

Aggregates, Cement and Ready-Mix Concrete Market Investigation

Tarmac response to the Competition Commission's Updated Statement of Issues published 26 November 2012

1 Executive Summary

Introduction

- 1.1** Tarmac recognises that the Competition Commission (“**CC**”) has gathered a lot of evidence in the course of its market investigation and is encouraged that the CC has taken much of this evidence on-board in reaching initial (and in Tarmac’s view, largely correct) opinions on a number of aspects, including the adoption of an all construction aggregates market definition including recycled and secondary aggregates, and the inclusion of volumetric concrete trucks in the ready mixed concrete (“**RMX**”) market definition.
- 1.2** However, Tarmac is concerned about the CC’s preliminary view that competition is not working effectively in the GB cement market. Tarmac disagrees with the CC that the evidence is consistent with a degree of coordination between some GB cement producers, or that the conditions for coordination are present.¹ Tarmac’s response to the CC’s updated issues statement will focus on rebutting the CC’s preliminary views in this regard.²
- 1.3** Further, Tarmac would like to re-iterate that this market investigation is occurring at a time when Tarmac has become a barely break-even business, struggling with the effects that the current GB economy is having on its business. Demand for Tarmac’s products has declined by 30-40% since 2007, whilst input costs, particularly in relation to fuel and energy, have continued to increase significantly. This has led to significant overcapacity across all of Tarmac’s products [X]. Profitability across Tarmac’s business remains extremely low. Tarmac’s EBIT margin has reduced from 12% in 2007 to 1% in 2011. Return on capital employed (“**ROCE**”) performance shows a similar declining trend from 11.6% in 2007 to -2.1% in 2011.³ Tarmac believes that it is essential that the CC takes this economic backdrop into consideration during the course of this market investigation.

Cement

- 1.4** As mentioned previously, Tarmac has historically been a net purchaser of cement [X]. Therefore, Tarmac’s position in the cement market is different from that of the other GB cement producers (Lafarge, Cemex and Hanson), who are all long in cement. Further, Tarmac considers that the shape of the cement market will change considerably and significantly in the very near future with the joint venture between Tarmac and Lafarge (the “**JV**”), and Mittal (the purchaser of the JV’s divestments) both being long in cement.

¹ Tarmac notes that paragraph 5 of the CC’s updated issues statement is misleading in that it suggests that the European Commission’s investigation into manufacturers of cement (and cement based products) is an investigation into manufacturers of cement, aggregates and RMX. Tarmac considers that this wording incorrectly implicates manufacturers with no involvement in the investigation as being part of the investigation.

² This response to the CC’s updated issues statement will address many of the points raised by the CC in a number of its working papers, particularly in relation to cement. Therefore, Tarmac proposes to respond to the working papers at a later stage, to the extent necessary. In particular, Tarmac has included comments on the analysis of price announcements for bulk cement (CEM I), price parallelism in bulk cement and cross sales in bulk cement working papers in this response.

³ As per Tarmac’s statutory accounts.

