other's freedom to choose with whom, or in what, it deals. Exclusive dealing of this type is prohibited where it has the purpose or effect of substantially lessening competition.
- 1.5. However, recognising that in some circumstances exclusive dealing can result in a benefit to the public that outweighs the detriment caused by the anti-competitive effect, the notification process in the Act allows immunity to be afforded to parties to engage in exclusive dealing conduct when it is in the public interest. The ACCC may remove the immunity afforded by a notification at any stage if it is satisfied that the conduct will have the purpose or effect of substantially lessening competition within the meaning of section 47, and that in all circumstances:
  - the conduct has not resulted or is not likely to result in a benefit to the public; or
  - any benefit to the public that has resulted or is likely to result from the conduct would not outweigh the detriment to the public constituted by any lessening of competition that has resulted or is likely to result from the conduct.

## The notified conduct

- 1.6. Under the distribution policy James Hardie will require that:
  - a) its distributors agree not to on-sell James Hardie's products other than its Artista Columns and Accessories, to:
    - i) fibre cement manufacturers;

- ii) distributors owned by, or franchisees of fibre cement manufacturers; and
  - iii) distributors who have an exclusive arrangement to acquire fibre cement products from fibre cement manufacturers that compete with James Hardie; and
- b) those of its distributors seeking to purchase the new technology differentiated products agree:
- i) to acquire 100% of their fibre cement products from James Hardie; and
  - ii) not to on-sell James Hardie's new technology differentiated products to other distributors
- unless James Hardie gives prior written consent to do otherwise.

1.7. James Hardie has advised that it will provide written consent to a distributor, exempting it from paragraph (b) of the distribution policy where:

- (a) the distributor can reasonably demonstrate that a builder customer has requested to purchase fibre cement products that are not manufactured by James Hardie, and the distributor is unable to influence the builder's choice because, for example, an alternative fibre cement product has been specified in architectural plans; and
- (b) the distributor's overall sales of a competitor's fibre cement products made pursuant to 1.7(a) above from the commencement of its agreement with James Hardie up to and including the time it supplies the competitor's fibre cement products comprise a minor percentage (as agreed on confidential basis with James Hardie) of that distributor's total sales of James Hardie fibre cement products for that period; or
- (c) the distributor acquires a competitor's fibre cement products during the first three months after entering a supply agreement with James Hardie in order to meet existing obligations to its customers, and it ceases to do so as soon as possible or in any event by the expiration of a period to be agreed on a confidential basis with James Hardie.

Where distributors acquire products from other distributors (two stepper distributors), rather than from James Hardie direct, James Hardie will:

- (d) request two stepper distributors to inform it prior to supplying another distributor, so that James Hardie can ensure the other distributor is not a distributor who comes within paragraph (a) of the distribution policy; and
- (e) in the case of paragraph (b) of the distribution policy, provide two stepper distributors with a list of distributors who acquire 100% of their fibre cement products from James Hardie. Two stepper distributors will be free to supply the new technology differentiated products to distributors on that list. For any distributor not on that list, two stepper distributors must seek the consent of James Hardie prior to supplying the distributor with James Hardie products. James Hardie will only grant consent if it can identify that the acquiring distributor purchases 100% of its fibre cement

products from James Hardie, or falls into one of the exceptions at (a)-(c) above.

- 1.8. The ACCC asked James Hardie to advise what they meant by the term exclusive arrangement in the context of paragraph (a) of the new distribution policy. To date James Hardie has not provided the ACCC with a definition of the term. However, the ACCC notes that CSR and BGC have advised that they do not currently have exclusive arrangements with any distributors that they do not own. Based on the ACCC's understanding of how the new distribution policy will work in practice the ACCC considers this to include distributors that obtain fibre cement products from fibre cement manufacturers that compete with James Hardie.

#### *New technology differentiated products*

- 1.9. The new technology differentiated products the subject of paragraph (b) of the distribution policy are identified as follows:
- **Linea Weatherboard** is a fibre cement weatherboard and fascia product, which is lower maintenance and more durable than traditional timber weatherboards, and is fire and termite resistant. Linea Weatherboard is thicker than any other fibre cement weatherboard currently available, yet it is said to be easy to work with.
  - **Trim is a range of fibre cement** products used for external windows or corner trim.
  - **Aqua Tec Wet Area Flooring** is a structural sheet flooring product developed for wet areas such as bathrooms and laundries.
  - **Eclipsa Eaves Lining** is a pre-painted eaves lining sheet with removable adhesive slipsheet.
  - **Ezi-Grid Tile Underlay** is a substrate for ceramic tiles laid over existing timber strip, particle board or plywood sheet floors.

#### **Submissions by James Hardie**

- 1.10. James Hardie advise that the new distribution policy is intended to:

*...protect James Hardie's capacity to compete vigorously in the various product markets in which it operates. More specifically the purposes of James Hardie's policy are to:*

- (a) maximise sales by increasing sales opportunities for James Hardie's core products;*
- (b) improve efficiencies of production through increased volumes and scale;*
- (c) encourage product development and innovation consistent with James Hardie's vision of product leadership; and*
- (d) respond competitively to bundling practices in the marketplace.*

- 1.11. James Hardie claim that CSR and BGC acquire James Hardie's products and resupply them to distributors and end-users. James Hardie also claim that the

bundling practices of CSR and BGC, coupled with their vertical integration through distribution channels, reduce James Hardie's opportunity to sell its own core products to many distributors and end-users.

