COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case No: 27/LM/Jun03

In the large merger between:

Alpha (Pty) Ltd

and

Slagment (Pty) Ltd

Reasons for decision

Conditional approval

1. On 27 September 2004 we conditionally approved the acquisition by Alpha (Pty) Ltd, now known as Holcim South Africa (Pty) Ltd, of Slagment (Pty) Ltd. This transaction represents the dismantling of the only remaining joint venture company that had its origin in the now disbanded cement cartel. [1]

The Transaction

2. Three major South African cement producers, Pretoria Portland Cement Company Ltd ("PPC"), Holcim South Africa (Pty) Ltd ("Holcim") and Lafarge South Africa ("Lafarge") hold equal shares in a joint venture company known as Slagment (Pty) Ltd ("Slagment"). In terms of the proposed transaction, Holcim will acquire the shares, which Lafarge and PPC hold in Slagment, resulting in it owning 100% of Slagment.

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[1] Prior to 1996 the cement industry was an acknowledged cartel where Anglo Alpha Ltd, Blue Circle Ltd and Portland Cement Ltd shared distribution systems, credit/account controls and marketing strategies. In 1996 this was disallowed by the then Competition Board and the companies were obliged to establish their own support systems and desist from fixing prices and marketing strategies.

3. This is a vertical merger since the target company, Slagment, supplies Holcim, the acquirer, with ground slag, a cement extender product.

Rationale

4. The three cement companies, the joint venture partners in Slagment, aver that the transaction is intended to allay Competition Commission suspicions of continuing horizontal co-operation in the cement market.[2]

History of proceedings

5. The Commission, initially, recommended that the transaction be approved unconditionally because it was of the view that the transaction lessened the potential for collusion between the cement manufacturers.

6. However, subsequent to a pre-hearing held on 12 November 2003, the Commission reconsidered its position and recommended in a letter, dated 19 May 2004, that the merger be approved subject to a condition whereby the off-take of slag by PPC, Holcim and Lafarge should be limited to 65% and that the remaining 35% be available on the open market.

7. It appears that the Commission changed its initial position because it became apparent that a new entrant, which had negotiated a supply contract with Iscor, was unlikely to be in a position to be able to process slag for the purpose of supplying independents.[3]

8. Hearings took place on 26 - 27 May and 24 June 2004 during which the Tribunal heard testimony by the following witnesses called by the Competition Commission:[4]

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[2] In 2001 the Commission investigated a case of alleged collusion against Slagment and PPC. Following an abortive search by the Commission on Slagment' s offices it appears the investigation was not pursued. In Pretoria Portland Cement Company Ltd and Slagment (Pty) Ltd v The Competition Commission and others, SCA Case No 64/2001, the SCA sets out the background to this search and the reasons why it held that the search was unlawful. In Board Minutes, dated 18 February 2003, of the then Alpha board link the investigation to the decision leading to the present merger. See record page 94 and 95 of the record (please note that this is confidential information).

[3] At least this is how the Commission has articulated its change in stance on the first day of hearing. It is likely that the vigorous opposition to the merger from some downstream firms must have had some influence as well.

[4] Since the parties proposed a remedy before their witnesses testified, we only considered their written argument and the G:enesis report filed by them.

1) Mr. Johannes Van Zyl, Manager Sales and Distribution of Iscor Coke and Chemicals (“ICC”) [5],

2) Dr Kenny Dakile, Executive Director of Maponya Investment Group (“MIG”)[6],

3) Mr. Anton Weavind representing Star Lime & Admixtures (Pty) Ltd (“ Star Lime & Admixtures”) [7],

4) Mr. Harold Muller, owner of Cemlock (Pty) Ltd (“Cemlock”) [8], and

5) Mr. John Wearne, Director in charge of the ready-mix concrete operation of Wearne (Pty) Ltd (“Wearne”) [9].

9. Initially the merging parties were unwilling to accede to the Commission’s proposed condition, and hence the hearing proceeded with the testimony of the Commission’s witnesses. Later, in the course of the proceedings the parties indicated a willingness to limit their off-take of slag to 65% of Slagment’s output, but indicated that PPC, Holcim and Lafarge would need to agree their respective individual shares. As a result the hearing was adjourned on 24 June until 10 September 2004 to allow the parties and the Competition Commission to consider a proposed condition.