- 1.5** As regards the CC's preliminary view on coordination, Tarmac disagrees with the CC's assertion that it is making a large ROCE in its cement operations despite a significant downturn in the market since 2007. [§]. There is therefore no evidence that returns are excessive. In addition, several elements have significantly impacted Tarmac's financial returns, [§].
- 1.6** Tarmac notes that the CC does not take into account the effect of efficiency gains generated by its cost reduction programme and development of the use of alternative fuels, initiatives which have helped to mitigate an otherwise worsening financial performance. The CC's ROCE is on a pre-tax basis and does not include intangibles or goodwill on the balance sheet. This will therefore potentially ignore a significant proportion of the historic investment made by the GB cement producers through their acquisitions, e.g. Heidelberg Cement acquiring Hanson; Cemex acquiring RMC and Lafarge acquiring Blue Circle. Attached at Annex 1 is a paper setting out Tarmac's calculation of its ROCE performance in cement.
- 1.7** Tarmac believes that the GB cement producers are subject to significant constraints from importers and that the CC downplays the impact of importers in the market by arguing that domestic producers have a significant cost advantage over importers. Imported and domestically-produced grey cement are fully substitutable and compete directly with each other (as acknowledged by the CC in its definition of the relevant product market for cement). Many of the independent RMX players source cement from importers, as well as from domestic players. The presence of importers in the cement market has grown significantly in recent years and half of the import facilities in GB are under the control of independents. A number of import terminals have opened recently, with two terminals opening in the last few months. Further, the implementation of EU ETS Phase III in 2013 will provide even greater incentives for non-GB cement producers to supply cement to GB. Tarmac considers that the CC has underestimated the impact of the EU ETS in this regard.
- 1.8** The CC has given some attention to price announcement letters. Given that these are only a starting point for negotiations, do not translate into realised prices and the evidence shows that price dispersion is wide, Tarmac does not consider that price announcement letters are an indication of, or facilitate, coordination. It is critical to emphasise that the price that matters to the customer is the price that is actually paid, not the announced price that a supplier would like to charge. Price announcements do not allow for either alignment or monitoring on the actual prices paid by customers: actual transaction prices can be shown to vary substantially across customers. In fact, the CC has indicated that they "*consider that the main focal points for coordination are more likely to be one or more of shares of production, shares of sales and/or wins and losses of customers rather than prices, as prices are individually negotiated and not as transparent as volumes or shares*".⁴ It is therefore hard to reconcile the role played by price announcements in that theory.
- 1.9** Testament to the absence of coordination is the success in downstream markets of customers supposedly harmed by the alleged coordinating group at the expense of the companies supposedly coordinating. Specifically, the RMX GB share of supply for non-Major RMX producers has grown in recent years at the expense of Majors (a fact acknowledged by the CC). This suggests that non-Major RMX producers are able to obtain their cement requirements at competitive prices, either from GB-based cement producers or from importers.

⁴ Updated issues statement, paragraph 84.

- 1.10** Finally, in relation to cement, Tarmac considers that the geographic market is national and not “at least regional”. All domestic cement producers move cement throughout the UK.

Aggregates

- 1.11** As noted above, Tarmac primarily agrees with the CC’s preliminary conclusions on market definition and is encouraged that the CC has recognised that recycled and secondary aggregates form part of an overall market for construction aggregates. However, Tarmac disagrees with the CC’s urban / non urban classification for catchment areas. Urban sites are typically located close to demand centres and it is for this reason that catchment areas are often smaller for urban than for non-urban sites. However, this does not mean that aggregates cannot travel further from urban sites or that urban sites are not constrained by non-urban sites located further away. Further, to the extent that catchment areas defined on the basis of a plant-centred approach are then applied in analyses where local areas are centred on customer sites, the CC’s analysis could lead to distortion, as it may not allow for catchment centred on the customer to capture fully the competition in the market.⁵ Further, Tarmac considers that the CC’s description of its catchment area analysis in its updated issues statement puts an unfair skew on the data, focusing on concentrated areas around 8% and 18% (respectively) of job sites. The analysis shows that, on the CC’s own calculations, the vast majority (92% / 82%) of sites are not highly concentrated. In addition, Tarmac has fundamental concerns about the CC’s PCA/EEA methodology and, in particular, with the CC’s analysis which suggests that non-Majors and recycled and/or secondary aggregates producers do not constrain prices charged by Majors, as this is not in line with reality. Tarmac will address its concerns regarding the analysis in its comments on the PCA/EEA.
- 1.12** In relation to transfer pricing, the CC is investigating whether internal prices are set higher than external prices. [§]. As the CC has noted in its approach to profitability in aggregates, cement and RMX paper, aggregates and cement require “*long investment horizons*”⁶ and therefore require feasible long-term treatment in terms of internal accounting. [§]. Further, the number of independent RMX producers has grown significantly in recent years, which evidences the fact that external RMX customers are not being “squeezed” in any way as a result of Tarmac’s internal transfer pricing policy.