- 1.12. James Hardie claim that paragraph (a) of the new distribution policy is pro-competitive as it allows James Hardie to market products to its competitors customers in circumstances where the competitor is unable to supply them with its own products and therefore provides an incentive to its competitors to be efficient and reliable.
- 1.13. James Hardie advise that its technology differentiated products are the means by which it distinguishes its business from its competitors and is thereby able to drive sales of its own core products.
- 1.14. James Hardie submits that paragraph (b) of the new distribution policy is calculated to take advantage of the narrow and transient window of opportunity afforded by the availability of the new technology differentiated products to maximise sales of James Hardie products, and especially its core products. The new distribution policy will operate as an incentive for distributors to deal with James Hardie rather than its competitors.

#### *Public benefits*

- 1.15. James Hardie submits that the following public benefits will flow from implementation of the new distribution policy:
  - enhanced innovation and consumer choice;
  - reduced costs and efficiency gains; and
  - promoting competition.
- 1.16. James Hardie submits that the new distribution policy will enhance dynamic efficiency as it provides an incentive for its competitors to invest in research and development to establish their own differentiated range of products. James Hardie submits that if it does not implement the new distribution policy its incentive to develop new products will diminish and it will consider whether to discontinue its research and development strategy in Australia.
- 1.17. James Hardie submits that the new distribution policy will prevent its competitors from 'cherry picking' its technology differentiated products and bundling them with their own general building products to increase their own sales. James Hardie claims that their ability to do this removes any incentive for its rivals to respond competitively to James Hardie's innovation.
- 1.18. James Hardie also claim that competitors are currently able to 'free ride' on its technology differentiated product range. James Hardie submits that the new technology differentiated products involve considerable sunk costs and seeks to recoup these costs through increased sales volumes, especially of its core products. James Hardie submits that it cannot recoup these sunk costs from selling its differentiated product range to competitors, even at retail prices.

1.19. James Hardie submits that the new distribution policy will enable it to use its new technology differentiated products to increase sales of its core products, which will allow it to achieve efficiencies and economies of scale. This will result in cost savings, which James Hardie can pass on to distributors or use to absorb foreshadowed increases in raw material and manufacturing costs.

## **2. Previous ACCC considerations**

### **Notification N30710**

- 2.1. On 13 February 1995 James Hardie and Coy Pty Ltd (James Hardie Coy) lodged notification N30710 with the Trade Practices Commission (TPC)(now the ACCC). Notification N30710 concerned conduct related to James Hardie Coy supplying or refusing to supply fibre cement products to CSR on condition, or for the reason, that 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 WA and NT.
- 2.2. On 19 April 1995 the TPC issued a Draft Notice to revoke the notification stating that it was satisfied that the conduct would have the purpose or be likely to have the effect of substantially lessening competition in the market for the manufacturing of fibre cement products. James Hardie did not provide any public benefit arguments in support of the notification and the TPC indicated that it was unaware of any public benefits in support of the conduct.
- 2.3. An important consideration for the TPC at the time was that James Hardie Coy was the only manufacturer of fibre cement in Australia. In October 1994 CSR had indicated that it intended to open a fibre cement manufacturing plant in Sydney. The TPC was of the view that James Hardie perceived its position as sole supplier to be at risk; and in response James Hardie embarked on a strategy to counter that risk.
- 2.4. Following the Draft Notice the TPC accepted undertakings provided by James Hardie Coy that it would not attempt to prevent supply of fibre cement products to CSR from any third parties, and that it would not discriminate against outlets aligned with CSR. The undertakings were provided by James Hardie Coy on 19 May 1995 and expired in 1997.
- 2.5. In 2004 the ACCC began a review of notification N30710 following a complaint. The ACCC found that following a corporate restructure legal immunity now rested with Amaca Pty Ltd (formerly James Hardie Coy). ACCC inquiries determined that Amaca Pty Ltd was no longer part of the James Hardie Group of companies and that they were no longer engaging in conduct that was the subject of the notification. On this basis the ACCC did not proceed with the review of the notification.

### **2004 ACCC investigation**

- 2.6. In 2004 the ACCC conducted an investigation into James Hardie's former distribution policy which restricted distributors from on-selling its fibre cement products to James Hardie's competitors, or to distributors owned by, or franchises of, its competitors. In particular, James Hardie requested its distributors to not:
  - re-sell James Hardie products to other distributors without written authorisation from James Hardie management, or

- re-sell James Hardie Products to manufacturers who compete with James Hardie.
- 2.7. James Hardie advised distributors that failure to comply with the requirements of the policy may result in the termination or voiding of parts, or all, of any written agreement with James Hardie or the closure of the distributor's trading account with James Hardie.
  - 2.8. On the basis of the evidence available at the time the 2004 investigation was concluded with no action taken in respect of the policy.
  - 2.9. The ACCC understands that at the time, and in the period following this investigation, James Hardie did not actively enforce this distribution policy and some distributors continued to on-sell James Hardie products to other distributors without written authorisation.
  - 2.10. As part of the current notification process James Hardie makes reference to the ACCC's consideration of James Hardie's former distribution policy in 2004 and its decision not to pursue the matter. The ACCC notes that its consideration of the current notification is based on a different set of facts and within a different context to previous decisions. For example, the ACCC has considered the conduct described in paragraph (a) of the new distribution policy having regard to its interaction with the conduct described in paragraph (b). Similarly, the ACCC considered the degree to which on selling has been undertaken in the past – despite James Hardie policies – and the current proposal to enforce the on selling restrictions. As such the ACCC's past considerations of James Hardie's policies can not be seen as determinative of its consideration of the current notification.



### **3. Summary of submissions by interested parties**

- 3.1. The ACCC received 18 submissions from interested parties in response to the notification. Several of these submissions were granted confidentiality and were not placed on the ACCC's public register. Copies of all non-confidential submissions are available on the ACCC's public register. The majority of submissions received opposed the notification.
- 3.2. In fact only one submission, from Blue Mountains Hardware Pty Ltd, was in favour of the notification and the new distribution policy on the basis that it would reward and encourage James Hardie to continue to develop new fibre cement products.
- 3.3. Blue Mountains Hardware submit that if CSR and BGC are denied access to James Hardie's new products market pressures will encourage them to consider the development of their own product range.
- 3.4. A summary of the main issues raised by interested parties opposing the notification is outlined below.