10. On 10 September 2004 the Competition Commission and the parties presented a draft order to the Tribunal listing the conditions to which they had agreed. At the request of the Tribunal the Competition Commission and the parties agreed to redraft the order so as to address certain issues raised by the Tribunal during the hearing.

11. After consultation with the parties and Iscor the Tribunal issued the following order on 27 September 2004:

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[5] Suprachem, a division of ICC, is contracted to sell 85% of its slag to the cement producers and the rest to Micromatica and others.

[6] Maponya Investment Group is a new entrant in the cement blending market through Micromatica (Pty) Ltd, a joint venture company. It concluded a short-term supply agreement with Iscor for the supply of raw slag.

[7] Star Lime and Admixtures develops and markets cement admixtures. It supplies its products mainly to independent blenders. It is thus neither a customer nor a competitor of Slagment. It would, however, be negatively affected by the merger, should Slagment increase its prices to independent blenders since these blenders would not be able to supply end-users at competitive prices. The blenders would be forced to exit the market and Star Lime and Admixtures would lose its customer base.

[8] Cemlock is an independent blender in the cement industry. It is a customer of both the Cement producers and Slagment as well as a competitor of the cement producers.

[9] It is a competitor of Lafarge in the ready-mix concrete market and a customer of Slagment.

The merger is approved, subject to the conditions set out below:

1. *Notwithstanding the fact that Holcim South Africa (Pty) Ltd, formerly Alpha (Pty) Ltd ("Holcim"), Pretoria Portland Cement (Proprietary) Limited ("PPC) and Lafarge South Africa (Proprietary) Limited ("Lafarge") (collectively referred to as "the cement producers" and each a "cement producer") have each entered into long term supply contracts (collectively referred to as "the long term contracts", and each a "long term contract") with Ispat Iscor Coke and Chemicals, formerly Suprachem ("Ispat Iscor") for quantities of slag produced by Ispat Iscor at its Vanderbijlpark works, the cement producers shall, subject to the provisions of the paragraphs set out below, reduce their aggregate off-take of slag to 65% ("the agreed percentage") of the amount Ispat Iscor notifies to its customers as being its total daily slag production at its Vanderbijlpark works ("Ispat Iscor's slag production"). For the avoidance of doubt, the agreed percentage shall not include the excess slag as defined in paragraph 3 below.*

2. *In order to limit the cement producers' aggregate off-take of slag as stated in paragraph 1, each of PPC, Lafarge and Holcim shall reduce its aggregate off-take of slag pro rata to its percentage of Ispat Iscor's slag production, specified in or ascertainable from such producer's long term contract, without regard to any maximum tonnage specified therein ("pro rata share").*

3. *To the extent that:*
   - *3.1 Ispat Iscor has not received orders for all or part of the remaining 35% of Ispat Iscor's slag production; and/or*
   - *3.2 any purchaser does not collect the slag purchased by it within three days of the day on which it is required to collect such slag in accordance with the terms of its agreement with Ispat Iscor,*

(together, “the excess slag”),

then, in addition to the agreed percentage, each of the cement producers shall be entitled but not obliged to acquire the excess slag on an ad hoc basis, in accordance with its pro rata share, but otherwise in accordance with the terms of its long term contract.

4. *This order shall be binding on each individual cement producer for so long as its long term contract with Ispat Iscor remains in force.*

5. *For the purposes of this order:*
   - *5.1 any distinction between white and black slag shall be ignored,*
   - *5.2 the long term contracts referred to in this order are those between:*
     - *5.2.1 Ispat Iscor and Lafarge, concluded on 13 February 2003,*
     - *5.2.2 Ispat Iscor and PPC, concluded on 30 June 2003, and*
     - *5.2.3 Ispat Iscor and Holcim concluded on 30 June 2003,*

     as amended to give effect to this order.

