



Statement of Issues 16 October 2014

CSR Ltd and Boral Ltd - proposed clay brick joint venture

Introduction

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (**ACCC**) on the proposed joint venture for supply of clay bricks between CSR Limited (**CSR**) and Boral Limited (**Boral**) (the **proposed joint venture**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed transaction, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. Consistent with the ACCC's Merger Review Process Guidelines (at www.accc.gov.au/processguidelines) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC anticipates completing further market inquiries by **6 November 2014** and anticipates making a final decision on **18 December 2014**. However, the anticipated timeline can change in line with the Merger Review Process Guidelines. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide interested parties with the basis for making further submissions should they consider it necessary.

The parties

CSR

5. CSR supplies various building products including plasterboard, fibre cement, insulation, processed glass, Hebel¹ and roof tiles.
6. CSR supplies clay bricks under the PGH brand and manufactures at Horsley Park, Schofields and Cecil Park in NSW, Oxley in Queensland, and Golden Grove in South Australia. CSR also has 'mothballed' clay brick manufacturing capacity at Cecil Park in Sydney and at Bathurst in western NSW.

¹ Hebel is CSR's autoclaved aerated concrete product.

Boral

7. Boral supplies building products and construction materials including plasterboard, fibre cement, insulation, concrete products, timber products and roof tiles.
8. Boral supplies clay bricks to the relevant Australian states under the Boral Bricks brand and manufactures clay bricks at Bringelly and Albury in NSW, Darra in Queensland, Thomastown and Scoresby in Victoria. Boral also has mothballed clay brick manufacturing capacity at Badgerys Creek in NSW.

Other key industry participants

Austral Bricks

9. Austral Bricks is a subsidiary of Brickworks Limited. Relevantly, Austral Bricks supplies clay bricks which it manufactures at Horsley Park, Punchbowl and Bowral in NSW, Rochedale in Queensland, Wollert in Victoria, and Golden Grove in South Australia. Austral Bricks also has mothballed clay brick manufacturing capacity at Horsley Park in NSW, Rochedale in Queensland, and Golden Grove in South Australia.

Industry background

10. Clay bricks may be classified as:
 - *face bricks* – which are typically used on the exterior of a building and are manufactured in different colours and with different textures for aesthetic appeal;
 - *common bricks* – or ‘commons’, which are typically used where they will not be seen, particularly in foundations or for rendered facades, since they do not have a particular aesthetic appeal or surface treatment; and
 - *pavers* – which are typically used to form an even surface for foot traffic. They are manufactured in a variety of colours and textures.
11. The clay brick production process commences with the mining and collection of clay. This clay is then mixed with water and dried before firing. Bricks are required to be ‘fired’ in kilns for between 10 to 40 hours depending on the kiln, type of brick to be produced and its appearance. Face bricks, common bricks and pavers are produced using very similar manufacturing processes, with minor variations to achieve different aesthetic qualities in relation to face bricks and pavers.
12. The vast majority of brick sales are either face or common bricks. Pavers account for approximately 1% of the joint venture parties’ clay brick sales overall, and are not therefore a focus of the ACCC’s review of the proposed joint venture and are not further discussed in this Statement of Issues.
13. Clay brick supply is principally directed at residential construction, whereas commercial construction principally uses other materials, as does high-rise residential construction. The ACCC’s review is therefore focussed on the likely competition effects of the proposed joint venture in relation to low and medium-density residential construction.

The ACCC's market inquiries

14. The ACCC has received written submissions from and/or spoken with a range of interested parties including builders, relevant industry associations, brick manufacturers, and suppliers of other forms of external cladding. The ACCC has provided market inquiry feedback to the joint venture parties and taken their responses into account in reaching the preliminary views identified in this Statement of Issues. The ACCC's investigations are continuing.

The transaction

15. CSR and Boral propose to form a joint venture to combine their clay brick businesses located on the east coast of Australia including their operations in New South Wales/ACT, Victoria, Queensland, South Australia and Tasmania. Boral's clay brick operations in Western Australia would not form part of the proposed joint venture. The joint venture entity would be 60% owned by CSR and 40% owned by Boral.
16. The proposed joint venture would comprise the manufacture, marketing and supply of clay bricks, as well as associated clay sourcing activities. Under the proposed joint venture, CSR and Boral would no longer offer separate clay brick product ranges or compete on price or other terms of supply to customers in eastern Australia².

Future with and without the proposed joint venture

17. Section 50 of the Act prohibits certain transactions that would be likely to have the effect of substantially lessening competition in a market. In assessing the likely competition effects of the proposed joint venture pursuant to section 50 of the Act, the ACCC will compare the likely future competitive environment if the proposed joint venture proceeds (the "with" position) to the likely future competitive environment if the proposed joint venture does not proceed (the "without" position, or "counterfactual").
18. Currently, Boral and CSR both manufacture and supply clay bricks in NSW and Queensland. Boral and CSR both currently also compete to supply bricks to customers in South Australia and Victoria, with Boral supplying South Australia and CSR supplying Victoria from interstate manufacturing operations. Boral also currently supplies bricks to Tasmania from its mainland operations.
19. The ACCC is considering whether or not the future competitive environment without the proposed joint venture should be treated as being similar to the current competitive environment. Relevantly, Boral and CSR have stated publicly that lower brick demand has resulted in reduced profitability, plant curtailments and closures, and that the proposed joint venture would enable them to achieve returns that recover the cost of capital through building cycles. Also, it was recently reported that Boral would close brick assets to realise land values if consolidation of clay brick suppliers does not occur.