#### *Substitutes for fibre cement*

- 3.5. Fibre cement products are used in a number of applications both internal and external. The use of fibre cement tends to be driven by its specific characteristics, such as being resistant to damage by water/insects and impact. In a number of applications, fibre cement has a leading position with alternative products that are less accepted by consumers. Further, alternative products have different characteristics that will be relevant to differing degrees when determining substitutability such as durability, finish and ability to shape. Few of the alternative products mentioned by James Hardie are direct substitutes to fibre cement.
- 3.6. Submissions from CSR and BGC claim that competition for fibre cement products comes at the 'design' stage of a building project and that considerations other than price are the driving force in the decision to use fibre cement products as opposed to other building materials. Both CSR and BGC contend that the relevant market is one for the supply of fibre cement products.

#### *New technology differentiated products*

- 3.7. The new technology products manufactured by James Hardie enable a design change for the builder. Therefore, the new technology differentiated products may have the same functionality as general fibre cement products, but could be specified by a builder or architect to enable a different finish for a project.
- 3.8. James Hardie has invested in marketing its new technology products (and their brand name such as Linea) as having certain distinct and desirable characteristics. Accordingly, there will be a distinct demand for the new differentiated products and customers are likely to request the products by their product name/trademark.

### *Sourcing building products from one distributor*

- 3.9. Several submissions received by the ACCC from distributors stressed the importance of being able to provide a complete range of fibre cement products. Interested parties claimed that if they were unable to supply certain key products then this would be enough to cause buyers to take all of their business to a distributor that could supply a complete range.

### *Bundling*

- 3.10. A number of submissions addressed the allegation by James Hardie that rival fibre cement manufacturers engage in bundling, which it is unable to do as it only manufactures fibre cement. In general fibre cement products and non-fibre cement products are required at different stages of the building process and are installed by different contractors, and are purchased separately by distributors.
- 3.11. The internal lining segment is the only distribution channel where fibre cement is sold as part of a bundle. However, most of the volume in this segment is made up of plasterboard sales (used for general wall lining), with a smaller proportion of sales being made in the more expensive linings (used in wet areas).
- 3.12. The largest part of the internal lining segment is supplied by plasterboard manufacturers such as Boral and LaFarge where they, or their distributors, will only acquire fibre cement products from James Hardie. CSR and BGC also manufacture plasterboard and have their own exclusive distribution channel arrangements.

### *Rebates*

- 3.13. Both James Hardie and CSR enter into arrangements with large volume builder customers entitling them to rebates if they use their particular branded fibre cement products in building projects. As builders prefer to buy all their requirements from a single source, the inability for a distributor to have access to James Hardie products would mean that James Hardie aligned builders are likely to consider obtaining all of their building products, not just their fibre cement, from a James Hardie distributor in order to qualify for their rebate with James Hardie.

### *Effect of the distribution policy*

- 3.14. Distributors suggest that the new distribution policy will effectively force distributors to take either the following two courses of action:
- Remain a dual stockist of James Hardie and CSR products, which will mean the distributor will lose a number of sales from not being able to supply the full range of fibre cement products; or

- Become an exclusive James Hardie stockist and pay a higher price for undifferentiated products from James Hardie and lose sales from builders aligned with CSR.

3.15. Distributors also fear that by being exclusively aligned with James Hardie they will not be able to obtain a competitive price on core fibre cement products. One submission indicated that:

*There is no mention in the Hardie submission of how purchasers will be able to obtain the best possible price on the old technology products if they are bound to an exclusive deal with Hardies.*

3.16. Distributors have indicated that they believe the new distribution policy will have the effect of entrenching James Hardie's position as the market leader and would result in a lessening of competition.

*Public benefits submitted by James Hardie - interested party submissions*

3.17. Submissions received by the ACCC are sceptical of James Hardie's claimed public benefits. In particular, interested parties claim that James Hardie should be entitled to receive the commercial benefit of the products it develops subject to the demand for those products. James Hardie should not be able to implement a restrictive arrangement with respect to other competitive products in order to recoup its research and development of new products. Submissions argue that the fact that James Hardie has already developed new products demonstrates that it does not need an anti-competitive arrangement to fund research and development.

3.18. Further, it has been submitted that the 'increased sales' James Hardie refers to in its public benefit argument that will enable it to achieve scale and increase efficiencies, are not an increase in sales overall in the market, but are increased sales to James Hardie from competitors BGC and CSR. Therefore, the policy does not seek to increase the fibre cement market, but rather to distort competition choices from those that would be made in a freely competitive market.

3.19. Further, a number of submissions suggest that the purchase of James Hardie's product range from rival manufacturers or aligned distributors at retail prices does not constitute a 'free ride'. Submissions suggest that James Hardie is able to derive the same revenue from sales to rivals or their distributors as it would to any other distributor.

## **4. ACCC Evaluation**

### **Statutory test**

- 4.1. On 23 December 2005, James Hardie lodged notification N31496 with the ACCC in accordance with section 93(1) of the *Trade Practices Act 1974* (the Act) relating to conduct of a kind referred to in subsection 47(2) of the Act.
- 4.2. Immunity provided by notification N31496 commenced on 23 December 2005 and will continue unless the ACCC issues a final notice revoking the notification.
- 4.3. Section 93(3) of the Act provides that the ACCC may give notice removing immunity for conduct described in subsection 47(2) if the ACCC is satisfied that the conduct will have the purpose or effect of substantially lessening competition within the meaning of section 47, and that in all circumstances:
  - the conduct has not resulted or is not likely to result in a benefit to the public; or
  - any benefit to the public that has resulted or is likely to result from the conduct would not outweigh the detriment to the public constituted by any lessening of competition that has resulted or is likely to result from the conduct.
- 4.4. The first step in assessing the effect on competition and the public benefits likely to result from the notified conduct is to consider the relevant market in which the conduct occurs.