RMX

- 1.13** As with aggregates, Tarmac broadly agrees with the CC’s initial conclusions on market definition and agrees that volumetric trucks and site plants should be included in the market for the supply of RMX. Nevertheless, Tarmac does not consider that it is correct that volumetric trucks are only used for smaller jobs and that site plants are only suitable for very large jobs. Further, Tarmac would like to clarify that site plants compete with fixed plants at the tender stage. Once a site plant is set up to supply specific construction projects, the vast majority of sales are not supplied to the general market (i.e. there is competition “for” rather than “in” the market). Tarmac has also not seen any evidence that customers requiring large volumes of RMX have a more limited choice of RMX supplier than other customers.

⁵ Where an urban customer is served by a non-urban site, defining a narrow catchment area around the customer may lead to the exclusion of the supplying site from the competitive assessment.

⁶ CC’s “*Note setting out our planned approach to assessing profitability in aggregates, cement and ready-mix concrete markets*”, paragraph 45.

2 Market Definition

2.1 Aggregates

Overall, Tarmac agrees with the CC's conclusions in relation to the market definition for aggregates. Tarmac is pleased that the CC has taken on board comments from the industry and is viewing the market as comprising all construction aggregates, including recycled and secondary aggregates.

However, whilst Tarmac is broadly in agreement with the CC, there are some distinctions it wishes to make.

In relation to recycled and secondary aggregates, Tarmac agrees that whilst they are not a perfect substitute for primary aggregates across all end-use applications, the CC has downplayed their importance. Recycled and secondary aggregates are a substitute for a substantial part of the market, in particular for lower specification general construction purposes.

In addition, Tarmac believes that the CC has underestimated the substitutability between sand and gravel and crushed rock. The choice between products depends on the geology of the area and on the grade required for a project but Tarmac believes that the two can be substituted to a greater degree than suggested by the CC.

Tarmac also considers that it is important to clarify that asphalt planings are recycled aggregates.⁷ The CC should consider them as part of the same market and take them into consideration when looking at the market for recycled aggregates used for asphalt production.

Lastly, as regards geographic market definition, Tarmac notes that 30 miles should be used as a starting point only for the competitive assessment. According to the CC's analysis, catchment areas are defined on the basis of the distance within which 80% of volumes are delivered and therefore, by definition, a non-trivial proportion of sales are made outside of the local areas. That is, a 30-mile catchment area is likely to be narrower than the geographic market. Please note that for aggregates Tarmac has raised concerns regarding the CC's urban/non-urban catchment area analysis in its response to the CC's PCA/EEA analysis.

2.2 Cement

Tarmac agrees with the CC's definition of the cement market, with CEM I, II and III categorised as forming the same product market. Tarmac also agrees with the distinction between bagged and bulk cement. Tarmac is pleased that the CC has recognised the homogenous nature of cement, appreciating that imported and domestic cement are substitutable.

The CC has stated the geographic market for cement is at least regional. However, in Tarmac's view, the market is national. Tarmac has a national footprint for cement and believes other cement producers, including importers, similarly distribute cement over a national footprint.

⁷ Asphalt planings have always been recycled and reused. Historically, they have been used as a sub-base for construction or fill product. Whilst the use of planings were not previously driven by their bitumen content/value, as oil prices have increased, companies have recognised the intrinsic value of the bitumen. Planings are being substituted into asphalt to lower input costs and mitigate the rising costs of bitumen.

2.3 RMX

Again, Tarmac is in broad agreement with the CC's conclusions on the RMX market definition and in particular, with the inclusion of volumetric trucks and site plants within the market. However, Tarmac wishes to make two small clarifications. First, in Tarmac's experience, site plants exert a competitive force on fixed plants. Site plants are involved in the competitive process in the market when jobs are being tendered for but once they are set up to supply specific projects, their production is not supplied to the general market. The CC has recognised they are part of the same market as fixed plants but Tarmac wishes to emphasise more clearly their competitive force. Secondly, the use of volumetric trucks is expanding. They are being used more frequently for progressively larger jobs and are not limited to small projects.