12. We now turn to the transaction and the reasons for conditionally approving the merger.

The cement industry

13. This merger is about access to the supply of slag. Slag is a by-product of steel production and it is sourced from steel foundries. In South Africa this is confined to the various plants owned by Iscor.[10] As a by-product Iscor has no further use for it, but as it is environmentally hazardous and expensive to stockpile, Iscor is understandably anxious to sell it as quickly and efficiently as possible to firms who can make use of it. For this reason it has had a preference for dealing with customers in terms of long-term contracts so that the obligation to uptake the slag is guaranteed, and secondly it has had a preference for “solid “ customers i.e. firms it can be

[10] In KZN Iscor’s Newcastle factory is a source and in the Western Cape , its Saldanha plant.

sure will be good for their obligations. Iscor's main objective is not price but to be in a 'sold out' situation.[11]

14. In Gauteng raw slag is only available from Iscor's Vanderbijlpark works. Due to transport costs only firms in the vicinity of Iscor's plant are potential customers for its slag. To date, only one firm has been a customer for slag for the purpose of refining it. That customer is the target firm Slagment and at present it accounts for 85% of the slag Iscor sells from Vanderbijlpark.[12]

15. Slagment was set up in the 1960's for the purpose of purchasing raw slag from Iscor and then refining that slag into what is known as 'slagment', a product that is then commercially useful, mostly as an extender for cementitious products, but it also has other uses as a binder, particularly as a backfill in the mining industry.

16. Thus the chain of supply in Gauteng, commences with a sole supplier of raw slag, Iscor's Suprachem division, which for convenience from now on, we will refer to as Iscor, which in turn supplies a sole refiner, Slagment, which then in turn supplies the market with refined slag.[13]

17. This situation will prevail, at least for the time being, post merger. What has made the merger controversial is the history of Slagment, which serves to reinforce fears about the intentions of Holcim (whom we shall refer to by its former name, Alpha, again for convenience) once one of its three co-owners, and now, its prospective sole owner.

18. To appreciate these concerns one must venture downstream a further level from the refining plant, to understand how the refined product is utilized. We will confine ourselves to how slag is used in the production of so-called 'cementitious products' as these are the sub-markets where the competition concerns arise.[14] The parties and the Commission are in agreement that three such sub-markets exist. They are the markets for -

    1) <u>Blended products</u> This is typically cement sold in bags or in bulk and contains a mixture of OPC and an extender. The use and ratio

[11] See the evidence of Mr. Van Zyl transcript page 5 and 27.
[12] According to Mr Van Zyl they also have supplied a small blender, a brickmaker and a glass manufacturer with raw slag from time to time. It does not appear that any of these firms have refining capacity.
[13] We will continue to refer to the refined product as slag as this is the way it was referred to by witnesses at the hearing and it also avoids confusing the product with the eponymous target company.
[14] The parties' experts identify a fourth as that of binders that is the use of the product as backfill in such processes as mining. As this sub-market is an end use one it does not give rise to foreclosure and remains unaffected by the merger and for this reason need not be considered further.

of the extender in the mix is dependant on the strength required. In Gauteng four different strengths are blended.

2) Concrete Concrete is either mixed on construction sites by construction firms who buy directly from Slagment or is supplied to construction firms' intermediaries known as ready-mix producers. The ready mix producers would source their inputs in the form of extenders and OPC, from firms such as Slagment and Alpha, and then mix them into a cement product which is then supplied to building sites in special trucks before the cement can harden; and
3) Manufactured concrete products Here we find a range of products such as paving, roof tiles, floor blocks and pipes.

19. Slag is commonly used, together with cement (OPC), as a key input into all these three sub-markets. [15] When slag is used in this way in the industry, as an input, it is referred to as 'an extender'.

20. Extenders, as the name suggests, are products that when combined with OPC, extend the use of cement by creating more volume at lower cost. In addition extenders are considered more environmentally friendly than OPC. Thus in all three sub-markets, both cost and environmental concerns act as a driver for the more extensive and optimal use of extenders, so as to dilute the use of OPC. The extent to which OPC can be replaced by an extender in a given mixture is not unlimited. Extenders not only have different chemical properties to OPC, but also to one another, and this has a bearing on the strength of the cement and the speed with which it hardens. As we shall see later, it is also the use to which these products are put, not just the cost, which has a bearing on what goes into the mix.

21. Apart from slag, fly ash and lime are typically used as extenders. However it is common cause that in Gauteng the choice of extender is limited to fly ash and slag.[16] Fly ash like slag is generated from waste products, specifically from the burning of coal at coal fired power stations.