### **Market assessment**

#### **Fibre cement**

- 4.5. The new distribution policy the subject of the notification relates to James Hardie's fibre cement products other than Artista columns and accessories.
- 4.6. Fibre cement is made up of cellulose fibre, cement and ground sand. Fibre cement products are capable of being used in a number of building applications – both internal and external. Broadly, fibre cement products can be used for:
  - internal lining – in wet area applications (eg bathrooms, laundries, kitchens) for walls and underlays due to its water resistant qualities;
  - flooring – for deck and balcony surfaces as well as an underlay for ceramic tile, vinyl and cork flooring;
  - external lining – as cladding products for example, weatherboard and fibre cement sheets, eaves lining;
  - columns – used primarily for decorative purposes; and
  - other applications such as corrugated sheet, bracing and fencing.

- 4.7. The ACCC notes that the degree to which other building products are substitutable for fibre cement, from an end use or demand point of view, varies. For example, fibre cement products such as weatherboard or sheets can be used as the external lining to a house as can bricks, cement blocks or treated timber etc. In these cases the decision to use fibre cement over substitute products is based on the design or look of the home and the price of the alternate products that are consistent in achieving the overall design. Builders, architects and designers have a key role in identifying the range of products that may be suitable. Other factors such as environmental considerations may also play a role in selecting the product used in the external construction of a house or building. For example, fibre cement is resistant to moisture, rotting, termites and fire and these characteristics may make them preferable to brick or wood in some circumstances. Similarly, fibre cement is able to be used in second story developments and renovations where other products such as bricks may not be suitable or may be too costly (for example due to the reinforcing of the lower level which is required if a heavy material is used on the upper levels).
- 4.8. The ACCC understands that the use of bricks, cement blocks or treated timber are more expensive than fibre cement for external cladding of housing. Despite this brick is currently the most popular material for house construction in Australia.
- 4.9. The ACCC notes, however, that the specific properties of fibre cement make it the product of choice for some building applications such as eaves lining and internal wet area lining where the use of alternate products are less accepted by end users. CSR submits that

*From a customer perspective, a number of fibre cement products have few if any direct or economic substitutes, including fibre cement sheets for internal wet lining applications such as bathrooms.*

- 4.10. In this regard, the ACCC understands that fibre cement is used almost exclusively for eaves lining. Timber lining board may be specified by architects in order to achieve a particular aesthetic look, however the timber lining board would require further processing and treatment before it would be suitable for this application and is a more expensive product than fibre cement. Market enquiries with builders suggest that a sustained increase in the price of fibre cement eaves lining products would be unlikely to have an effect on the demand for these products.
- 4.11. For internal wet area lining the ACCC understands that while it is possible to use water resistant plasterboard instead of fibre cement products, the product of choice by end users for these applications is fibre cement. When plasterboard is used the edges have to be taped or coated by the builder before installation to ensure that water does not get into the plasterboard. Often this means that the plasterboard does not fit together as well as fibre cement products which are already water resistant. Market enquiries with builders suggest that fibre cement is generally accepted throughout the industry as the product to use for wet area lining.

4.12. On the supply side, the substitution possibilities between fibre cement and other building products appear to be limited. BGC submit:

*Clearly, a plant used to manufacture fibre cement products can not be re-tooled or configured to produce plasterboard, wooden cladding or many of the purported substitutes put forward by James Hardie ...*

4.13. Although BGC also note that:

*From the supply side, it is apparent from the description of the manufacturing process of fibre cement products that there is a significant degree of supply side substitutability within the category of fibre cement products. The manufacturing plant used to produce most categories of fibre cement products is common, with the main differences being in the additional valuation processes such as cutting, grinding and painting that may be applied to produce some specific categories of products.*

4.14. Interested parties have identified two broad categories of fibre cement products:

- core products - which are primarily flat-sheet internal and external lining products; and
- technology differentiated products - which have advanced characteristics that make them superior to core products (eg thickness, weight, durability and ease of use). The new technology differentiated products that are the subject of paragraph (b) of the new distribution policy are a sub-set of the technology differentiated fibre cement products.

4.15. While it appears that core fibre cement products are functionally similar to the technology differentiated products they are differentiated products with innovative elements or advanced characteristics that create, or are likely to create, their own demand. For example, the Linea™ and AquaTec™ products are lighter and thicker than current fibre cement products on the market and their ease of use make them attractive to builders for the applications they were designed for. In this regard Boral submit that:

*.. the basis on which the application is made is that the new technology differentiated products are differentiated products and are therefore distinguishable from other products and less substitutable.*

4.16. In addition, James Hardie has undertaken significant marketing efforts with respect to the new technology differentiated products over the core products which is likely to continue to generate demand for these products over core products by end users. BGC submits:

*The core of the manufacturing process (manufacturing the fibre cement sheet) is essentially the same and involves 70% of manufacturing costs. BGC submits it is in the advertising and marketing of the “new technology differentiated products” that James Hardie places the majority of its effort and expenditure”*

4.17. Further, CSR submits that James Hardie's marketing will likely result in:

*...a distinct demand for the Differentiated Products and customers are likely to request the products by name. Additionally a builder or architect may specify those products, in which case a distributor will not have any substitution options.*

### **Manufacturers of fibre cement**

4.18. There are currently three fibre cement manufactures in Australia:

- James Hardie Australia Pty Ltd (James Hardie)
- CSR Building Products Limited (CSR) and
- Buckeridge Group of Companies (BGC).