² The joint venture parties also each supply building products such as plasterboard, insulation solutions and roof tiles, however these other building products are not part of the proposed joint venture.

20. In assessing this counterfactual issue, the ACCC has considered confidential submissions by each of the joint venture parties and has also reviewed certain internal company documents. The ACCC has separately written to each of the joint venture parties to detail the ACCC's preliminary view regarding the counterfactual in light of the ACCC's review of their submissions and internal documents.
21. The ACCC's preliminary view is that the appropriate counterfactual by which to assess the proposed joint venture involves three major brick suppliers - CSR, Boral and Austral Bricks - competing independently to supply customers in markets in eastern Australia. In other words, the ACCC, at this stage, intends to assess the likely competition effects of the proposed joint venture against the current market structures.

The ACCC is seeking further information from interested parties regarding this counterfactual issue and, in particular:

- a. the extent to which further rationalisation of capacity is required in order to better match industry capacity to expected future demand, and the feasibility of alternative means to achieve this outcome (other than the proposed joint venture), as further addressed below;
- b. the opportunities for the joint venture parties, independently, to further restructure their operations, such as by improving plant utilisation, having regard to current production configuration and the costs involved in changing these configurations, as well as opportunities to sell or redevelop parts of existing manufacturing sites; and
- c. the opportunities for the joint venture parties to instead enter additional toll manufacturing arrangements with each other and/or with other manufacturers in order to reduce costs.

Relevant markets

22. As discussed below, the ACCC at this stage considers that the relevant markets in which to assess the proposed joint venture are the markets for supply of clay bricks in each of NSW (including ACT), Queensland, Victoria, South Australia and Tasmania.

Product dimension

23. The joint venture parties submitted to the ACCC that the relevant product market is the manufacture and supply of external cladding products, on the basis that there are a range of materials which are technical and functional substitutes for clay bricks. The ACCC's preliminary review does not generally support this submission, as discussed below. The ACCC is also considering whether there are separate markets for face bricks and common bricks, as discussed below.

Other external cladding products

24. The ACCC's main focus in relation to defining the boundaries of the relevant product market is the extent to which other external cladding products are substitutes for clay bricks on the demand side. This will depend on the extent to which customers, particularly residential home builders which account for most clay brick demand, would be likely to switch to other external cladding products in response to a small but significant and non-transitory increase in the price (**SSNIP**) of clay bricks – in the order of 5 - 10%. If the extent of switching by customers is not sufficient to make such a price increase unprofitable for clay brick suppliers, then other external cladding products are unlikely to be close substitutes to clay bricks and would not be included in the relevant market.
25. Other than clay bricks, cladding materials which are available for use in the construction of external walls include:
- fibre cement panels or board;
 - autoclaved aerated concrete (**AAC**) products, often referred to as 'Hebel' (Hebel is CSR's AAC brand);
 - concrete masonry blocks and bricks;
 - concrete wall panels (including precast wall panels and tilt-up wall panels);
 - structural insulated panel systems; and
 - alternative non-load bearing facades.
26. The ACCC understands that there has been a structural shift over the past few decades in the mix of residential construction in Australia, from single detached residential dwellings towards multi-residential attached dwellings. As a result of these structural changes there has been an increase in the usage of alternative forms of external cladding and a reduction in the overall demand for clay bricks.
27. Market feedback suggests that the increased uptake in other forms of cladding appears to be mainly in relation to multi-residential and commercial construction, and in the second storey of two storey residential dwellings. Builders involved in commercial construction and high-rise residential construction typically use different forms of cladding materials from those used by builders of low and medium density dwellings, especially detached homes. In commercial and high density residential construction, clay bricks are used to a much lesser extent and materials such as concrete wall panels and structural insulated panel systems are used in significant quantities.
28. The ACCC's preliminary view is that other external cladding materials are not close substitutes for clay bricks in the construction of residential detached dwellings. Market feedback suggests that the underlying demand for clay bricks for use in construction of detached residential dwellings remains strong. Residential builders account for most clay brick demand and market feedback suggests that it is consumers building detached homes that are most likely to be affected by the proposed joint venture.

29. Clay bricks have been, and remain, the main type of external cladding used by residential builders in the construction of a very large proportion of single and double storey detached dwellings, despite the changes that are evident in other residential and commercial construction segments. Market feedback to the ACCC suggests that, for many residential builders, clay bricks comprise approximately 80-90% of external cladding materials used.
30. Residential builders consider a range of factors when selecting cladding materials such as durability, cost effectiveness, availability of labour and materials, insulation properties and maintenance requirements. The ACCC understands that each type of external cladding material, including clay bricks, is differentiated to varying degrees on the basis of these factors.
31. From a technical point of view, each of the external cladding materials could be used for the construction of an external wall. However, the views and preferences of their customers (home buyers) are also one of the most significant factors taken into account by builders for the selection of external cladding materials.
32. The high proportion of clay brick utilised in construction of residential dwellings, especially detached homes, in eastern Australia appears to reflect the current views and perceptions of both builders and end-consumers that clay brick has desirable characteristics that distinguish it clearly from other external cladding products. These perceived characteristics include that clay brick:
- has a proven track record of reliability and durability;
 - is the most cost effective cladding choice;
 - is maintenance free (or at least very low maintenance);
 - has good thermal and insulation qualities; and
 - is the most practical form of external cladding taking into account the familiar and accepted construction techniques and expertise.
33. Marketing by clay brick suppliers seeks to reinforce these perceptions by emphasising the historic use, proven record and ongoing trusted nature of clay brick usage.³ Clay brick suppliers also emphasise the key benefits of clay brick such as low maintenance, energy efficiency, cost and durability.
34. The ACCC notes that manufacturers of alternative forms of external cladding seek to market their products as strong alternatives to clay bricks. Marketing materials associated with Hebel⁴ and James Hardie⁵ seek to address customers' perceptions and suggest that these products perform as well as clay brick (if not better) on key metrics such as insulation, energy efficiency, sound proofing, fire resistance, ease of installation and cost.

