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**BY EMAIL: adjudication@acc.gov.au**

**NON-CONFIDENTIAL VERSION**

The General Manager  
Adjudication Branch  
Australian Competition and Consumer Commission  
PO Box 1199  
Dickson ACT 2602

Dear Mr Gregson

**EXCLUSIVE DEALING NOTIFICATION N31496 LODGED BY JAMES HARDIE AUSTRALIA PTY LTD**

We refer to your letter to Alec Brennan of CSR dated 16 January 2006 regarding Exclusive Dealing Notification N31496 lodged by James Hardie Australia Pty Limited (**James Hardie**) on 23 December 2005 (**the Notification**).

**RESPONSE TO COMMISSION QUESTIONS**

The Commission has asked certain questions in relation to the supply of fibre cement products. CSR's answers to those questions are provided in the attachment to this letter. Please note that certain of the information provided in response to the Commission's questions is commercial in confidence to CSR. This information has been specifically identified.

## **SUBMISSIONS IN RELATION TO NOTIFIED CONDUCT**

In addition to the response to those questions, CSR wishes to make submissions in relation to the notified conduct. James Hardie has not substantiated its arguments, rather its submissions are based on assertion and do not contain any evidence as to the effect on competition, or to demonstrate in any tangible way the public benefits James Hardie claims.

CSR submits that the conduct is likely to substantially lessen, prevent or hinder competition in the supply of fibre cement products and is unlikely to provide any benefit to the public. CSR submits, therefore, that immunity for the notified conduct should be withdrawn. Additionally, CSR takes this opportunity to clarify some of the information provided in the Notification, which has the potential to mislead the Commission.

The submissions set out below should be read in conjunction with the further detailed information provided by CSR in its response to the Commission's information request.

### **Manufacture, supply and distribution of fibre cement products**

James Hardie, CSR and BCG manufacture a range of fibre cement products for use in the building industry in Australia. In addition, some fibre cement products are imported. Further details on the composition and range of fibre cement products is set out in the response to the Commission's questions.

Fibre cement products are distributed through various distribution channels. For example, fibre cement products used in conjunction with specialist trade applications, such as tiling (eg, ceramic tile underlay), or internal lining of houses (eg, wallboard) are distributed through specialist distribution channels. However, by both range and volume, the largest quantities of fibre cement products are distributed through generalist hardware and timber outlets, that serve builders and also the DIY segment.

By way of illustration, CSR estimates that hardware and timber outlets account for the distribution of over 60% of fibre cement products consumed in Australia.

James Hardie, CSR, BCG and specialty fibre cement resellers such as Guardian compete to supply fibre cement products to hardware and timber outlets. This competition covers all those elements that the Commission would expect, including price, service, product support, marketing and promotional support.

Some hardware and timber outlets may prefer to deal with a sole source of supply for fibre cement products, while others may stock products from multiple suppliers. Whether an outlet has

a sole or multiple source of supply strategy, in CSR's experience all hardware and timber outlets encourage and value competition for their business.

To support its Notification James Hardie presents a picture of the fibre cement products industry which is simply misleading. James Hardie presents itself as a small niche operator, under attack from larger, more diverse businesses, CSR and BGC, which engage in a range of business practices which inhibit its ability to compete. In reality, however James Hardie is indisputably the dominant supplier of fibre cement products in Australia and internationally.

For example, James Hardie states (at 4.3) that the broader range of building products manufactured by CSR and BCG gives them a competitive advantage over James Hardie. This statement is misleading, as neither CSR nor BCG has any relevant competitive edge over James Hardie in relation to fibre cement products. On the contrary, James Hardie has a dominant international position in the manufacture and supply of fibre cement products and has previously sought, and in its Notification again seeks, to entrench and expand its market dominance through anti-competitive practices, discussed below. The broader building products portfolios of CSR and BCG do not give them a competitive advantage in relation to fibre cement products, as fibre cement products and non-fibre cement products are generally required at different stages of the building process and are installed by different contractors, and are purchased separately by distributors. More detail in relation to the distribution chain for fibre cement products is set out in response to the Commission's questions.

Further detail is provided in relation to market shares and the scale and scope of operations in the attached response to the Commission's questions. In summary:

- James Hardie is the dominant producer of fibre cement products with annual international sales of A\$2 billion, compared to CSR's total fibre cement sales of A\$61 million;
- James Hardie has the dominant share of supplies of fibre cement products, including a dominant share of sales of fibre cement products through the timber and hardware distribution channel. CSR estimates that James Hardie's sales account for over 70% of all fibre cement product sales through the hardware and timber distribution channel;
- James Hardie has the widest range of fibre cement products.

James Hardie also has a dominant position in research and development in relation to fibre cement products, principally because its historical leadership of this sector and the scale and scope of its operations give it the ability to amortise research and development costs over a very large sales base.