#### *James Hardie*

4.19. James Hardie is the largest fibre cement manufacturer in Australia with an estimated share of approximately 65% of fibre cement sales by volume. James Hardie pioneered the development of fibre cement technology in Australia in the mid-1980s. Currently, James Hardie achieves annual net revenue in Australia of approximately \$200 million from the sale of fibre cement products.

4.20. James Hardie is the only Australian manufacturer that currently supplies the full range of both core and technology differentiated products. In Australia James Hardie operates 2 fibre cement manufacturing plants located in Sydney and Brisbane. The ACCC understands that total production capacity of James Hardie's plants in Australia is 34 million m<sup>2</sup> per annum. James Hardie also has manufacturing plants located in the United States, Chile, New Zealand and the Philippines.

4.21. As James Hardie is not vertically integrated it has relationships with distributors for the supply of its products. James Hardie currently has 210 distributors with whom it has a written supply agreement and a number of other customers who are not parties to a written supply agreement. James Hardie is currently the largest supplier of fibre cement products to Bunnings (although Bunnings also sells fibre cement products manufactured and supplied by CSR and BGC). James Hardie also supplies Boral with the majority of its fibre cement products. Boral is a major plasterboard manufacturer which operates 48 company owned interior lining stores throughout Australia. Boral's distribution footprint is similar to that of CSR's Gyprock Trade Centres (GTCs).

#### *CSR*

4.22. CSR began production of fibre cement products in 1995. It is the second largest manufacturer of fibre cement in Australia and estimates that it has a market share of approximately 19% of fibre cement sales by volume. In addition to fibre cement products, CSR also manufactures a range of building products such

as insulation, plasterboard, lightweight concrete products, roof tiles and bricks. CSR also produces sugar and aluminium.

- 4.23. CSR operates a single fibre cement manufacturing plant located in Wetherill Park in Sydney. The ACCC understands that it has a production capacity of 10 million m<sup>2</sup> per annum.
- 4.24. CSR owns and operates the distribution chain for building products known as Gyprock Trade Centres (GTCs) which supply fibre cement as well as other internal dry lining products. CSR advise that GTCs are a specialist distribution channel for dry lining contractors, rather than builders generally. They are designed as a one stop shop for products used to line the inside of a house and which are used at the same time in the building process, being primarily plasterboard and fibre cement wallboard which is used in wet areas. As internal lining specialists the GTCs do not supply the full range of CSR fibre cement products or the full range of CSR building products.

#### *BGC*

- 4.25. BGC is a West Australian based group of companies and submits that it currently supplies approximately 13% of fibre cement products in Australia from its plant in Canningvale in Perth. BGC advise that its annual production capacity is 12 million m<sup>2</sup> per annum. BGC commenced production of fibre cement products in 1994 and began supplying fibre cement to the eastern states of Australia in 1996.
- 4.26. In addition to fibre cement, BGC also manufactures a number of building products including steel, cement, and plasterboard. BGC is vertically integrated in the building/construction industry with interests in residential and commercial building, contract mining, civil engineering construction and maintenance, quarrying, road transport, property ownership and insurance.
- 4.27. BGC currently maintains an agreement with Australian Plasterboard Company (APC) pursuant to which APC supplies exclusively BGC products (including fibre cement) through its franchisees in NSW.

#### **New entry**

- 4.28. The ACCC considers the likelihood for new entry in the manufacture of fibre cement products in the short to medium term is low. BGC estimate:

*...the cost of building an equivalent plant to its own in Western Australia with a capacity of approximately 12,000,000 m<sup>2</sup> per annum at approximately \$45M.*

- 4.29. It is relevant to note that this cost is for a relatively small plant and if a new entrant were to meet James Hardie's capacity of approximately 34 million m<sup>2</sup> per annum the costs would be significantly higher.
- 4.30. BGC also submit that given the high fixed costs of production, economies of scale are significant particularly as they affect the capacity of new entrants to



invest in product development and advertising. With approximately 65% of the market, James Hardie's scale advantage is significant.

- 4.31. In addition, new entrants face the strength of James Hardie's brand name. After years of manufacturing and marketing its brand, some of James Hardie's products are known by architects and builders by trademark for use in particular building applications. In this regard, BGC submits:

*Several of James Hardie's brands, such as Hardiflex and Villaboard have attained "hoover" status of brand recognition and usage. In the construction industry, where builder specification is crucial, such an advantage is valuable.*

- 4.32. Access to the distribution network is also a significant issue for new entrants, given that the major supply channels are already significantly aligned with the incumbent manufacturers through preferred supply or exclusive supply agreements. This is likely to increase following implementation of James Hardie's proposed new distribution policy which will require distributors to stock James Hardie's products exclusively, thereby forcing new entrants to create alternate distribution channels as well the new product.
- 4.33. Given these barriers it is considered that expansion by the current manufacturers to produce new technology differentiated products in competition to James Hardie is more likely than new entry, although still difficult.
- 4.34. The ACCC is aware that CSR and BGC have developed some products of their own to compete with James Hardie's new technology differentiated products. As already indicated, BGC submit that the manufacturing of James Hardie's new technology differentiated products incorporates 70% of the technology used to manufacture core fibre cement products. However, the ACCC understands that the alternate products developed by CSR and BGC are still not equivalent to James Hardie products in terms of thickness and weight or as extensive in terms of range.
- 4.35. The size of the fibre cement market in Australia is approximately \$300 million per annum and the new technology differentiated products are currently a small portion of total sales. This, combined with the current market presence and economies achieved by James Hardie, are likely to make it difficult for CSR and BGC to create a full line of fibre cement products that compete with James Hardie's range of new technology differentiated products, particularly in the short to medium term.