³ <http://australbricks.com.au/vic/sustainability/build-a-home-you-can-live-in-happily-ever-after-~/>

⁴ <http://www.hebelaustralia.com.au/Pages/About/Hebel-Benefits.aspx>

⁵ <http://www.jameshardie.com.au/page/fibre-cement/>

35. However, market feedback from residential builders indicates that many end-consumers, especially those building detached homes, do not perceive some of the characteristics of other external cladding products to be as desirable as clay bricks. In particular:
- fibre cement products are perceived as having longer term maintenance issues and are often regarded as a “cheap alternative”;
 - Hebel (AAC) products are not yet proven as being a reliable cladding choice and are perceived as having potential ongoing quality issues such as insufficient durability and strength; and
 - concrete bricks can be problematic given that they shrink and expand when temperatures changes, and architectural concrete bricks are prone to discolouration.
36. Market feedback suggests that fibre cement products and AAC are generally used by residential builders where a rendered finish is to be applied to the dwelling. They are also often used:
- in conjunction with clay brick, to vary the appearance of a home, for example by adding a feature piece to the external façade of a home;
 - in the construction of the second storey of a two storey home; and
 - for unique home projects or for particular situations such as building on slopes.
37. Residential builders appear to use concrete blocks and bricks to varying degrees. Concrete blocks or common bricks can be used where a rendered finish is to be applied, or concrete architectural bricks can be used for an external finish or as a feature piece. However, market feedback has indicated that concrete masonry products are not used to a great extent in detached residential construction.
38. To the extent that residential builders are using alternative forms of external cladding, it does not appear to represent switching by builders in response to a 5 – 10% price increase for clay bricks. Market feedback obtained by the ACCC indicates that the frequent and not insignificant price rises by the major clay brick suppliers, examples of which are described later in this Statement of Issues, have not resulted in customers switching to other forms of external cladding. Instead, the higher prices have either been absorbed by the residential builder or passed onto prospective home owners.
39. Also, clay bricks are estimated to comprise approximately 1 - 3%⁶ of the construction price of an average (detached) dwelling. In this context, prospective home owners appear unlikely to change their choice of external cladding in response to even a relatively significant change in the price of clay bricks.

⁶ This estimate excludes labour. The labour to physically lay bricks represents approximately two-thirds of the installed cost of bricks – that is, the labour input is approximately twice the cost of the bricks.

40. The ACCC's preliminary view is that the clear and strong preferences held by many customers for the use of clay bricks in the construction of many residential dwellings means it is unlikely that other external cladding products are close substitutes for clay bricks. To further understand the level of potential substitution between clay brick and other forms of external cladding, the ACCC is seeking further information about customers' purchasing behaviours in response to historical clay brick price increases by the joint venture parties and Austral Bricks (as identified below).

Face and common bricks

41. The ACCC understands that there is a spectrum of brick types used in construction of walls, ranging from common bricks (or 'commons') through to premium face bricks. The joint venture parties, as well as Austral Bricks, supply both face and common bricks.
42. Face and common bricks are technical substitutes in the sense that an external wall can be constructed using either type of clay brick. However, for aesthetic reasons, common bricks are very unlikely to be considered a substitute for face bricks by home builders and end-consumers. Also, face bricks are unlikely to be used by residential builders where a rendered finish is to be applied to the external cladding given the lower cost of common bricks (although on limited occasions low-end face bricks are used for this purpose).
43. On the supply side, the ACCC understands that common bricks are often produced at manufacturing plants where low-end face bricks are also produced, although face bricks generally move through the kiln at a slower pace. This may indicate a degree of supply side substitutability between manufacture of face and common bricks.
44. Additional costs would be incurred in switching a common brick manufacturing plant to the production of face bricks because this may require additional equipment and inputs (including equipment to enable the addition of other raw material to face bricks and, to undertake forming and texturing, specialised dryers and kilns). The costs of switching supply vary in accordance with the type of face brick to be produced. The ACCC understands that costs may be approximately \$8 to 17 million to upgrade a manufacturing plant that only produces commons to enable production of face bricks.
45. For the purposes of this Statement of Issues, the ACCC considers the likely competition effects of the proposed joint venture on the basis of a market for supply of clay bricks, encompassing both face and common bricks. However, the ACCC's review will take account of any particular effects on competition within segments of this market, such as for supply of face bricks (which account for the majority of the market based on volume and value).

Geographic dimension

46. The ACCC at this stage considers that there are state-based markets for the manufacture and supply of clay bricks. The ACCC has also observed that the major clay brick suppliers contract with customers on a state basis, clay brick prices vary somewhat depending on the state, and price increases are implemented on a state-by-state basis. Also, transport costs for clay bricks can be high relative to the total value of the product meaning that most clay brick demand is supplied by plants located in the same state as that customer demand arises.

47. However, the ACCC noted that major clay brick suppliers do supply some clay bricks interstate. For example, Boral supplies clay bricks in South Australia from interstate plants, and CSR supplies clay bricks in Victoria from interstate plants. Also, Boral and CSR structure their clay brick operations as east coast businesses rather than state-based businesses. The ACCC will therefore be considering whether the likely competition effects of the proposed joint venture should be considered on a wider geographic basis.