To maintain their customer relationships, it is important for hardware and timber outlets to stock a range of fibre cement products that meets their customer needs.

As CSR and BCG do not have as complete a range of fibre cement products as James Hardie, it is often important for timber and hardware distributors to be able to stock James Hardie products. Nor are all fibre cement products homogenous, such that end customers may specify particular James Hardie products in preference to products from another competitor which may be suitable for the task.

James Hardie has a long history of seeking to leverage the distinct demand for some of its product range from end customers to obtain exclusive distribution arrangements in hardware and timber outlets. James Hardie's objective in so doing is to reduce the ability of other suppliers of fibre cement products, including CSR, to compete.

This history is reflected in:

- the notification lodged with the Commission by James Hardie and Coy Pty Limited on 13 February 1995 (CN95/1), in respect of which the Commission issued a Draft Notice that the conduct would have the purpose and would be likely to have the effect of substantially lessening competition, and would not be likely to result in a benefit to the public;
- [commercial in confidence]

In order to overcome the significant obstacles James Hardie puts in the way of supplying its products to hardware and timber distributors who acquire CSR products, and to address the desire of many hardware and timber distributors to obtain their fibre cement products from one supplier, CSR has established a practice of acquiring James Hardie products that its customers want and supplying those James Hardie products to those customers. Because James Hardie refuses to supply CSR directly, CSR acquires these products from other distributors of James Hardie products.

To support the Notification James Hardie characterises this practice in a misleading way. In its supporting submission, James Hardie states (at 4.3) that “[CSR and BCG] seek to destroy James Hardie's competitive edge [gained through its extensive range] by obtaining particular James Hardie products – usually its innovative, technologically differentiated products – for themselves and on-selling them as part of their own product range”.

In order to meet its customers' requirements CSR does purchase James Hardie's products at retail prices and onsell them to distributors with which it has a supply relationship, however James Hardie's statement is misleading in that it implies if not expressly states that CSR onells James Hardie products as part of its own product range. Similar comments are made later (at 5.1(b)) which suggest that CSR misleads its customers as to the source of products. CSR does not do so – the source of James Hardie products is obvious on the face of the products and is clear to CSR's customers.

Nor does CSR purchase at retail such products to destroy James Hardie's competitive edge. First, it should be noted that CSR pays retail prices for such products because James Hardie refuses to supply direct at wholesale prices. Secondly, as noted above, CSR acquires James Hardie product at retail prices and onells to its customers because those customers prefer to deal with CSR, but either value a single source of supply or cannot get competitive terms of supply from James Hardie for particular products in the James Hardie range.

It is accepted that not all fibre cement products are homogenous and that CSR's range is not as extensive as James Hardie's, such that end customers may specify particular James Hardie products from their distributor. This conduct does not destroy James Hardie's competitive edge – those of its products for which it has a distinct demand are still purchased and are purchased at premium prices. As mentioned above, CSR is required to buy these products at retail prices.

James Hardie in its supporting submission also seeks to portray itself as the victim of exclusive dealing and bundling practices purportedly engaged in by CSR and BCG that it says inhibit its ability to compete. This too is misleading. For example, James Hardie states (at 4.3(b)) that the "policy is no different from the bundling policies of its competitors whereby they offer price discounts or rebates as an incentive to distributors to deal exclusively with them". This statement is misleading for the following reasons:

- James Hardie is the only company providing the "new technology differentiated products", and as such there is a clear difference. If distributors are unable to obtain the "new technology differentiated products" other than by agreeing to obtain James Hardie products exclusively, they will often have no real choice but to agree, given the limited substitution possibilities discussed in CSR's response to the Commission's questions.
- James Hardie is implementing an exclusive distribution model built around its "new technology differentiated products". CSR does not require exclusivity from any of its independent fibre cement distributors.

### **Effect and rationale of the notified conduct**

The James Hardie distribution policy the subject of the Notification is a further step taken by James Hardie directed to achieving the exclusive distribution of James Hardie fibre cement products by hardware and timber distributors who wish to or need to stock certain James Hardie fibre cement products.

It does this through two interlocking restraints. First, conduct (b) requires as a condition of access to certain distinct James Hardie products (in effect, the tying products) that distributors agree to deal with James Hardie exclusively for all fibre cement products. Distributors may feel that they must agree or find themselves at a competitive disadvantage. Secondly, conduct (a) requires as a condition of access to any James Hardie fibre cement products that its distributors not onsell any James Hardie products (excluding its columns and capitals) to other manufacturers of fibre cement products.

The first restraint (conduct (b)) means that distributors seeking access to the particular James Hardie products must agree to an exclusive supply arrangement. The restraint also stops distributors onsupplying those products at normal retail prices to other distributors. That will ensure that other fibre cement product manufacturers cannot meet their customers' demand for those products by purchasing them at retail and onsupplying those James Hardie products in conjunction with their own fibre cement products. Further, the second restraint (conduct (a)) prevents all distributors, including those distributors that do not stock the technologically differentiated products, reselling any of James Hardie's products to other fibre cement manufacturers or distributors with an exclusive arrangement with another manufacturer.