22. From a cost point of view OPC is the most expensive of the three products, followed by slag and then fly ash.

[15] Cement is a mixture of limestone, shale, clay, iron ore and silica sand, which are crushed and blended in the right proportion, ground down and heated in a kiln to form clinker. The clinker is then ground to a fine powder to which a small amount of gypsum, which retards setting, is added, the end product being Ordinary Portland Cement ("OPC"), commonly referred to as cement.
The process of producing cement is highly capital intensive, with the minimum efficient scale of a kiln often being quite large relative to the size of the market it serves. Cement is also heavy and expensive to transport relative to its value. As a result cement is, in most cases, combined with a less expensive material known as 'an extender' (see more on this below) in order to increase its volume and lower the cost of cement, whilst retaining the strength needed. This also reduces the pollutants released in the atmosphere when clinker is made in kilns

[16] See Genesis report Record page 934-5

23. The cementitious products market is characterized by a number of firms who compete in the supply of the various products. These are mostly small or medium sized firms, who are purchasers of the key ingredients namely extenders and OPC. Herein lies the potential anti-competitive rub.

24. Since the 1960's Slagment has been owned by three of the four major cement producers viz. PPC, Lafarge and Alpha. All three of these firms not only produce cement, and via Slagment produce one of the extenders, but they are also major players in the downstream markets for cementitious products. Slagment as we have noted enjoys a supply agreement with Iscor in terms of which it purchases approximately 85% of its slag. Slagment then refines the slag and sells the product firstly to its shareholders, and then a residual amount into the open market.

25. The joint venture between three ostensible competitors was not previously the subject of competition scrutiny, because for many years the cement companies enjoyed the right to operate as a cartel by virtue of an exemption in terms of the then Maintenance and Promotion of Competition Act. In 1995 this exemption was terminated and the companies found themselves in a situation where their historic relationships no longer enjoyed officially sanctioned insulation. This made pre-existing joint ventures, one of which was Slagment, particularly vulnerable to competition scrutiny. The Commission's investigation into Slagment and its raid on its premises in 2001 proved to be the catalyst for the cement majors to reconsider their relationships in the new, more aggressive enforcement environment. As part of that exercise, the companies, as we alluded to earlier, decided to wind down their several joint ventures one of which was Slagment.[17] The decision to sell the company to Alpha is not surprising. Of the three firms it appears to have been the major purchaser of slag from the joint venture, but more importantly, it primarily sells into the Gauteng market.

26. Post the merger arrangements with Iscor will change. Now each of the three erstwhile partners will enter directly into a long-term supply agreement with Iscor for an agreed percentage of its output.[18] The three contracts account for approximately 85% of Iscor's slag output from Vanderbijlpark. Each then has a back-to-back arrangement with Slagment,

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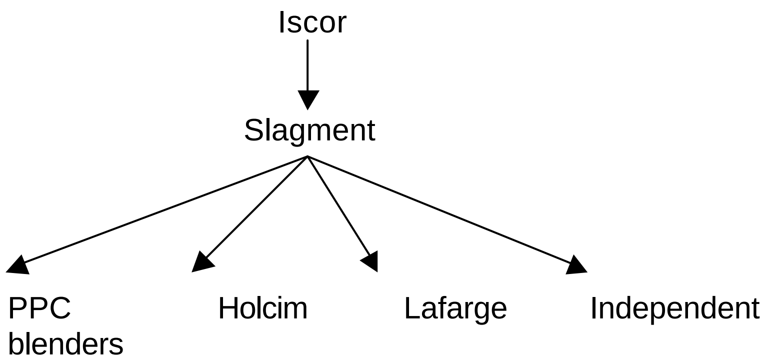
[17] Other joint ventures now terminated are: (1) Ash Resources – PPC Has already sold its interest in Ash Resources to Lafarge, and Alpha is also seeking to dispose of its share. (2) NPC - the three producers sold their interest in NPC to Cimpor, a Portuguese firm, thus they say introducing a fourth player into the market.

[18] The contract terms range from 10 to 15 years. The firms agree to guarantee Iscor a minimum take up. These amounts are not uniform and although the precise figures are confidential information it suffices for the purpose of this decision to say that Alpha takes up the lions share.