3 Theory of Harm 1 – High levels of concentration and barriers to entry mean that the suppliers can exercise unilateral market power

3.1 Aggregates

The CC has analysed the market conditions in relation to aggregates and has identified preliminary concerns in a small number of local markets.

Tarmac does not consider that unilateral market power exists in any local market. Whilst Tarmac acknowledges there can be some barriers to entry and that expansion of an existing site generally is easier than entry, it is important to note that barriers to entry are not prohibitive, are substantially lower for recycled and secondary aggregates, and that capital cost is only sometimes a barrier to entry, depending on the scale of the job and the geology in the local area.

Majors and independents both represent a constraint on prices in local markets, making any unilateral market power unsustainable. As stated above, the CC focuses on concentration and high market shares in catchment areas around 8% and 18% of job sites. Tarmac believes this presentation of the statistics gives a skewed view of the concentration in the majority of markets. The statistic the CC has not cited is that 92% and 82% of sites are fragmented and have a large number of credible competitors. Importantly, as reported in the CC's PCA/EEA, nearly 100% of customers have a choice of six or more suppliers.

At paragraph 36 of its updated statement of issues, the CC has expressed an interest in internal margins. Tarmac refers the CC to discussions at its recent hearing with the CC on 12 December 2012, [redacted]. Tarmac intends to separately provide the CC with an economic paper explaining internal vs. external pricing and profitability in more detail.

3.2 Cement

Tarmac does not consider that unilateral market power exists in the cement market. Cement is a homogenous product and there are a number of cement suppliers in the market, both domestic and importers, making the exercise of unilateral power exceedingly difficult. The inability to exert unilateral power is exacerbated by significantly decreased demand for cement in GB, spare capacity, and the increased role of importers which impose an important competitive constraint on the GB cement producers and mean that the market is not as concentrated as the number of GB cement producers would suggest.

GGBS

The CC has stated that it remains concerned about GGBS. GGBS is an input into CEM III products. Tarmac does not produce a CEM III product but does produce a substitute by blending CEM I and GGBS directly at the RMX plant. CEM II is produced using pulverised fly ash (PFA). CEM I, II and III are all substitutable products (as acknowledged by the CC in its definition of the relevant product market for cement).

[✂]

Given the above and as noted by the CC in its approach to profitability paper, the cement market features “*long investment horizons*”, which can range from 30 to 40 years for a cement plant,⁸ Tarmac needs to ensure that it has long term source of supply of arisings for granulating, due to the investment costs.

GGBS can be, and is, imported, meaning the supply arrangements for GGBS in GB do not have a negative impact on the GB cement market. Further, it follows from the substitutability between CEM II and CEM III that GGBS and PFA are substitutable and PFA is widely available from power stations in GB. Tarmac notes that no issues were raised by third parties in their hearings over the availability of GGBS.

3.3 RMX

The CC has not expressed a concern with unilateral market power in relation to RMX. Tarmac agrees with this view.

The CC has expressed some concerns that due to capability requirements, customers requiring large quantities of RMX have fewer suppliers to choose from. Tarmac does not agree this is the case. First, large customers have a wide array of choice between suppliers and low barriers to expansion mean that smaller RMX producers can easily adapt and expand in order to meet the demands of larger customers. Second, large customers also have the option to set up their own site plant for larger orders. Tarmac has recently seen the increasing use by customers of volumetric trucks and site plants for larger jobs. For example, Volker Fitzpatrick used a mobile batching plant to supply an onshore windfarm at Bradwell, Essex in the second half of 2012. Balfour Beatty has also recently used site plants on the A1 near Edinburgh and the M77 south of Glasgow.