Accordingly, there can be no doubt that the rationale of the James Hardie distribution policy is to limit or restrain the freedom of timber and hardware distributors in sourcing supplies of fibre cement products from a range of competing fibre cement product suppliers.

Indeed this position is made clear from the James Hardie submission regarding conduct (a) (at 4.3):

*The pro-competitive strategy is that, if end-users are not able to acquire [the new technologically differentiated products] from a distributor that otherwise refuses to acquire James Hardie products, they will resort to the many distributors prepared to distribute James Hardie products. This will then increase the likely sales of James Hardie products overall, while at the same time providing an incentive to distributors to deal with James Hardie generally, and not merely in relation to particular technology differentiated products. In short, it may lead to a breakdown of the exclusive dealing*

*arrangements engaged in by competitors which foreclose opportunities for the sale of James Hardie products.*

Even though the premise underlying James Hardie's submission - that "the exclusive dealing arrangements engaged in by competitors ...foreclose opportunities for the sale of James Hardie products" - is unfounded and misconceived, the passage cited above is likely correct in its conclusion that the policy is likely to force distributors to deal with James Hardie. Indeed, distributors will necessarily be forced to acquire from James Hardie on an exclusive basis. When read with conduct (b), the notified conduct will require any distributor wanting the "new technologically differentiated products" to cease to stock other manufacturers' fibre cement products. It is not merely an "incentive" to deal with James Hardie. A distributor may wish to stock non-technologically differentiated products from both CSR and James Hardie, but would not be permitted to exercise that choice and receive the differentiated products.

Each distributor will be confronted with the choice of acquiring all of its requirements from James Hardie or itself offering an incomplete range. Accordingly, the conduct proposed by James Hardie has the potential to diminish competition in both wholesale and retail supply of fibre cement products.

The policy will prevent CSR from competing effectively with James Hardie in the supply of fibre cement products to timber and hardware distributors. It will therefore restrict the choice of customers purchasing fibre cement products.

While CSR acknowledges that there are situations in which exclusive distribution is not anti-competitive, they do not apply in this situation. First, exclusive dealing conduct is more likely to be anti-competitive where it is associated with market power. Clearly James Hardie has substantial market power in relation to fibre cement products. Secondly, exclusive dealing conduct is more likely to be anti-competitive where it has the potential to tie up all or a large share of the market. It is noted that the James Hardie conduct has the potential to completely tie up the hardware and timber outlet distribution channel. Thirdly, exclusive dealing conduct is more likely to be anti-competitive where it involves leveraging market power in one segment of a market, that is where there is a distinct demand for James Hardie products, into another segment of the market where there is no or less market power, that is where customers may be generally indifferent between James Hardie and fibre cement products of other producers. Fourthly, exclusive dealing may be justified where there is some requirement to align the commercial interests of supplier and distributor in relation to a particular product, so as to underpin the investment of the supplier in that product and/or the distributor in stocking and supplying that product. However, even if that did provide some rationale for an exclusivity in relation to the "new technology differentiated products", it would not support an exclusive bundling arrangement as is being proposed by James Hardie. (We comment further below on the

misapplication of free rider and cherry picking concepts relied on in support of the public benefit claims of James Hardie).

While ignoring the clearly restrictive nature of the conduct, James Hardie seeks to support the conduct as pro-competitive stating (at 4.3) that the conduct in (a) “may lead to a breakdown of the exclusive dealing arrangements engaged in by competitors which foreclose opportunities for the sale of James Hardie products”. The reference to “exclusive dealing arrangements engaged in by competitors” is, in context, a reference to CSR’s Gyprock Trade Centres (**GTCs**). The statement is also misleading in a number of respects:

- CSR does not have an exclusive arrangement with GTCs, rather it is the owner of the GTC networks and has invested in that distribution network. The notified conduct is unlikely to have a significant effect on GTCs, as they currently do not stock any James Hardie products.
- James Hardie has an equivalent exclusive supply arrangement with Boral in relation to its plasterboard distribution centres, which have a distribution footprint comparable to CSR’s GTCs.
- The James Hardie policy is not directed to supplies of fibre cement products by specialist plasterboard suppliers (who sell fibre cement products as an associated line), but to the major distribution channel of hardware and timber distributors.
- James Hardie already dominates the supply of fibre cement products through the hardware and timber distributor channel and with its proposed conduct is seeking to further entrench that market dominance.

#### **Lack of Public Benefit**

James Hardie’s submission in support of its Notification is based on the premise that the notified conduct is necessary for it to be able to achieve a commercial return on its research and development in new products. This is based on the further premise that it cannot achieve a commercial return on its research and development in new products from the price of those products alone, and therefore they must be bundled with other products.