Preliminary conclusion - relevant markets

48. The ACCC's preliminary view for the purpose of this Statement of Issues is that the relevant markets in which to assess the proposed joint venture are the markets for the supply of clay bricks in each of NSW (including ACT), Queensland, Victoria, South Australia and Tasmania. The focus of the ACCC's competition assessment, as detailed below, is on clay bricks supplied for low and medium density residential construction, especially detached homes.

The ACCC invites further views and information from interested parties regarding the product and geographic dimensions of the market/s and the specific factors identified above, including the extent to which customers of clay bricks, in response to clay brick price increases, have switched to alternative forms of external cladding. In particular, the ACCC is seeking further information from interested parties regarding the following specific matters:

- a. the impact of the significant clay brick price increases in Queensland in late 2011 and early 2012 and the extent to which these price increases caused clay brick customers to switch to other external cladding products. To this end, the ACCC is seeking information about changes in demand and prices in Queensland over the last 3 years for AAC, fibre cement and concrete masonry products;
- b. the extent to which the potential competitive constraint from other external cladding products may differ between common bricks and face bricks;
- c. the nature and level of costs involved in switching some manufacturing capacity from production of common bricks to production of face bricks; and
- d. the extent to which clay bricks are supplied on an interstate basis and the circumstances in which such interstate supply arises.

Statement of issues

49. For the purposes of this Statement of Issues, the issues arising from the proposed joint venture have been categorised as 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise competition concerns'. These issues are addressed below.

Issues of concern – supply of clay bricks in NSW and Queensland

50. The ACCC's preliminary view is that the proposed joint venture is likely to substantially lessen competition in the NSW and Queensland markets for the supply of clay bricks. The following section describes the ACCC's preliminary concerns in this regard and provides details of further information that is being sought from interested parties.

51. The proposed joint venture would reduce the number of *major* suppliers of clay bricks in the NSW and Queensland markets from three to two. No other clay brick suppliers in eastern Australia operate on the same scale or have comparable product ranges and distribution as the major suppliers, Boral, CSR and Austral Bricks.
52. Many residential builders in NSW and Queensland have expressed concerns to the ACCC that this reduction from three to two major clay brick suppliers would result in increased prices for clay bricks. Higher prices for clay bricks would increase costs for end-consumers seeking to build new homes. For example, a new two-storey home built with 14,000 bricks would cost approximately \$1,200 extra as a result of a 10% increase in clay brick prices (depending on the bricks used).
53. As discussed below, the ACCC's review to date suggests that the joint venture entity would not be constrained by a credible threat of new entry or expansion by a rival supplier of clay bricks, or by any countervailing power of customers. Thus, a key issue for this review is whether Austral Bricks would have the ability and incentive to constrain an attempted exercise of unilateral market power by the joint venture entity.
54. Also discussed below is the fact that the proposed joint venture would effectively create a duopoly in the supply of clay bricks in NSW and Queensland. A key issue in this regard is whether the proposed joint venture would result in a material reduction in competitive tension between major clay brick suppliers and the extent to which the proposed joint venture would make tacit coordination more likely, more complete and more sustainable.

Unilateral effects

55. Currently, Boral and CSR have extensive product ranges, high-volume production capabilities, and wide geographic distribution in the NSW and Queensland clay brick markets. Many residential builders consider Boral and CSR to be close competitors in these respects.
56. The proposed joint venture would remove this competition and increase concentration for the supply of clay bricks in NSW and Queensland. The joint venture entity would account for over 50% of sales of clay bricks in NSW. In Queensland the proposed joint venture would combine the largest and second-largest suppliers of clay bricks, with the joint venture entity accounting for approximately 75% of sales in Queensland.
57. The removal of this close competition and this significant change in market structures raises the concern that the joint venture entity would have the ability to unilaterally exercise market power, such as to increase prices for clay bricks. Also, the proposed joint venture would likely result in reduced choice between brick product ranges, in terms of the variety of colours and other aesthetic characteristics offered for construction of new homes. This reduction in choice and variety would be to the detriment of builders, architects/designers and end-consumers.
58. As noted above, the joint venture entity would be one of only two major suppliers of clay bricks in NSW and Queensland. The remaining major alternative supplier, Austral Bricks has some spare operational capacity (in addition to mothballed capacity) in NSW and Queensland.

59. The ACCC is considering the extent to which this spare capacity could be used to constrain the exercise of unilateral market power by the joint venture entity having regard to the types of brick products manufactured at these plants and the extent to which the production mix could be altered. The ACCC is also continuing to consider the extent to which Austral's significant mothballed production capacity in NSW and Queensland could be used to constrain the exercise of unilateral market power by the joint venture entity.
60. Smaller clay brick suppliers in NSW and Queensland are unlikely to have the ability and/or incentive to respond competitively to any exercise of unilateral market power by the joint venture entity. In particular, the ACCC considers that small suppliers, such as Namoi Valley Bricks in NSW and Claypave in Queensland, generally operate in niche segments of the relevant markets. Also, there are significant barriers to entry and expansion that would restrict the ability of actual and potential suppliers of clay bricks to competitively constrain the joint venture entity. These factors are discussed further below.