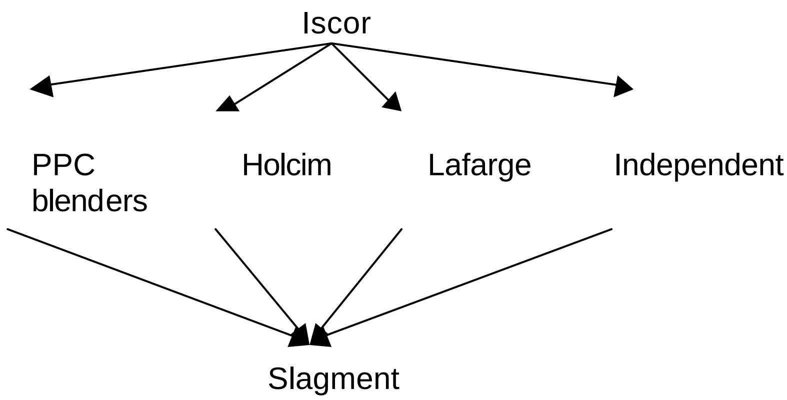
in terms of which Slagment will refine its slag at an agreed price. The companies may then do with the refined slag as they see fit. [19]

27. We show the change in arrangements in the diagrams below.

28. Pre-merger distribution structure



29. Post merger distribution structure:



30. Thus the merging parties argue that from a third party perspective, nothing much has changed. For them, they argue, the identity of Slagment's shareholder should be irrelevant.

31. The objectors who gave evidence in this case were less convinced. Their concerns relate to the incentives of the target firm, now solely controlled by Alpha, to foreclose on Slagment's independent customers in the

[19] A new entrant has already procured some of the remaining 15% via a short-term supply agreement with a renewal option from Iscor.

cementitious products markets, by either raising prices or constraining supply.

Objections to the merger

32. Although various submissions were made both in writing and in oral submissions by various firms that objected to the merger we will confine ourselves to two witnesses whose evidence best summarises the broader concerns.

Weavind

33. Mr. Anton Weavind is employed by Starlime Admixtures . He has been involved in aspect of the cement industry for a number of years, and although initially called as an objector to the merger, was used by the Commission as an industry expert.

34. In a letter to the Commission dated 7 July 2003 Mr. Weavind first expressed his reservations about the merger's affects on cement blenders and the ready-mix cement markets. [20] His concerns were premised on the fact that Alpha now the controller of Slagment was both a supplier to and a competitor of its customers. He argued that Alpha could reduce the supply of slag by either taking up much of the supply for itself or increasing its price to its customer/competitors thus undermining the latter's' competitiveness vis-à-vis Alpha. According to Mr. Weavind it was the stated intention of Alpha to enter into the blended market more aggressively than they already have. He added that in ready-mix cement Alpha could again use the supply of Slagment to dominate the market by control over a c rucial input.

35. In a subsequent report, and in his oral testimony, Mr. Weavind expanded on these ideas and spent much of his time arguing why there is limited substitutability for slag in the various sub-markets. His solution to the problem of Alpha being able to foreclose the market because of its control over the supply of slag, was to ensure that a certain amount of raw slag was available to the general market and kept out of Alpha's control. He accordingly supported the Commission's proposed conditions

Wearne

36. Mr. Wearne represents WJ Wearne, a ready mix concrete company operating in Gauteng. Alpha is one of his major competitors, but he also

[20] See Record page 652-3.

sources slag from Slagment, which he uses to mix with OPC in his various products. The strength of the product i.e. the ratio of OPC to the extender in the mix, varies depending on the requirements of the customer. He testified that he uses slag in 80% of the concrete he sells.[21] Slag is for him, a specialist in supplying the residential construction market, a key ingredient, because it is a lot cheaper than OPC. In this market they can use a 50% slag replacement. Fly ash, he says, can only replace OPC by up to 30%. Thus slag is the preferred extender as it obviates the need for more OPC, the most expensive of all the ingredients. He testified how an increase in the price of slag would impact on the price of concrete and make firms, in what he described as a margin thin industry, uncompetitive. Moving out of the residential supply market is not an attractive market as one would then have to use even more OPC and that is when as he put it *"one bumps ones head up"* against the three cement producers.[22]

Analysis

37. The difference between the pre and post-merger scenarios, are the probable incentives of Alpha. Unlike its erstwhile partners, Alpha is primarily a Gauteng based firm. As such its competitive relationship with the customers of Slagment is likely to be a more intense one than that of PPC and Lafarge. As it appears that the re-arrangements of the various joint ventures will enhance Alpha's dependency on slag for use as an extender, it is likely to be a more aggressive and voracious owner, and indeed at least one board minute suggests that part of its strategy is to make increased use of slag as an extender. [23] But foreclosure concerns are not limited to the fact that customers have to buy one key input, namely an extender, from a large vertically integrated competitor. The other input, which they have to purchase is OPC. Here, in all likelihood given the nature of the cement industry, the supplier for a Gauteng based customer is Alpha. They are thus customers for two essential inputs from their much larger competitor.