4 Theory of Harm 2 – Coordination between producers reduces or prevents competition

4.1 Aggregates

Tarmac agrees with the CC’s views that, since aggregates markets are local with a fragmented customer base, and since the number and nature of competitors varies from one local area to another, it would be hard to reach and maintain a system of coordination across the country. Indeed, given that competition takes place at the local level and, accordingly that pricing is determined locally and is widely dispersed across customers, the characteristics which would be necessary for coordination to be possible and sustainable simply do not exist in the market for the supply of aggregates.

Features of the aggregates supply market

The CC notes that there are some features of aggregates supply in GB that may be conducive to coordination, citing concentration in the supply of aggregates at a national

⁸ CC’s “*Note setting out our planned approach to assessing profitability in aggregates, cement and ready-mix concrete markets*”, paragraph 45.

level by the Majors; high market shares by the Majors in some local markets; barriers to entry; and structural links between the Majors.

In relation to the first market feature, since competition for aggregates takes place at a local level, it is not meaningful to look at shares of supply on a national level. Tarmac has a national footprint for aggregates but actively competes for jobs within each local area in which it is active and it faces a mix of national, regional and local players in these local markets. Despite not always having a national footprint, non-Majors are nevertheless strong competitors and a significant proportion of the volumes Tarmac loses are won by independents. Up to October 2012, Tarmac had lost nearly [X] contract jobs to independents during 2012.⁹ This amounts to approximately [X] of jobs lost and shows the hugely significant role of independents in local markets. Similar percentages are obtained if losses are expressed in terms of tonnage lost rather than number of jobs. These numerous and successful independents would be able to undermine any coordination between larger players, should it exist (which Tarmac does not believe is the case in any event).

In relation to high barriers to entry, opening a new primary aggregates site can involve a significant investment, however, as correctly indicated by the CC, entry costs are not prohibitive, especially if land and mineral rights are leased. Further, barriers to expansion in aggregates are not high particularly in light of the excess capacity which is a feature of the aggregates market in GB.

Lastly, Tarmac does not consider that joint ventures and membership of common trade associations increase transparency between aggregates suppliers. In relation to production only joint ventures, the joint venture participants market the output materials independently from each other and, where Tarmac is on the board of a joint venture (e.g. MQP), the joint venture parties would not share any trading or commercial contract information. In relation to trade associations, MPA data is aggregated and therefore generally gives data on a wider geographic basis than the relevant market. As such, MPA data is not granular enough for Tarmac to get any real insight into its competitors' behaviour and therefore to change its own behaviour accordingly.

Price announcement letters

Tarmac notes that the CC has focused on price announcement letters and whether they might play a part in sustaining coordination amongst aggregates suppliers. Similarity in timing or magnitude of announced price rises, to the extent that this has occurred in recent years, cannot by itself imply sustained coordination. Tarmac sets prices independently and usually seeks to increase prices in response to increased input costs. Tarmac normally changes prices as of 1 January in line with its annual budgeting process. The majority of Tarmac's customers also prepare budgets on an annual basis and prefer clarity on prices from the start of each new year so that they can plan their own costs accordingly. Throughout the year, if required, Tarmac may announce additional price increases in response to increased input costs, for example, if oil and energy prices increase.

Moreover, it cannot be presumed that a price announcement by, say, Tarmac amounts to a "signal" that strengthens the ability of another supplier to achieve a higher price. As Tarmac has previously mentioned, price announcement letters are only the starting point for negotiations with customers and almost never translate into realised prices. In some cases, the outcome of price negotiation after a price announcement letter is a reduction in

⁹ Tarmac notes that this data is based on jobs for 500t or larger – the percentage would be even higher if the data captured jobs won/lost for less than 500t.

prices. Importantly, actual prices are not transparent: [REDACTED]. Therefore, whilst it may be the case that price announcement letters sent by GB aggregates suppliers often occur around the same time, price announcements do not allow for either alignment or monitoring of the actual prices paid by customers.

Supply agreements

The CC notes that it is intending to explore aggregates cross-supply agreements. Whilst supply agreements do exist within the industry, Tarmac does not consider them to be very widespread and they form a small percentage of the overall volume of aggregates supplied.