Likelihood of entry or expansion by other clay brick suppliers

61. The joint venture parties submitted that BGC (owner of Brikmakers), which commenced manufacturing bricks in Western Australia in 2009, is a good example of the potential for new entry into the industry when conditions are right. Also, BGC has recently announced plans to create a new Melbourne home-building business in joint venture with Metricon. The joint venture parties submitted to the ACCC that, if BGC's operations attained the necessary scale in eastern Australia, it would be possible that it could, or could threaten to, vertically integrate into clay brick manufacturing, as it did in Western Australia.
62. However, the ACCC considers that new entry to the NSW or Queensland markets is highly unlikely. The capital costs associated with land and equipment are substantial, and entry on a significant scale (in terms of product range and volume) would be necessary to compete effectively with the joint venture entity and Austral Bricks. BGC's entry to brick manufacturing in Western Australia required capital expenditure of over \$100 million. Furthermore, there are environmental compliance issues, and a new entrant may face difficulty in obtaining access to the clay inputs necessary to manufacture an adequate range of bricks.
63. In addition, the excess manufacturing capacity of the remaining two major suppliers may represent a strategic barrier to entry and/or expansion by rival suppliers. Moreover, market participants informed the ACCC that establishing a new metropolitan plant in eastern Australia is not realistic anymore for any new or existing Australian clay brick manufacturer.
64. The joint venture parties also submitted to the ACCC that other clay brick suppliers in NSW and Queensland, as well as Selkirk in Victoria, would provide effective competitive constraints on the joint venture entity's supply of clay bricks in NSW and Queensland. However, the ACCC's review to date does not support these submissions.

65. In the ACCC's market inquiries residential builders generally identified that price is a key factor in their choice of supplier/s. Many of these customers in NSW and Queensland identified that Boral, CSR and Austral Bricks have implemented significant price increases over the last 5 years. However, for the reasons discussed below, customers have generally accepted these price increases, rather than obtaining or seeking to obtain supply from interstate clay brick manufacturers or from niche clay brick manufacturers (or from suppliers of other forms of external cladding).
66. The ACCC therefore considers that neither independent interstate manufacturers, nor local 'niche' manufacturers, would be able to expand to supply the required volumes or product range in order to competitively constrain the proposed joint venture in either NSW or Queensland. This is discussed further below.

Interstate manufacturers

67. The ACCC's market inquiries identified that residential builders in NSW and Queensland do not generally regard interstate manufacturers such as Selkirk (Victoria) and BGC (Western Australia) as potential alternative sources of regular clay brick supply.
68. The ACCC did not identify any significant instances of supply in NSW or Queensland by interstate manufacturers of clay bricks. More specifically, the ACCC's market inquiries suggest that BGC and Selkirk do not presently supply customers in NSW and Queensland (with the exception of some limited supply by Selkirk). Customers in NSW and Queensland generally identified that they would not consider sourcing from these interstate manufacturers because:
- some interested parties considered Selkirk (in Victoria) to have a much smaller product range than the joint venture parties and Austral Bricks, and submitted that because of capacity constraints, Selkirk would be unable to supply large customers in sufficient volumes in the event that the joint venture entity increased prices; and
 - NSW and Queensland customers did not consider BGC (in Western Australia) as an option because of freight costs from Western Australia and BGC's lack of distribution channels in NSW and Queensland.
69. The ACCC's market inquiries have also indicated that BGC and Selkirk would be unlikely to commence manufacturing operations in NSW and Queensland, or expand their present manufacturing capacity in order to supply interstate.

Local niche suppliers

70. The ACCC's market inquiries with both customers and small clay brick suppliers were consistent in identifying that small-scale brick suppliers, often referred to by market participants as 'niche' or 'boutique' manufacturers, were not considered to be viable or realistic alternative sources of supply of large volumes of clay bricks now or in the foreseeable future. These manufacturers include Claypave in Queensland, and Namoi Valley Bricks and Lincoln Brickworks in NSW.

71. Interested parties submitted that these small-scale brick suppliers mainly manufacture pavers, architectural-style bricks or dry-pressed bricks for niche applications, and only in small volumes. They have relatively high manufacturing costs and their niche products are significantly more expensive than the extruded clay bricks supplied in relatively large volumes by Boral, CSR and Austral Bricks.
72. The ACCC's market inquiries indicated that the barriers facing a smaller-scale supplier expanding its capacity and range, to the extent that it could compete effectively with the joint venture parties and Austral Bricks, would be akin to the barriers facing a completely new entrant. In comparison to the major suppliers, small-scale suppliers typically have different manufacturing processes, kilns and equipment which is inadequate for supplying large volumes. They also have land limitations, different types of customers and limited capital. Furthermore, the ACCC's market inquiries identified no small-scale suppliers that considered they would be in a position to expand their capacity or product range to the extent that they could compete with the joint venture entity or Austral Bricks, irrespective of volume commitments by customers.
73. The ACCC therefore considers that these smaller 'niche' suppliers are not generally in close competition, in a practical day-to-day sense, with Boral, CSR and Austral Bricks. Based on market inquiries, the ACCC considers that small and/or niche suppliers would not place an effective competitive constraint upon the joint venture entity.

Countervailing power of customers

74. In the ACCC's view, countervailing power exists when buyers have special characteristics that enable them to defeat a seller's attempted exercise of market power by credibly threatening to bypass the merged firm by vertically integrating into the upstream market, establishing importing operations or sponsoring new entry⁷. Countervailing power is therefore more than the ability of a key customer/s to switch to alternative products or suppliers⁸.
75. Large clay brick customers would not generally be able to offer sufficient volumes to justify capital investment in a new clay brick manufacturing plant or significant expansion in capacity of an existing plant. Moreover, the ACCC's market inquiries indicated that residential builders do not generally wish to guarantee purchase volumes and would not enter an exclusive arrangement with a new and potentially unreliable clay brick supplier or with a small-scale clay brick manufacturer, even in the event of an attempted price increase by a major clay brick supplier. Finally, the record of price increases to large customers by CSR and Boral, as addressed further below, is not consistent with large customers having countervailing power that would constrain attempted price increases by the joint venture entity.
76. In light of the factors discussed above, the ACCC is at this stage concerned that the joint venture entity would have the ability to unilaterally increase prices, reduce output or otherwise exercise market power.