CSR acknowledges that James Hardie is entitled to receive the commercial benefit of products it develops, subject obviously to there being demand for those products. However, CSR rejects entirely the premise (relied on as a public benefit) that James Hardie should be entitled to implement a restrictive arrangement with respect to other competitive products in order to underwrite its research and development costs of new products.



CSR makes the following observations in relation to the basis of James Hardie's public benefit case:

- (a) James Hardie overstates significantly the extent to which its product range is technology differentiated, to create an impression that its research and development activities are more innovative than they truly are. For example, the Eclipsa™ Eaves Lining allows an extra step to be completed before the product is transported to site, but the product itself is similar to the CSR Eaves Lining System, except that it has a paint finish and coating that is available from third party manufacturers. CSR acknowledges that James Hardie's Linea™ and AquaTec™ products are distinct.
- (b) The 'increased sales', which James Hardie anticipates, are not an increase in sales overall in the market (which would reflect a public benefit), but are simply increased sales which will accrue to James Hardie at the expense of CSR and BGC. In short, the conduct is not intended to increase the market and to confer any benefit on consumers or the general public, but to distort consumption choices from those that would be made in a freely competitive market. This is a public detriment not a public benefit. At best, any benefit is a benefit to James Hardie. The public will suffer the detriments of reduced choice of supplier and, inevitably, increased prices as James Hardie leverages its tied arrangements to recover the costs of its research and development by increased margins across its whole product range.
- (c) James Hardie simply makes a bare assertion that it cannot recoup the research and development costs of the "new technology differentiated products" from sales of those products. In this regard, it should be noted that James Hardie has substantial international sales. For example, it is highly likely that the commercial case for research and development of Linea™ products is based on potential sales of fibre cement products such as Trim and Weatherboard primarily in the largest lightweight cladding market, the United States, as well as in New Zealand and Australia. The argument that exclusive bundling arrangements in Australia are necessary to underpin research and development of a product that is likely to have its greatest commercial success in the United States does not withstand scrutiny.
- (d) The premise on which the public benefit case is based is specious. James Hardie suggests that the "new technology differentiated products" cannot sustain a price in the market to recoup its research and development costs, yet it is these very products which are the tying products, that is, the products which must have sufficient commercial attraction to customers that they are prepared to bear the cost of the restraint in relation to the tied products.

This contradiction is highlighted in James Hardie's own submissions. On the one hand it is submitted that the research and development costs are low (to avoid any conclusion of market power), but on the other hand it is suggested such costs must be high (to support the argument that some form of cross subsidy is required from the sales of other products to recoup their costs).

- (e) Ignoring the illogicality of the case presented and its implausibility, it would follow that, if any supplier, having undertaken research and development of any new product, finds that it cannot recover those (sunk) costs from that product, it should be entitled to implement restrictive trading arrangements to ensure it can recover those costs. This is an argument that the market should bear the cost of the research and development through anti-competitive restraints on other products. This cannot be supported for two reasons:
  - (i) if a company seeks the rewards from its research and development program, it should bear the costs/risks;
  - (ii) given that these research and development costs are admittedly sunk, there can be nothing gained in implementing restrictive arrangements after the event to allow their recovery. James Hardie made the decision to incur those costs (whatever they might be and whether or not economic) fully aware of the prevailing market circumstances and with the benefit of substantial market dominance.
- (f) Assuming that the research and development costs are substantial, that investment no doubt has been justified by James Hardie on the basis that as products with distinct market characteristics they can achieve a premium price and, more importantly, that James Hardie will be able to recoup the costs through its huge volume of global sales.

What James Hardie actually seeks to ensure from the conduct is to achieve an additional benefit of exclusive distribution of their full range of products through the hardware and timber outlet channel. This is in line with the long term strategy of James Hardie to achieve exclusive distribution of its products in that channel in order to reduce competition.

- (g) Ultimately, there is no economic case established for the bundling of "new technology differentiated products" with other James Hardie products.

#### **Use of economic concepts**

The case in support of the notified conduct is also supported by the emotive use of economic concepts of free riding and cherry picking. Both concepts are misused by James Hardie.

CSR neither seeks to free ride on nor cherry pick James Hardie's development of new products. In fact, that development is supported by the fact that it gives James Hardie a commercial advantage in the market, which CSR cannot affect.

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<sup>1</sup>. That is consistent with the use of the term by the Australian Competition Tribunal in the passage cited by James Hardie. The purchase by CSR of certain James Hardie products at retail prices is not a free ride on those products. If it could be established that there was some economic case for joint production or joint supply of the products to end customers, where it was not possible to recoup the cost of one or other component other than through joint production or joint supply, then there could be a possible argument of free riding. Without that, there is no possible argument of free riding. As noted above, it is clear that there is no basis to a claim that James Hardie cannot recover the costs of producing "new technology differentiated products" or its other products, other than through their joint production or joint use by consumers.