### **Imports**

- 4.36. The ACCC understands that James Hardie imports some of its fibre cement products for supply in Australia from its overseas plants, particularly those located in the Philippines and New Zealand. Imports of fibre cement products, other than those manufactured by James Hardie in its own manufacturing plants located overseas, account for approximately 1-2 % of the total volume of fibre cement sales in Australia. CSR submits that the limited number of imports is indicative of the fact that:

*Fibre cement products manufactured in Australia are designed to perform well under 'wet and dry' weather cycles, which suits our climate. Fibre cement products produced for 'freeze and thaw' cycles, such as those made in Europe, use different fibre reinforcement, are more expensive and do not perform optimally in Australia. Imports are therefore viable only from those countries producing products for 'wet and dry' weather cycles.*

## **Distributors of fibre cement products**

4.37. Fibre cement products are distributed through various channels including via:

- General hardware and timber distributors – such as Bunnings, Mitre 10, Hudson Building Supplies and many independent outlets. A number of these distributors purchase fibre cement products through buying groups such as the Hardware and Building Traders Buying Group (HBT) and National Building Suppliers Group (NatBuild). According to CSR over 60% of fibre cement products are distributed via this channel.
- Internal lining distributors – such as the Australian Plasterboard Company, Boral, La Farge, and CSR's GTCs. These distributors supply the full range of internal lining products to builders and therefore generally stock plasterboard as well as fibre cement products. Most of the volume in this segment is made up of plasterboard sales which reflect the ratio of plasterboard to fibre cement usage in any new house. For example, James Hardie submit that the internal linings of an average house in Australia are 77% plasterboard and 8% fibre cement, with the remainder largely rendered brick.
- Specialist distributors – which deal in more specific building requirements such as flooring or cladding.

4.38. Many distributors, particularly in the general hardware and timber channel, sell products to other distributors as well as directly to end users.

## **End users**

4.39. The end users of fibre cement products are:

- large building companies;
- independent builders;
- internal lining contractors; and
- home renovators and DIYs.

4.40. In addition to functionality, the major factors affecting the purchase decisions for fibre cement by end users, particularly large building companies, include:

- any rebate arrangements in place with manufacturers. The ACCC understands that both James Hardie and CSR offer rebates or discounts to major end users of fibre cement products to encourage brand loyalty. This appears to be a

widespread and effective method by which the manufacturers are able to generate demand and brand loyalty for their products with end users; and

- the desire to minimise the number of different suppliers they deal with. Submissions from distributors stressed the importance of being able to provide a complete range of building products including the fibre cement products to meet their customers' requirements. For example, Hudson Building Supplies (HBS) advised that a review of their customers shows that where a builder requires fibre cement material for more than one area of the house or building (ie eaves and wet area), they will purchase all of their requirements from one source, in 100% of cases. HBS advised that a likely reason for this is that builders seek to minimise the complexity and costs of the building process through fewer deliveries, fewer invoices and fewer points of contact.

### **Conclusion on market**

4.41. The ACCC considers that the relevant market for the purpose of assessing the impact of James Hardie's new distribution policy is the Australian market for the manufacture and supply of fibre cement products. The ACCC considers that imports and new entrants are not likely to be significant constraints in this market.

### **Purpose or effect of the new distribution policy**

4.42. Paragraph (a) of the new distribution policy prevents James Hardie's distributors from on-selling any of James Hardie products (with the exception of Artista™ columns and accessories) to competing fibre cement manufacturers or distributors or franchisees that are owned by, or have exclusive arrangements with, fibre cement manufacturers that compete with James Hardie.

4.43. The ACCC understands that this on-supply restriction may already be part of James Hardie's current supply arrangements with many distributors. However, the amount of on-supply that currently occurs suggests that it has not been widely enforced by James Hardie, although this is likely to change as a result of the notification of the new distribution policy.

4.44. The enforcement of paragraph (a) of James Hardie's new distribution policy will stop the large amount of re-selling which currently occurs in the industry. This will prevent CSR and BGC and their distributors from gaining access to James Hardie's products that they offer in conjunction with, or in addition to, CSR or BGC branded core products in order to be able to provide a full line of fibre cement products to their customers. James Hardie advise that distributors that on-sell James Hardie's fibre cement products to other fibre cement manufacturers and/or distributors (two stepper distributors) account for less than 5% of James Hardie's sales. CSR indicate that it believes that 5% of sales from distributors are sales to other distributors and that CSR's purchases of James Hardie products from distributors represents this amount.

4.45. Under paragraph (b) of the distribution policy, distributors wishing to supply the new technology differentiated products must agree to acquire all of their fibre

cement products from James Hardie. As a result they will not be able to supply fibre cement core products manufactured by CSR and BGC. These distributors will also be restricted from on-selling the new technology differentiated products to other distributors.

- 4.46. In limited circumstances distributors will be able to seek a written exemption from James Hardie from paragraph (b) of the new distribution policy. James Hardie advised that it will consider providing a written exemption where a distributor can reasonably demonstrate that a builder customer has requested to purchase fibre cement products not manufactured by James Hardie and that customer will not change its choice of product because, for example, the architectural plans specify the alternate product. Written exemption may also be provided by James Hardie to enable a distributor to continue it to meet existing obligations to customers for an agreed period immediately after entering into a supply agreement with James Hardie.
- 4.47. Both the individual and combined effect of paragraphs (a) and (b) of the new distribution policy have the immediate effect of preventing James Hardie's competitors from supplying those distributors that agree to the exclusive arrangement with James Hardie.
- 4.48. In essence, paragraph (b) of the policy forces distributors to take one of two options:
- i) to supply the new technology differentiated products and become an exclusive distributor of James Hardie fibre cement products at the expense of core products manufactured by CSR and BGC; or
  - ii) give up the ability to supply James Hardie's new technology differentiated products in order to sell the core products of James Hardie and/or CSR and/or BGC.
- 4.49. Paragraph (a) of the policy has the effect of blocking re-supply so that non-exclusive distributors are prevented from obtaining James Hardie's products through other distributors. This reinforces the exclusive supply situation created by paragraph (b) of the policy.
- 4.50. A central consideration for a distributor in this position is the importance of access to James Hardie's new technology differentiated products. James Hardie have provided confidential information emphasising that its technology differentiated products form a small proportion of its total output. In contrast, the ACCC has received many submissions from interested parties highlighting the strategic importance of those products for competing manufacturers and distributors and the demand for them by end users. The ACCC notes the comment by BGC:

*.. the proportion of sales of the new technology differentiated products in comparison to the total market does not convey the level of demand for the products. While distributors may acquire relatively small volumes of the*

*products, they do so as part of an essential strategy of offering the full range to their customers.*

- 4.51. Further, market enquiries suggest that the concerted marketing campaign by James Hardie to key participants in the building industry such as builders, architects and civil engineers, is likely to result in an increase in demand for new technology differentiated products in the near future.
- 4.52. In any event, the ACCC considers that the success of the new distribution policy relies on the strategic importance of the new technology differentiated products to end users and therefore distributors. If James Hardie was not confident that distributors, or the majority of distributors, would accept the exclusive dealing restriction it would be unlikely to want to implement the new distribution policy.
- 4.53. As further evidence of the importance of being able to supply the full range of fibre cement products, CSR advise that it acquires James Hardie products at retail prices from James Hardie distributors and on sells them at a wholesale price to distributors with which CSR has a supply relationship. CSR advise that in 2005 it purchased approximately \$1.9 million of James Hardie products (excluding columns and capitals). CSR submit that it does this because many of its hardware and timber distributors and their customers have a strong preference to limit the number of suppliers they deal with and if CSR is unable to meet the demands of its customers it risks losing their business for all CSR products. Paragraph (a) of the policy will prevent CSR from being able to continue to meet these demands.
- 4.54. In summary, the ACCC considers that having access to the full line of James Hardie's products is important for distributors and consequently CSR and BGC. This is due to a number of factors including:
- James Hardie's market position with over 65% of sales and widely recognised brand name products.
  - James Hardie being the only manufacturer of the new technology differentiated products.
  - The preference for end users to limit the number of suppliers they deal with and the resulting pressure on distributors to be able to supply the full range of products.
  - The existence of rebates offered by manufacturers generating demand for specific brands or products.
- 4.55. Given the importance for distributors of being able to offer the complete range of fibre cement products and the number of end users that have a preference for the James Hardie brand, for example as a result of the rebates they receive, the ACCC considers that a substantial number of these distributors are likely to forego supplying CSR and BGC core products rather than James Hardie's new technology differentiated products. In this regard the ACCC notes that Boral currently obtains supply from more than one fibre cement manufacturer and it has indicated that a possible effect of the proposed policy in paragraph (b) could

require it to discontinue its current purchases of fibre cement products from other manufactures and source exclusively from James Hardie.

- 4.56. The ACCC considers that there is currently price competition resulting from the ability for distributors to source products from a number of manufacturers. For example, the ACCC notes that the existence of re-supply arrangements have assisted CSR to provide a greater level of price competition to James Hardie in respect of its core products as evidenced by CSR winning a competitive tender over James Hardie and BGC for the supply of fibre cement products to Hudson Building Supplies (HBS) in August 2005. While CSR is currently HBS's preferred supplier, HBS also purchases James Hardie's core fibre cement products directly from James Hardie and the new technology differentiated products from other distributors. HBS has submitted that if it chose to become an exclusive James Hardie stockist in order to maintain access to the full range of products it will lose sales to builders who are aligned to CSR and will result in it having to pay a higher price for James Hardie's core products (as it is currently able to source CSR's core products at a lower price as a result of the competitive tender process).
- 4.57. Similarly, Bunnings submit that it is opposed to the notification as it will impact the choice of fibre cement products that are currently available to Bunnings' customers as some customers specifically request products from CSR or BGC and it may potentially insulate James Hardie's products from price competition. Bunnings advise that it objects to the requirement in the distribution policy to acquire 100% of fibre cement products from James Hardie if it chooses to stock the new technology differentiated products.
- 4.58. The new distribution policy will have an effect of limiting the ability of distributors to dual source fibre cement products and remove any competitive constraints that are likely to exist.
- 4.59. Therefore the ACCC considers that competition for the supply to distributors and end users is likely to be reduced as distributors who currently rely on the ability to gain access to James Hardie products via other distributors will have their supply cut off as a result of paragraph (a) of the new distribution policy. These distributors are likely to forego supplying CSR and BGC products in order to access the full range of products. Further, paragraph (b) will force distributors to make the choice of acquiring all of their fibre cement requirements from James Hardie or offering an incomplete range of CSR or BGC products to their customers.
- 4.60. The result for end users is likely to be:
- a reduction in the number of distributors that are able to offer a complete range of fibre cement products;
  - less competition between distributors and between manufacturers; and
  - higher prices for core products.

## **Conclusion on the purpose or effect of the new distribution policy**

- 4.61. For the reasons outlined above, the ACCC considers that the new distribution policy will have the effect of substantially lessening competition in the manufacture and supply of fibre cement products in Australia. The enforcement of paragraphs (a) and (b) is likely to result in the reduction of the number of distributors supplying James Hardie's new technology differentiated products or make it impossible, at least in the short to medium term, for CSR and BCG to compete by offering the full range of fibre cements products and by foreclosing their access to distributors who need to supply the full range of fibre cement products to meet their customers demands.
- 4.62. The ACCC also notes concerns by a number of distributors over their ability to comply with paragraph (a) of the new distribution policy in terms of ensuring that they do not re-supply to purchasers who are associated with competitors of James Hardie. For example, Bunnings submit that it is not practical for it to enforce the policy throughout its store network, particularly in relation to smaller trade and retail sales.