⁷ ACCC Merger Guidelines 2008, 7.48.

⁸ This Statement of Issues has already addressed the ability of customers to switch to alternative external cladding products or to switch to smaller suppliers of clay bricks.

Coordinated effects - clay brick duopoly

77. The proposed joint venture would effectively create a duopoly in the supply of clay bricks in NSW and Queensland. The joint venture entity and Austral Bricks would account for approximately 99% of supply of clay bricks in NSW and Queensland.
78. The ACCC's preliminary view is that the proposed joint venture would materially reduce the intensity of competition between the remaining major clay bricks suppliers or, in other words, result in a general reduction in competitive tension. The proposed joint venture would alter the nature of interdependence between rivals such that the joint venture entity and Austral Bricks would be more likely to consider that it is in their mutual interests to tacitly coordinate their key commercial decisions, such as price increases, customer allocation, output and/or production capacities.
79. Importantly, the ACCC does not consider that such coordination would necessarily require any explicit communication or commitment between rivals. Rather, rivals would act in their own self-interest, taking into account each other's likely actions and reactions.
80. Many residential builders in NSW and Queensland submitted to the ACCC that, if the proposed joint venture proceeds, Austral Bricks would be the only credible or realistic alternative source of supply of clay bricks. Specifically, Austral Bricks would be the only other clay brick supplier having the manufacturing capacity to supply clay bricks in high volumes to residential builders. Furthermore, Austral Bricks would be the only other clay brick supplier having the ability to offer the wide range of clay brick products required by residential builders.
81. The joint venture parties submitted to the ACCC that the proposed joint venture would not increase the ability and incentive for the major suppliers to coordinate, in part because Austral Bricks would have a strong incentive to deploy spare capacity in order to expand supply in response to an attempted price increase by the joint venture entity. The joint venture parties submitted to the ACCC that this is because, in summary:
 - the incremental cost of Austral Bricks expanding output at operational plants would be very low, meaning that an increase in output would lower the average cost of production (as well as increasing revenue);
 - Austral Bricks retains several mothballed plants. While there would be some cost involved in re-firing mothballed kilns, these costs would be more than offset by the pay-off from increasing output, both in terms of increased revenue and lower average cost across all units of production; and
 - the returns that Austral Bricks could expect to derive from maintaining its pricing and increasing output to capture market share would be greater than the returns it could expect to derive from coordinating to align its prices with the joint venture entity.
82. The ACCC's review to date does not generally support the joint venture parties' submissions in this regard. Market feedback to the ACCC as well as the ACCC's review of the joint venture parties' internal documents both suggest that there would be only limited price competition between the joint venture entity and Austral Bricks.

83. Austral Bricks and each of the joint venture parties already have the ability to expand output, utilising inventories, existing excess capacity and/or mothballed capacity, to gain market share in response to rivals' price increases. However, based on the information presently before the ACCC, the major clay bricks suppliers have not historically used their spare capacity (or inventories) to constrain clay brick price increases.
84. For example, the ACCC notes that in recent years there have been very large clay brick price increases - in the order of approximately 20% - to residential builders in Queensland. These have not been constrained by rival clay bricks suppliers (or by other suppliers of external cladding products).
85. Rather, there have been periods when the major clay brick suppliers have increased prices in parallel with one another. For example, in May 2011 Boral and CSR each notified NSW customers of two price increases, with the increases to have the same effective dates in 2011 and 2012. Also, in Queensland in late 2011 and early 2012 Boral and CSR both implemented a price increase of the same amount.
86. This information accords with market feedback to the ACCC. Residential builders expressed concerns to the ACCC that, based on their experience of price changes by major clay brick suppliers, the timing of future price changes by the joint venture entity and Austral Bricks would likely coincide and the size of price changes would likely be very similar. Similarly, based on the ACCC's review of internal documents provided by the joint venture parties, the major suppliers have visibility over price changes by their rivals and can utilise this information to identify opportunities to increase their own prices.
87. The ACCC's preliminary view is that any price competition between remaining major clay brick suppliers would largely be an attempt to win market share from each other, and would therefore be self-defeating. A relevant factor in this regard is that demand for clay bricks is quite price inelastic⁹, such that a reduction in the price of bricks is unlikely to generate a significant increase in overall demand. Further, given the high degree of transparency in the clay bricks markets (as addressed below) and the high fixed cost component of clay brick production, competing on price would only serve to reduce prices towards marginal cost, without securing market share gains.
88. Strong price-based competition between the two remaining major clay brick suppliers would therefore reduce profitability. Accordingly, the joint venture entity and Austral Bricks would be unlikely to have incentives to compete strongly on price.
89. Other features of the clay brick markets are also likely to make tacit coordination between the joint venture entity and Austral Bricks more complete and more sustainable:
- the proposed joint venture would generally increase symmetry between major clay brick suppliers, in terms of their manufacturing scale and their shares of sales or production capacity. This would reduce incentives for the joint venture entity and Austral Bricks to compete effectively to win market share from each other, and would make it more likely that their commercial decisions would be tacitly coordinated;

⁹ This price inelasticity is consistent with the ACCC's definition of a separate market for supply of clay bricks.