As explained to the CC during Tarmac's hearing on 12 December 2012, supply agreements provide a means to maximise logistical savings and efficiencies. They are also often borne out of specific transactions, e.g. the purchase of a Tarmac RMX plant by another Major. Given the high levels of capital investment and fixed costs in the industry in general, it is important to maintain a secure source of supply for, often relatively isolated, production units.

Supply agreements with Majors are negotiated on an arm's length basis and where these agreements run for periods longer than twelve months, prices are usually reviewed by reference to an index, which will reflect market price. Where the index price is no longer an appropriate reflection of the market, the agreements may allow for commercial negotiations instead.

4.2 Cement

Cement market

As mentioned above, Tarmac has historically been a net purchaser of cement [REDACTED].

Further, as explained in more detail in the ROCE paper provided at Annex 1, [REDACTED] there is no evidence that Tarmac earns excess profits from the sale of cement in GB.

Tarmac's position in the cement market is different from that of the other GB cement producers (Lafarge, Cemex and Hanson) who are all long in cement. The CC has noted that there are only 10 plants producing cement in GB and this lack of market complexity means that the number of variables on which cement producers would need to have a common understanding in order to arrive at a coordinated outcome in the market is likely to be small. The CC further states that there appears to be some preliminary evidence that competition is not working effectively in the GB cement market. As described in more detail below, Tarmac disagrees with the CC's preliminary view and argues that the evidence put forward is not sufficient for a conclusion to be reached that there is a degree of coordination in the GB cement market, even if only on a preliminary basis.

"Coordination characteristic" 1 - agreement, monitoring or sufficient awareness of each others actions¹⁰

Tarmac does not consider that the market conditions necessary for tacit collusion to be sustainable are present. The CC has indicated that the main focal point for coordination is unlikely to be prices as prices are individually negotiated and not as transparent as volumes or shares. In particular, in relation to the requirement that firms must be able to monitor whether the tacit understanding is being adhered to, Tarmac considers that the

¹⁰ As set out by the CC in paragraph 68 of the updated issues statement.

CC's conclusion that "each GB cement producer has a high degree of transparency of its own share of cement production and sales as a result of figures for total UK production and sales published (with a one-month lag) by the MPA", and its analysis that cement producers are able to infer how their competitors are behaving, is incorrect.¹¹ The monthly MPA data allows a cement producer to determine its relative market share amongst MPA members but does not allow visibility over cement producers' market shares, nor enables producers to calculate their market shares on the true wider cement market, which includes imported cement. Consequently, an MPA cement producer would not be able to identify with certainty whether any change in market share was the result of potential competitor deviation, or customer switching to a non-MPA cement importer. Further, whilst Tarmac does track its own gains and losses of individual cement customers, it does not have transparency of which rivals those customers are lost to/gained from in every case.

"Coordination characteristic" 2 – internal sustainability

The CC has considered whether cement price announcement letters sent out by Majors may play a part in sustaining any alleged coordination. From the outset, Tarmac wishes to note that the CC acknowledges that prices are not transparent and is therefore not considering prices to be the main focal point for the coordination and so it is unclear as to the role that price announcement letters play within the CC's theory of tacit coordination.

As noted above for aggregates, similarity in timing or magnitude of announced price rises, to the extent that this has occurred in recent years, does not, by itself, constitute effective coordination. Price announcement letters are sent to try to recover projected cost increases and are often requested by customers for their internal budgeting purposes. To the extent there has been any correlation between timing of price announcement letters between the Majors, Tarmac considers that this is likely to be due to the fact that cement producers are subject to similar variable input costs and thus are affected concurrently by any spikes (as has occurred in recent years). For example, the mid-2008 price announcement letter followed a spike in oil prices to USD \$147 per barrel. Tarmac, and presumably other producers, needed to try to recover some of these input costs.