## **Public benefits from the new distribution policy**

- 4.63. James Hardie submits that the principal public benefits that will flow from the new distribution policy are:
- enhanced product innovation and expanded consumer choice;
  - an ability for James Hardie to increase sales volumes, that will lead to economies of scale and consequent cost benefits; and
  - increased competition

## **Enhanced product innovation and expanded consumer choice**

- 4.64. James Hardie claim that its distribution policy provides an incentive for it to continue to innovate, and encourages its competitors to respond competitively through conducting their own research and development in fibre cement products.
- 4.65. Further, James Hardie submits that its rivals are currently 'cherry picking' its new technology differentiated products and selling them as a bundle with their own core fibre cement range. James Hardie submits that this practice reduces the addressable market to which James Hardie can market its technology differentiated products, and removes any incentive for its rivals to respond competitively to James Hardie's innovation.
- 4.66. The ACCC does not accept that the bundling practices of CSR and BGC have foreclosed the ability for James Hardie to access distributors for the supply of its products. The ACCC understands that neither CSR nor BGC have exclusive arrangements with general hardware and timber distributors which account for over 60% of the volume of fibre cement products consumed in Australia and include Bunnings, Mitre 10 and HBS.

4.67. James Hardie also submits that competitors are currently able to ‘free ride’ on its investment in its new technology differentiated product range. James Hardie submits that due to the strong competition it faces it can not recoup its investment in its new technology differentiated products even through sales to competitors at retail prices.

4.68. In response CSR submits:

*The economic problem of a ‘free rider’, and hence the potential public benefit in countering it, is, in general terms, a person or organisation who benefits from a good, but neither provides it nor contributes to the cost of its provision...the purchase by CSR of certain James Hardie products at retail prices is not a free ride on those products.*

4.69. The ACCC considers that James Hardie has not demonstrated how the purchase of James Hardie’s new technology differentiated products by rival manufacturers at retail prices constitutes a ‘free ride’ on James Hardie’s investment in those particular products. Rather, as BGC submits:

*Competitors do not free ride if they pay fair market prices to acquire differentiated products that they do not supply in order to meet customer demand for a total range of products. The manufacturer of the differentiated product achieves the same price for that product and may increase that price in the absence of competition in order to recoup sunk costs in product development.*

4.70. The ACCC notes that investment in research and development of the currently available new technology differentiated products has already occurred and did so without the implementation of the new distribution policy. The ACCC has not been provided with any evidence to suggest that its investment was contingent on rent seeking and the ACCC would expect that James Hardie justified its decision to undertake the investment on the basis that, among other things, the development of new products allow it to recoup a higher margin in the markets in which it supplies, including Australia and internationally.

4.71. The ACCC does not accept that enhanced product innovation and expanded consumer choice are public benefits that are likely to flow from the notified conduct.

#### **Increase in sales volumes, economies of scale and cost benefits**

4.72. James Hardie claim that paragraph (b) of the policy allows it to provide the new technology differentiated products on an exclusive basis and thereby compete more effectively. This is because it can use its new technology differentiated products to increase sales volumes of its core products. James Hardie claim that by selling large volumes of its products it can achieve efficiencies and economies of scale which will allow it to either pass on cost savings to distributors or absorb foreshadowed increases in input costs.



4.73. The ACCC does not accept that an increase in sales to James Hardie constitutes a public benefit. While in some cases, the ACCC accepts that supply restrictions can encourage public investment, the ACCC notes that the new distribution policy is not intended to increase the market overall but rather sales of James Hardie's products at the expense of its competitors. The ACCC considers that realisation of the increase in sales would be the result of an anti-competitive exclusive arrangement.

### **Promoting competition**

4.74. James Hardie claim that implementation of the distribution policy will increase competition as it allows James Hardie to:

- respond competitively to its competitors' practices of bundling James Hardie products with other building products;
- enhance its ability to compete at the manufacturing level of the market with vertically integrated competitors; and
- preserve its ability to compete vigorously on price and product quality.

4.75. The ACCC does not accept this as a public benefit likely to flow from the notified conduct. In fact as concluded above, the ACCC considers that it will have the effect of substantially lessening competition in the market for the manufacture and supply of fibre cement products.

### **Conclusion on public benefits**

4.76. The ACCC does not accept the claimed public benefits by James Hardie.

4.77. The ACCC does not accept that it is a public benefit for the costs of producing the new technology differentiated products to be recouped through rents on the core products achieved through exclusive arrangements.

## **Conclusion**

4.78. The ACCC is satisfied that the new distribution policy the subject of notification N31496 has, or would have, the effect of substantially lessening competition in the market for the manufacture and supply of fibre cement products in Australia.

4.79. Further, the ACCC is not satisfied that the public benefits claimed by James Hardie will outweigh the likely detriment to the public constituted by the lessening of competition that is likely to result from the new distribution policy.

## **5. Draft Notice**

- 5.1. For the reasons outlined in section 4, the ACCC is satisfied that the conduct the subject of the notification N31496, has or would have the effect of substantially lessening competition, and that the any benefit to the public that is likely to result from the conduct will not outweigh the likely detriment to the public constituted by any lessening of competition that will result.
- 5.2. Accordingly, the ACCC proposes to issue a notice to revoke the notification lodged by James Hardie Australia Pty Ltd on 23 December 2005.