James Hardie also implies that CSR 'free rides' by supplying James Hardie products as its own. This is a misleading suggestion on the part of James Hardie. All James Hardie products are clearly branded and CSR does not alter the branding before on selling them, or in any way suggest that they are CSR products.

James Hardie also describes CSR's conduct as 'cherry picking'. The economic problem of cherry picking, consistent with the Australian Competition Tribunal passage cited by James Hardie, is generally understood as dividing elements in a pool (whether customers, products or something else), which share common fixed costs, into profitable and unprofitable segments and choosing only to deal with the profitable part, thereby leaving the supplier of the unprofitable part unable to recoup its fixed costs. The Australian Competition Tribunal decision cited deals with the cherry picking by private pathology laboratories of profitable tests, while declining to perform unprofitable tests, which would be left to public laboratories.<sup>2</sup>

The conduct pointed to by James Hardie is quite different. The profit it extracts from each sale of a product to CSR (through a distributor) is the same as, or greater than, the profit it extracts from the sale of that product to an end user. The only potential loss of profit is through its inability to leverage its position across its full range, due to competition with other manufacturers.

Ultimately, James Hardie's policy can be tested by asking three simple questions:

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<sup>1</sup> See eg John Black, *Oxford Dictionary of Economics*, (2<sup>nd</sup> ed, 2002) 187.

<sup>2</sup> *Australian Association of Pathology Practices Incorporated* [2004] A CompT 4

- Why would James Hardie refuse to sell a product at a price it would be happy to charge another customer?

Answer: Because it prevents or hinders a competitor from competing with it.

- How is it able to engage in this conduct?

Answer: Because it can leverage its position in products for which it is the sole manufacturer in respect of products for which there is competition.

- How can it afford to engage in this conduct - that is potentially to lose potential sales of its products?

Answer: Because it does not anticipate significant loss in sales of its “new technology differentiated products” and it anticipates reduced competitive pressure on it in relation to prices, terms and conditions, service, product support and promotion and marketing in relation to its competitive products.

#### **James Hardie's Previous Undertakings to the Commission**

As mentioned above, James Hardie has in the past sought to engage in similar behaviour. In 1995 James Hardie and Coy Pty Limited lodged an exclusive dealing notification with the Commission, in respect of which the Commission stated in a Draft Notice published 19 April 1995:

*withdrawing supply of fibre cement from CSR would have a significant effect on the business of CSR distributors and distributors tied to CSR.*

In Recital G of its undertaking to the Commission given on 18 May 1995 James Hardie stated, in answer to the Commission's concerns about James Hardie and Coy Pty Limited's then proposed conduct, that:

*it is not its [James Hardie and Coy Pty Limited's] intention nor will it in the future attempt to prevent supply of fibre cement products to CSR Limited from any third party neither will it discriminate against outlets aligned with CSR Limited and it now gives those undertakings in solemn form.*

This, among other things, is precisely what James Hardie now seeks to do. Even though the specific undertakings provided by James Hardie have now lapsed the same objections pertain.

## **Conclusion**

If the notified conduct is implemented, distributors who deal with CSR or BCG will not be able to provide a full line of fibre cement products to customers. The commercial response will be for those distributors for whom it is important to stock a full range to move their business towards the only manufacturer that is able to supply the full range, that is, James Hardie. Not only will James Hardie's position as the dominant manufacturer of fibre cement products be entrenched, it is likely to be enhanced, as CSR and BCG lose customers and manufacturing volume, with the consequential loss of economies of scale in their plants.

James Hardie's submissions are based on assertion and do not contain any evidence as to the effect on competition, or to demonstrate in any tangible way the public benefits James Hardie claims.

In any event, the 'public benefits' identified by James Hardie are not correctly characterised as such, and can in no way outweigh the substantial anti-competitive detriment likely to be caused by implementation of the notified conduct.

If you require any further assistance in relation to this matter, please contact Luke Woodward on 02 9263 4063.

Yours sincerely

A handwritten signature in black ink, consisting of a large, stylized initial 'G' followed by a long horizontal line extending to the right.

**Gilbert + Tobin**

## ATTACHMENT – RESPONSE TO THE COMMISSION'S QUESTIONS

1. Please identify your competitors in the production of fibre cement products. What is your estimation of the relative positions of Australian manufacturers of fibre cement products?

James Hardie, CSR and the Buckeridge Group of Companies (**BCG**) manufacture fibre cement products in Australia. CSR estimates that those companies have market shares by volume of approximately 62%, 19% and 17% respectively. Imports (other than those on-sold by James Hardie) account for the remaining 2%.

The table below (which is **commercial in confidence**) shows market shares by fibre cement product for 2004. The figures are CSR estimates and it is likely that the figure for James Hardie underestimates its share.