As recognised by the CC, price announcement letters for cement are only the starting point for negotiations with customers and almost never translate into realised prices. Prices are negotiated by Tarmac on a customer by customer basis and the prices set out in the announcement letters represent aspirational, rather than actual, prices increases. As is noted in the CC's guidelines,¹² coordination requires that "*firms need to reach and monitor the terms of coordination*". It is critical to emphasise that the price that matters to the customer is the price that is actually paid, not the announced price that a supplier would like to charge. Price announcements do not allow for either alignment or monitoring of the actual prices paid by customers: actual transaction prices can be shown to vary substantially across customers. Indeed, observed market evidence demonstrates that price increases are widely and non-systematically dispersed across customers and that they are almost always lower than the announced increase.

Given that price announcements cannot provide a clear signal of realised prices to a given customer, Tarmac does not consider that price announcement letters can be used for any alleged coordination.

¹¹ Paragraph 85.

¹² See CC/OFT, *Merger Assessment Guidelines*, paragraph 5.5.9.

Further, the CC has indicated that cross sales provide scope for repatriation as a punishment mechanism for deviation from coordination. In that regard, Tarmac wishes to note the following. First, cross-sales arrangements between cement producers are in place for logistical reasons. Tarmac is a net buyer of cement as it requires more than it can self supply and it purchases from other Majors where this leads to efficiencies associated with savings on transport costs. Secondly, repatriation cannot provide an effective and credible retaliation mechanism; once repatriation has occurred, there is limited scope for further punishment. Tarmac also wishes to note that repatriation can arise for reasons unrelated to coordination. For instance, as a unilateral response to the economic downturn and/or a change in logistical circumstances that makes self-supply more attractive than before.

“Coordination characteristic” 3 – external sustainability

In relation to the third condition needed for coordination, namely that coordination needs to be externally sustainable and unlikely to be undermined by competition from outside the coordinating group or the reactions of customers, the constraint posed by importers means that this condition could not be met.

Tarmac believes that the CC has underestimated the role of importers on the GB cement market and also the importance of the EU ETS in incentivising importers. Whilst Tarmac is not a major player on the external cement sales market, especially as regards supplies to independents (those customers that would supposedly be harmed by the alleged coordinating group), there is undoubtedly significant competition from importers such as Morrissey, Dudman, Dragon, Southern and Quinn. Importers are able to compete actively with domestically produced cement and this is evidenced by the fact that independent importers have opened a number of new import terminals since 2008 (two new terminals have opened in the past two months) and have seen their market shares increase significantly since 2007. Further, importers are not capacity constrained as there is substantial excess capacity in Europe. Tarmac does not consider that there is any cost disadvantage to importers over domestic producers for the average variable ex-works cost for GB-produced cement, however, to the extent that there is, it is not preventing importers from entering the GB market and competing effectively with domestic producers.

In relation to the EU ETS, the need to comply with this scheme imposes a cost on cement producers and creates an incentive for customers to use imported cement from non-EU countries which is cheaper to produce. Further, Phase III of the EU ETS will incentivise non-GB based suppliers to sell into GB, e.g. from Spain or Republic of Ireland, due to the change whereby cement plants using less than 50% of their allocated annual CO₂ allowance each year will not automatically retain their full allocation for the following year, and will lose 50% of their allocation. This regulation provides strong incentives for cement producers in countries where domestic demand is low relative to recent production levels (e.g. Spain, Greece and Ireland – countries that already export to GB) to export in order to meet the 50% production threshold. As a result importers will impose an even greater competitive constraint on domestic cement producers going forward as they maintain production levels and export to GB in large volumes.¹³

Tarmac intends to provide the CC with a separate analysis showing the incentives for cement producers to export to GB to ensure they maintain their CO₂ allowances going forward.

¹³ The EU ETS also incentivises producers to blend cement, to use a lower proportion of clinker and thereby to reduce CO₂ emissions.