- the nature of brick supply involves frequent and small customer orders (in comparison to total output). For this reason, there would be little incentive for the joint venture entity and Austral Bricks to deviate from a consensus in order to capture market share when the benefits are relatively small and short-lived;
- there is a high level of transparency about clay brick pricing and production capacities, which would facilitate tacit coordination between the two remaining major suppliers. Changes in price levels for clay brick product ranges appear to be well known between competing major suppliers. The ACCC notes in this regard that:
 - all three major clay brick suppliers regularly increase prices, generally every six months. As addressed above, the ACCC's market inquiries suggest that there are already instances of parallel behaviour between the major clay brick suppliers in terms of the timing and amount of price increases;
 - prices are generally increased by the same amount across a supplier's full range of face bricks. These changes in price levels are notified to customers and this information is visible between rival suppliers. Effective coordination between two remaining major suppliers would not therefore require them to reach consensus on final or absolute prices for each of their products;
 - any excess capacity (including mothballed capacity) and/or inventories held by Austral Bricks and the joint venture entity would be likely to operate as a disincentive to 'cheat' on the terms of any consensus as it could be used to punish any deviation from such consensus, rather than this capacity being utilised to expand production and constrain a rival supplier's price increase;
- there is a high level of transparency, in terms of clay brick customers, which would facilitate customer allocation between two major clay brick suppliers. The ACCC notes in this regard that:
 - based on the ACCC's market inquiries, key customers such as high-volume residential builders do not readily switch between clay brick suppliers. This stability or 'stickiness' of key customers would be likely to facilitate customer allocation between the two remaining major clay brick suppliers;
 - the major clay brick suppliers' market shares have generally been stable over time. In the context of markets with stable market shares held between two remaining major suppliers, there is unlikely to be an incentive to 'cheat' on the terms of coordination, such as by price discounting to particular customers, since both major suppliers would recognise that capturing short-lived market share at lower profit margins would ultimately be self-defeating;
- there are frequent interactions between CSR, Boral and Austral Bricks in multiple product and geographic markets. The ACCC notes in this regard that:
 - CSR has a joint venture for clay brick supply in New Zealand with Austral Bricks' parent company, Brickworks. Accordingly, the joint venture entity's major competitor in Australia would be a firm with which the joint venture entity's majority shareholder (CSR) already has a joint venture in a closely related market. This is likely to facilitate market transparency and tacit coordination between remaining major clay brick suppliers;

- there is multi-market contact between CSR, Boral and/or Brickworks, which compete in relation to supply of other building products. A key example is supply of plasterboard in Australia. These multi-market interactions are likely to increase the scope for reaching terms of coordination as well as punishing deviations from those terms, and thereby increase the ability and incentive for tacit coordination between the joint venture entity and Austral Bricks;
 - the stability of coordinated conduct would be unlikely to be undermined by any countervailing power of large customers, or by actual or potential rivals, as barriers to entry and expansion are high, as discussed above.
90. In light of these factors and market inquiries, the ACCC at this stage considers that the proposed joint venture would materially reduce the intensity of competition between the major clay brick suppliers remaining in the markets. The ACCC's preliminary view is that the proposed joint venture would be likely to increase the potential for the major clay brick suppliers to recognise their mutual interdependence and tacitly coordinate their commercial decisions, rather than to compete effectively.

Preliminary conclusion – supply of clay bricks in NSW and Queensland

91. The ACCC's preliminary view is that the proposed joint venture is likely to substantially lessen competition in the NSW and Queensland clay bricks markets, compared to a situation with three major competing suppliers - CSR, Boral and Austral Bricks. The proposed joint venture would reduce the number of major suppliers from three to two.
92. There do not appear to be effective competitive constraints, such as countervailing power of customers or a credible threat of new entry or expansion, that would prevent clay brick prices from increasing. Also, the proposed joint venture would remove a product range from the markets and would thereby reduce consumer choice.
93. The ACCC is seeking further information from interested parties, particularly in relation to how a duopoly of major clay brick suppliers would be likely to affect the residential construction industry and end-consumers in NSW and Queensland, as detailed below.

The ACCC invites further views and information from interested parties on the likely competition effects of the proposed joint venture in NSW and Queensland. In particular, the ACCC is seeking further information from interested parties regarding the following specific matters:

- a. the nature and extent of differentiation between the clay bricks currently offered by CSR, Boral and Austral Bricks, and in this regard:
 - (i) how this influences price competition between them;
 - (ii) the extent to which the proposed joint venture would result in a reduction in choice of products, with particular reference to face bricks;
- b. the extent to which Austral Bricks operational and mothballed production capacity could be used to constrain an exercise of unilateral market power by the joint venture entity;

- c. how price-based coordination may occur between the joint venture entity and Austral Bricks, having regard to customer experience of price increases by the major suppliers of clay bricks. For example, is it likely that a price change would be applied across a supplier's full range of face bricks and to what extent would negotiations with customers for discounts reduce price transparency between suppliers;
- d. how any customer allocation may occur between the joint venture entity and Austral Bricks, such as based on a customer's geographic location or merely to not actively poach existing customers or otherwise seek to win sales from each other;
- e. the extent to which existing toll manufacturing and supply arrangements between the joint venture parties in Queensland and NSW have an effect on current competition between the major clay brick suppliers; and
- f. whether, in any other building products markets in Australia, there are examples of a reduction in the number of major suppliers leading to an apparent increase in coordination by the remaining suppliers, in terms of pricing or customer allocation.