**Commercial in confidence**

## 2. What substitute products are available for fibre cement products?

Fibre cement contains cellulose fibre, cement and ground sand. It is a durable low maintenance building product used in both residential and non-residential buildings for the following applications:

- internal lining – used in wet area applications (such as bathrooms) on account of its water resistant qualities, as a sheet product to line garages and also as a substitute for plasterboard in wet areas;
- flooring – used for deck and balcony surfaces as an alternative to timber products as well as under ceramic tile and vinyl or cork flooring;
- external lining (residential) – cladding products including planks, sheets, and weatherboard;
- external lining (non-residential) – cladding products and applications such as facades and faces;
- columns – used primarily for decorative purposes on account of superior quality of finish, aesthetics and strength; and
- special applications – such as corrugated sheet for fencing material, brace board used to strengthen timber frames and lattice.

While fibre cement products compete with other types of building materials for some applications, for a number of applications fibre cement products are the only or dominant product used. From a customer perspective, a number of fibre cement products have few if any functional or economic substitutes, including fibre cement sheets for internal wet lining applications such as bathrooms. Other products may have functional substitutes in some circumstances, such as engineered wood products for weatherboard, but the use of the fibre cement product may be particularly desirable in some situations, and its use may be specified by an architect or builder.

## 3. What substitute products are available for James Hardie's new technologically differentiated products?

CSR broadly agrees with the substitution possibilities listed in paragraphs (a) to (c) on page 8 of the Notification regarding the “new technology differentiated products” (the **Differentiated**



**Products**), subject to the comments above about substitution possibilities for fibre cement products generally.

However, the Differentiated Products are likely to be attractive to end customers and therefore also to distributors. James Hardie has marketed them as having certain distinct and desirable characteristics. As a result there is likely to be 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.

4. What costs are likely to be involved in the development of products similar to James Hardie's new technology differentiated products for an existing manufacturer of fibre cement products?

It is difficult to estimate how much it would cost an existing fibre cement manufacturer to develop products similar to the Differentiated Products. While the costs may be substantial, it is important to note that the scale and reach of James Hardie's operations is such that it can amortise research and development costs over a far greater level of sales than other fibre cement manufacturers.

CSR understands that the James Hardie group spent US\$27.1 million on research and development in 2005. (Source: James Hardie Industries N.V. report submitted to the United States Securities and Exchange Commission for the fiscal year ended March 31, 2005, Commission file number 1-15240.) Given the international nature of James Hardie's fibre cement business, it is able to recover research and development expenditure across international sales.

In comparison, CSR spent approximately [commercial in confidence] on fibre cement research and development in 2005.

5. Where are your company's manufacturing plants located? How are products transported from a manufacturing plant to distributors?

CSR manufactures fibre cement products in Wetherill Park, New South Wales. Products are transported by road to other locations in New South Wales, Queensland, Victoria, South Australia and the Northern Territory. Products are transported by sea to Western Australia.

6. Do customers generally purchase fibre cement products within their local geographic area or is it economically viable to purchase fibre cement products from a distributor in a different city or a different state?

End users generally purchase fibre cement products within their local area due to the costs of transporting products. When purchasing very large quantities, they may be able to source products from an interstate distributor at an acceptable price, as the distributors may be willing to supply a large quantity at reduced margins.

Distributors generally purchase fibre cement products within the state in which they are located, or from their nearest capital city. [commercial in confidence]

As a result, a distributor will incur higher transport costs in transporting products from further away.

7. What is the level of fibre cement imports, if any, and to what extent do they compete with products manufactured domestically?

Approximately 5 million m<sup>2</sup> of fibre cement products was imported into Australia in 2005.

CSR understands that James Hardie imports eaves linings and flat sheet cladding from its plant in the Philippines and specialty wall linings and weatherboards from its plant in New Zealand. James Hardie's imports account for over 90% of all imports of fibre cement products.

Some ceramic tile companies import ceramic tile underlay, principally from Humes in Malaysia and Everite in South Africa, which used to be a James Hardie licensed technology partner.

CSR understands that Humes imports some eaves linings and claddings through an export agent and through its subsidiary, Humes Doors, and that timber merchants import small quantities of those products from Everite.

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.

8. Please provide a brief description of your company's distribution network, including such information as the identity of your company's distributors (particularly those distributors which account for the majority of your company's sales), the ownership status of your company's distributors (are they company owned, franchisees or independent) and the location of your company's distributors (on a state basis). Do you supply fibre cement products to any customers directly?

The end customers for CSR's fibre cement products are generally building companies and contractors. CSR therefore distributes its fibre cement products through building supplies outlets. CSR's main distribution channel for its fibre cement products is hardware and timber outlets.