38. Foreclosure therefore seems highly probable. The merging parties did not seriously contest the notion that Alpha may have an incentive to foreclose downstream rivals. Rather, the debate was over whether a foreclosure strategy could be successful if fly ash, an input that Alpha does not control, is an adequate substitute.

39. It was common cause that the extent to which slag was a 'must have' extender, not capable of substitution by fly ash, varied according to the technical requirements of the particular sub-market and product.

[21] See transcript pages 219 -220
[22] Transcript page 225.
[23] See Record page 94 Minutes of Alpha Board 18 February 2003.

40. It thus appears that at least in the cement products market, fly ash from a technical point of view is an adequate substitute and, according to the parties' experts, has for one customer been a preferred extender because it dries more quickly. [24] This perhaps is also a market in which foreclosure is less likely as Alpha does not compete with its customers in this market.

41. However, the same is not true for the remaining two sub-markets – ready-mix concrete and blended cement. Here both Mr. Weavind and Mr. Wearne seriously disputed the merging parties notions that fly ash is a "perfect or near perfect substitute" for slag over most applications.[25] At times this debate became extremely technical and we need not burden this decision with all its subtlety; what suffices is that the parties' view of the extent of substitutability, has been seriously questioned by credible witnesses.

42. This debate has now been rendered largely academic, because in order to address the concerns raised by the objectors, the cement producers and Iscor agreed, during the hearing, to limit their supply agreements to 65% of Iscor's total raw slag production, as set out in the Tribunal's order.

Conclusion

43. Given that the parties have undertaken, in consultation with Iscor, to limit their off-take of raw slag, it is unnecessary for us to make a definitive finding on the question of the relevant market – and particularly on the substitutability between ground slag and fly ash. Under the circumstances we are simply called upon to evaluate whether the remedy proposed forestalls the independent blenders' and ready mix producers fears of foreclosure.

44. In drafting the remedy we have consulted with the parties to the transaction, the Competition Commission, the objectors and Iscor. [26]

45. The split of 65/35 to which the parties have agreed makes available approximately 250 000 tons of raw slag annually to independent users who currently off-take approximately 215 000 tons per annum. This is more than what the independents currently require.

46. Iscor, in its comments, indicated that it would want a clause inserted that would oblige the cement producers, in terms of their long-term

[24] See Genesis report page 945.
[25] See Genesis report page 931-2.
[26] At the hearing on 10 September a representative of the independent cement producers raised some concerns, nevertheless we felt these concerns were addressed adequately in the order.

agreements, to acquire any part of the remaining 35% of its raw slag production should it not receive sufficient orders from any other customers. We do not think that it is necessary to include such an obligation since, based on the evidence before us, there is a huge demand for raw slag from buyers not only in the independent blender market but also, it seems, in the mining industry where it is used as a binder for backfill. It is also a proposal that is at odds with the basic tenets of a market economy – if ISCOR is left with an excess supply of slag, or any other product for that matter, it may want to consider the simple expedient of dropping the price of the product in question, rather than the imposition on their customers of a requirement to absorb their slag supply.

47. Since Iscor and the parties agreed to make available more raw slag to the open market than that which the independents currently require we are satisfied that the order ensures that even, on the most conservative view of substitution, a sufficient independent source of supply of slag is available to enable independents and other users to continue as competitors in the downstream market.

48. We therefore find that the remedy addresses the concerns raised by the independent blenders.

49. No public interest concerns have been raised in respect of the merger.

____________ **<u>26 October 2004</u>**

D. Lewis **Date**

Concurring: N. Manoim, F. Fourie

For the merging parties:	Adv. D Unterhalter, instructed by Deneys Reitz, Webber Wentzel Bowens & Bowman Gilfillan Inc.
For the Commission:	Mr. M Worsley, Competition Commission.