Issues that may raise concerns - supply of clay bricks in Victoria and South Australia

- 94. The ACCC's preliminary view is that the proposed joint venture may substantially lessen competition for the supply of clay bricks in Victoria and South Australia. The following section describes the ACCC's potential concerns and provides details of specific further information that is being sought from interested parties.
- 95. While the joint venture parties compete with each other to supply clay bricks in Victoria and South Australia, there is no overlap between them in the *manufacture* of clay bricks in these states. CSR does not manufacture clay bricks in Victoria, and Boral does not manufacture bricks in South Australia.
- 96. Both joint venture parties currently have a relatively small share of clay brick supply in the state in which they have no manufacturing presence, accounting for less than approximately 5% of sales. This is likely to be in significant part a consequence of the impact of interstate freight costs.
- 97. However, the only other major clay brick supplier present in Victoria and South Australia is Austral Bricks. The ACCC's market inquiries identified a concern among residential builders in both States regarding a reduction from three to two major suppliers as a result of the proposed joint venture.
- 98. Although CSR does not manufacture bricks in Victoria, some residential builders submitted that CSR competes effectively with the other major brick suppliers, using its distribution network to supply bricks manufactured interstate. Similarly, some residential builders in South Australia submitted that the loss of Boral as an independent supplier (transporting bricks from Victoria and/or Western Australia) would have a significant impact on competition in South Australia.

99. The ACCC therefore considers that, even with small shares of supply of clay bricks, the presence of CSR in Victoria and Boral in South Australia as actual and potential suppliers may currently act as an effective competitive constraint on the other major suppliers in each State and have a destabilising effect on the potential for coordination.
100. Moreover, the presence of both CSR and Boral as suppliers in Victoria and South Australia increases the product range available to consumers, in terms of the variety of aesthetic characteristics of clay bricks offered for construction of new homes. The proposed joint venture would remove a product range from these markets and would thereby significantly reduce the choice of clay brick product range offered to builders, architects/designers and end-consumers in Victoria and South Australia.
101. The ACCC notes the presence of Selkirk in Victoria, which manufactures bricks in Ballarat and principally supplies regional areas in Victoria. Selkirk's market share is greater in Victoria than CSR's. However, the ACCC's market inquiries indicated that residential builders in Victoria generally considered Selkirk to be a less significant competitor to Boral and Austral Bricks, and also to CSR. The reasons for this included that Selkirk:
- cannot supply the high volumes required by high-volume contract home builders;
 - offers a relatively limited product range; and
 - has comparatively low brand awareness outside regional Victoria.

Preliminary conclusion - supply of clay bricks in Victoria and South Australia

102. For the reasons outlined above, the proposed joint venture may substantially lessen competition in relation to clay brick supply in Victoria and South Australia, notwithstanding the relatively small volumes currently supplied there by CSR and Boral, respectively. The ACCC is seeking further information from interested parties, particularly in relation to the extent to which the removal of competition from CSR and Boral in Victoria and South Australia, respectively, would change competitive dynamics in these clay brick markets.

The ACCC invites further views and information from interested parties on the likely competitive effects of the proposed joint venture in Victoria and South Australia.

The ACCC is seeking further information from interested parties regarding the extent to which CSR in Victoria and Boral in South Australia offer to supply and/or actively compete in clay brick tenders for large projects, with particular reference to specific examples of such activity creating additional competitive tension (for example, lower prices than would otherwise be the case) in these markets for supply of clay bricks.

Issue unlikely to raise competition concerns - supply of clay bricks in Tasmania

103. The ACCC considers that the proposed joint venture is unlikely to raise competition concerns in this market. However, the ACCC will accept submissions and further consider this issue if it considers that such an assessment is warranted.

104. Boral currently supplies clay bricks in small volumes to Tasmanian customers from its mainland manufacturing operations, in competition with Austral Bricks. CSR does not currently supply Tasmania. On this basis, there is no current overlap or competition between the joint venture parties in supply of clay bricks in Tasmania. That is, the proposed joint venture would not change the current market structure in the supply of clay bricks in Tasmania.
105. However, the ACCC has considered whether the proposed joint venture would be likely to remove significant *potential* competition in Tasmania. In other words, the ACCC considered whether the proposed joint venture would substantially lessen competition by removing CSR as a significant future supplier or as a credible threat of supply of clay bricks to Tasmanian customers.
106. The ACCC has reviewed material provided by CSR in this regard, and has also had regard to information provided by Boral about the volumes and product range it supplies to Tasmanian customers. The ACCC has also taken into account views and information provided to the ACCC by interested parties in Tasmania in relation to how the proposed joint venture may change competitive dynamics for supply of clay bricks. Based on the ACCC's review of this information and in light of the matters identified above, the ACCC's preliminary view is that the proposed joint venture would be unlikely to substantially lessen competition for supply of clay bricks in Tasmania.

ACCC's future steps

107. The ACCC will finalise its view on the proposed joint venture after it considers market responses invited by this Statement of Issues. The ACCC now seeks submissions from interested parties on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
108. Submissions in response to this Statement of Issues are to be received by the ACCC no later than **6 November 2014**. The ACCC will consider the submissions received from the market and the joint venture parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the joint venture parties, come to a final view on the likely competition effects arising from the proposed joint venture.
109. The ACCC intends to publicly announce its final view by **18 December 2014**. However the anticipated timeline may change in line with the ACCC's Merger Review Process Guidelines. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.