Approximately 64% of fibre cement products, by value, are distributed through hardware and timber outlets. Those outlets are the main distribution channel for most fibre cement products, accounting for, by value, approximately 92% of residential external linings, 77% of flooring, 44% of non-residential external linings and all of special applications such as lattice and bracework. CSR's top 10 customers are:

[commercial in confidence]

CSR also distributes fibre cement products through its wholly-owned Gyprock Trade Centres (GTCs, referred to in the Notification as Red Sheds). GTCs are the main distribution channel for wallboard. (Note that James Hardie calls its wallboard product 'Villaboard'.)

In the Notification James Hardie depicts GTCs as a key competitive issue. In fact, they are largely irrelevant to broader consideration of the proposed conduct. GTCs are a specialist distribution channel designed as a 'one stop shop' for dry lining contractors, rather than builders generally. They carry products used to line the inside of a house and which are used at the same time during the building process, being primarily plasterboard, and also fibre cement wallboard, which is used in critical wet areas.

The description of CSR's GTCs in the Notification is misleading. In section 1.4 of the Notification, James Hardie states that CSR bundles fibre cement products with plasterboard, and

other building products such as bricks. It also states that because James Hardie manufactures only fibre cement products, it is unable to engage in equivalent bundling practices. It is incorrect to suggest that GTCs provide CSR with a fully integrated distribution channel for fibre cement products. GTCs do not sell the full range of CSR fibre cement products, nor the full range of CSR building products. They sell primarily plasterboard, which is not a fibre cement product, and fibre cement wallboard. The products are made available through the same outlet for customers' convenience, but no discount is given as an incentive to buy both.

CSR does not, contrary to the assertion in section 1.4 of the Notification, bundle fibre cement products with its other building products such as bricks. They are used at a different stage in the building process and it is unlikely that a customer would want to buy them together, or that a customer who purchases from a GTC would want them at all. Some GTCs may carry a very limited range of other CSR fibre cement products, largely for historical reasons, for example where a particular dry lining contractor also performs other works and has requested that a product be available at the GTC. Sales of those products would account for less than 5% of sales through GTCs.

Nor is it the case that James Hardie does not have an opportunity to compete with the GTC distribution channel. CSR understands that James Hardie has an exclusive agreement with Boral to supply wallboard to Boral's Boral Direct dry lining outlets, which are equivalent to CSR's GTCs. On CSR's estimates, approximately 22% of all wallboard sold would be James Hardie wallboard sold through Boral Direct. CSR understands that BCG has a similar arrangement with another plasterboard manufacturer, Lafarge, which controls a separate dry lining distribution stream.

CSR also distributes wallboard through other outlets known as 'VIPs'. VIPs are independent dry lining specialists which target the non-residential market. VIPs generally purchase plasterboard on an exclusive basis from CSR, but are free to stock wallboard from other suppliers. Approximately 90% of CSR's wallboard by value is distributed through GTC and VIP channels. The rest is distributed through hardware and timber outlets.

CSR distributes smaller amounts of fibre cement products through:

- independent fibre cement specialists, who add value to the product by, for example, cutting it to different sizes eg Archiclad (Victoria), Guardian Building Products (New South Wales) and Precision Building Supplies (Queensland);
- outlets with particular specialisations specific to that product, such as tile outlets for ceramic tile underlay; and

- commercial fit out contractors eg North West Commercial (Queensland), Brighton Ceilings (New South Wales), Le Pat (Victoria), Constitution Industries (New South Wales) and Kingston Interiors (New South Wales).

CSR supplies fibre cement products directly to customers only where it does not have adequate distribution channels. The product sold directly is limited to a very small amount of compressed sheet used by façade contractors.

9. Do any of your company's distributors stock your company's products exclusively? Are you aware of the proportion of your company's distributors that also stock James Hardie's products and more specifically, James Hardie's new technology differentiated products?

CSR does not place restrictions on its independent distributors restricting their ability to stock other manufacturers' fibre cement products. Only GTCs are required to stock CSR products exclusively.

The majority of CSR's distributors stock James Hardie products. Some distributors may stock CSR's fibre cement products exclusively, particularly those distributors that sell primarily to the renovation sector, as opposed to new build sector, for which a different range of products has traditionally been required. However, as James Hardie continues its marketing campaign for the Differentiated Products to make them more attractive and well-known to end customers, CSR expects that most, if not all, distributors will want to stock those products.

CSR believes that James Hardie has a practice of promoting exclusive supply arrangements for its products. For example, CSR understands that James Hardie has refused to supply Linea™ to at least one CSR distributor on the grounds that it also stocks CSR fibre cement products.

10. To what extent do distributors seek to carry the full range of fibre cement products? Are there advantages in stocking a full range?

Most distributors will seek to carry a full range of fibre cement products. They may choose not to stock some small value niche products, but they will seek to carry those products demanded by customers, which are likely to include the Differentiated Products.