In summary, the evidence put forward so far is not consistent with a degree of coordination in the cement market in GB and is therefore not sufficient for a conclusion that competition is not working effectively, especially when assessed under the cumulative criteria of the CC's guidelines. Importantly, testament to the absence of coordination is the success in downstream markets of customers supposedly harmed by the alleged coordinating group at the expense of the companies supposedly coordinating.

Future of the GB cement market

Even if there was any coordination in the GB cement market (which Tarmac does not consider to be the case), the entry of Mittal and the formation of the JV between Tarmac and Lafarge (both of which will be long in cement) will change the structure of the cement market and Tarmac urges the CC to consider this change in its provisional findings.

5 Theory of harm 3 – Vertical integration and exclusionary behaviour

5.1 Foreclosure

Tarmac agrees with, and welcomes, the CC's position that the evidence is not consistent with the fact that independent RMX producers have been unilaterally foreclosed from obtaining supplies of either cement or aggregates as an input to RMX. Tarmac further welcomes the CC's views that the evidence is inconsistent with a coordinated strategy of foreclosure.

5.2 Barriers to entry

In relation to the effect of vertical integration on barriers to entry, independents' market shares increased from 22% in 2006 to 27% in 2011.¹⁴ This suggests that non-major RMX producers are able to obtain their cement requirements at competitive prices, either from GB-based cement producers or from importers. Importantly, this evidences the fact that it is not essential for companies to be vertically integrated in order to compete effectively and gain market share and that the structure of the cement and aggregates markets has not deterred new entry (and growth) into the RMX market. Further, there should be no concerns that vertical integration could increase barriers to entry or expansion in the cement market, as evidenced by the entry and growth of non-integrated cement importers.

5.3 Coordination

The CC is considering whether vertical integration down to RMX may facilitate coordination in the upstream markets, particularly in relation to cement. For the reasons set out above in section 4, Tarmac does not consider that there is any evidence of coordination in either the aggregates or the cement markets. Even if the markets were conducive to coordination, Tarmac does not consider that this is, or would be, facilitated by vertical integration.

In relation to information exchange, which the CC considers could be facilitated by multiple points of contact at different levels of the supply chain, Tarmac does not consider this to be a realistic concern since Tarmac does not use detailed market information from their in-house RMX operations for the purpose of monitoring market shares or customer wins and losses. Further, changes in RMX sales volumes are driven by a host of factors other than the price of bulk cement (aggregates, for example, account for a greater share of costs in

¹⁴ BDS estimates.

RMX than does cement). In addition, developments in some local RMX markets are an unreliable guide to what is happening in hundreds of RMX markets across GB.

In relation to cement, it is explained above that repatriation of cement volumes used for RMX production and previously purchased from rivals is not a credible punishment mechanism.

Further, the CC itself notes, and Tarmac agrees, that the theory that players deviating in cement may be punished through reducing the price downstream (i.e. of RMX) may not work very well because the punishment is likely to be less effective and less immediate than punishments in the cement market (which Tarmac considers are not effective either). Punishment clearly becomes more complex if it relies on lowering prices in one or more of the hundreds of local RMX markets, especially in light of the fact that RMX prices are non-transparent. Further, a price war in the downstream market, would harm other local RMX producers (either within or outside the alleged coordinating group) too. That is, punishment could not and would not be targeted on the deviant.

6 Theory of harm 4 – Policy and regulation

The CC has argued that the current system for planning gives rise to an incumbency advantage. Tarmac acknowledges this but would like to emphasise that although this advantage exists, the reality is that there are hundreds of incumbents who benefit from the advantage, since there are over 200 incumbents¹⁵ in the aggregates market. As recognised by the CC, the new National Planning Policy Framework (NPPF) will address many of these concerns. In particular, local planning authorities will take competition issues into account.

In relation to the EU ETS, Tarmac would like to reiterate the importance of the scheme for cement market dynamics and refers the CC to section 4.2 above.

¹⁵ The OFT identified approximately 235 primary aggregates operators and approximately 450 recycled aggregates companies in its market study report.

Annex 1

Tarmac paper on ROCE calculations