There are advantages in stocking a full range of fibre cement products. If a distributor carries a full range, it is able to supply all the fibre cement needs of its customers. End customers, generally building companies and contractors, often prefer to deal with a distributor which can supply all their needs, meaning they do not have to source products elsewhere. That is the case not just for fibre cement products but for a broader range of building products, such that

distributors compete to offer the best range of building supplies and a distributor with an incomplete range of fibre cement products may lose sales of other products.

Customers may prefer to deal with a single distributor for the following reasons:

- the need to establish an account with only one supplier, or, even if the customer has an account with other suppliers, the convenience of receiving only one invoice;
- the ability to receive deliveries from only one supplier, simplifying logistics and minimising delivery costs;
- the ability to negotiate favourable service standards with a single supplier, such as delivery times;
- the chosen distributor might be located most conveniently.

As noted above, there are some distributors of fibre cement products that service a niche building sector that currently do not stock a full range of products. However, CSR expects that those businesses are likely to want to stock the Differentiated Products in the future.

11. Do distributors generally establish a full range of fibre cement products by acquiring stock from a single manufacturer or from a number of manufacturers?

Distributors may undertake either approach.

Some distributors, generally larger hardware and timber chains, choose to deal with more than one supplier of fibre cement products. For example, Bunnings purchases fibre cement products from both CSR and James Hardie.

There may be advantages in stocking products from multiple manufacturers, even where those products are otherwise equivalent. For example, CSR and James Hardie have agreements with end customers whereby the end customer receives a rebate from the manufacturer when it buys its products, such as James Hardie's agreement with Masterton Homes. CSR's agreements generally apply to external cladding and do not include internal cladding of the sort sold largely through GTCs. Therefore, end customers may seek to purchase products from a distributor of the manufacturer with which they have a rebate agreement.

Some distributors have a firm preference to deal with a single supplier of fibre cement products, for reasons including:

- the need to establish an account with only one supplier, or, even if the distributor has an account with other suppliers, the convenience of receiving only one invoice;
- the ability to receive deliveries from only one supplier, simplifying logistics and minimising delivery costs.

The ability to source fibre cement products from a single supplier is especially important for regional distributors, due largely to higher delivery costs.

In order for CSR to maintain or establish a supply relationship for fibre cement products, some of its customers have insisted that CSR be able to provide an extensive range of products. The required range includes products which CSR cannot manufacture, but which James Hardie does manufacture. Those products include columns, weatherboard and some of the Differentiated Products.

For example, CSR provides James Hardie products to [commercial in confidence]

In order to provide the James Hardie products, CSR purchases James Hardie products at retail prices from a James Hardie distributor, and at times from a third party who has acquired the products from a James Hardie distributor. In order to compete with James Hardie, CSR sells those products at a wholesale price. CSR therefore makes a loss on the James Hardie products, being the difference between the retail price at which CSR purchases the products and the wholesale price at which it sells them, plus transport and administration costs. In 2005, CSR purchased approximately \$2.8 million worth of James Hardie products (approximately \$1.9 million once columns and capitals are excluded).

CSR notes that when James Hardie states in section 1.2 of the Notification that the class of distributors which on-sells to distributors accounts for no more than 5% of total James Hardie sales, CSR assumes that this is intended to mean that no more than 5% of sales from distributors are sales to other distributors. CSR believes that this figure is likely to represent the quantity of James Hardie products purchased by CSR.

CSR is aware that James Hardie offers incentives for exclusive supply.

12. In the event that distributors are prevented from acquiring stock from more than one manufacturer, is it possible for a manufacturer to acquire fibre cement products from a competitor for supply to its own distributors?

For CSR the answer is no.

In the event that distributors are prevented from reselling James Hardie products, CSR will be unable to acquire fibre cement products from James Hardie. CSR has requested that James Hardie supply it directly, but James Hardie has refused to supply CSR with its products.

In the event that James Hardie prohibits the onsupply of its products, CSR will be unable to supply a full range of fibre cement products to distributors. Given the desirability of obtaining a full range from a single supplier, CSR will be at a competitive disadvantage in the supply of fibre cement products, even before considering the impact of James Hardie's exclusive supply policy regarding the Differentiated Products.

James Hardie has created a specialised demand for the Differentiated Products. In the event that James Hardie uses that position to secure exclusive supply of all fibre cement products, CSR will be unable to supply fibre cement products to distributors wishing to stock the Differentiated Products. Given the likely demand for those products, both as a result of their characteristics and James Hardie's marketing, in those circumstances, CSR is unlikely to be able to supply distributors with fibre cement products.

13. Are you aware of the extent to which your company's distributors on-sell fibre cement products?

CSR is not aware of the extent to which its distributors on-sell its fibre cement products.

CSR does not place any restrictions on the parties to whom its distributors can on-sell CSR fibre cement products. Nor would there be a commercial reason for CSR to impose such a restriction, as CSR would receive the benefits associated with the sales.

For example, CSR supplied compressed fibre cement to BCG before BCG developed its own manufacturing capability.