

## **BREEDON/AGGREGATE INDUSTRIES MERGER INQUIRY**

### **Summary of provisional findings**

**6 February 2014**

1. On 24 September 2013, the Office of Fair Trading (OFT) referred the completed acquisition by Breedon Aggregates Limited (Breedon) of certain Scottish assets of Aggregate Industries UK Limited (Aggregate Industries) (the transaction) to the Competition Commission (CC) for investigation and report. We are required to publish our report by 5 May 2014.<sup>1</sup>
2. Breedon is a producer of heavy building materials, which serves primarily the North, West and East of Scotland (through Breedon Aggregates Scotland Limited, hereafter referred to as Breedon Scotland), together with the East and West Midlands, East Anglia, North Wales, Greater Manchester and South Yorkshire. In Scotland, it operates 29 sites and produces aggregates, asphalt, ready-mix concrete (RMX) and concrete blocks. It also provides contract surfacing services (ie services associated with laying asphalt). Its revenue in 2012 was £174 million. Aggregate Industries is the UK holding company for the operations in GB of Holcim Limited. It generates revenue from the sale of aggregates, RMX, asphalt, concrete products and paving and construction services. Its turnover in 2012 was over £1 billion.
3. Breedon and Aggregate Industries initiated discussions in 2012 and after considering a number of possible asset packages for acquisition by Breedon, in early 2013 the two companies started specific negotiations regarding the sale of certain of Aggregate Industries assets located in north Scotland (ie to the north of the 'Central

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<sup>1</sup> On 4 February 2014, the CC extended the reference period by eight weeks to 5 May 2014 due to the late provision of new market data that has delayed the publication of its provisional findings.

Belt'<sup>2</sup> of Scotland) to Breedon. Conditional contracts were exchanged on 10 April 2013 and completion took place on 30 April 2013. The sale package included: 11 aggregates quarries, 4 asphalt plants (including associated contract surfacing services), 9 RMX plants and 2 concrete block factories and associated business, located at 18 sites. We refer to this package as the 'acquired operations'. Aggregate Industries retained only one asset in north Scotland: its large quarry at Glensanda from which it supplies aggregates to the South-East of England and other countries.

4. We provisionally found that the activities of Breedon and of the acquired operations overlapped in the area of Scotland comprising Grampian, Tayside, Fife, the east part of the Highlands and the area of the Highlands north of Inverness (referred to in these provisional findings as north-east Scotland). We also provisionally found that Breedon did not produce concrete blocks in this part of Scotland. We therefore focused our analysis of competition on the supply of aggregates, RMX, asphalt and contract surfacing services in north-east Scotland.
5. There are different grades of aggregates and they can be extracted either from crushed rock quarries or sand and gravel quarries (referred to as primary aggregates). Certain types of aggregates are used for aesthetic purposes and referred to as decorative aggregates. Aggregates can also be produced from demolition activities and are referred to as recycled aggregates.<sup>3</sup> For large projects (eg road building), aggregates can be extracted on-site in 'borrow pits'. Aggregates are used for general construction purposes (including housing and the building of roads), in the production of asphalt (which also requires bitumen) or in the production of RMX (which also requires cement).<sup>4</sup> RMX can be produced at fixed plants (typically located in an aggregates quarry), mobile plants (temporarily set up on a

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<sup>2</sup> The area covering the 'waist' of Scotland, including the cities of Edinburgh in the East and Glasgow in the West.

<sup>3</sup> Aggregates can also be produced as a by-product of other quarrying or mining operations (referred to as secondary aggregates) but are not produced in this way in north Scotland.

<sup>4</sup> Aggregates are also used in specialist applications, but these were not relevant to our analysis of the transaction.

project site) or using volumetric trucks that transport the materials to the site and mix them on delivery. Asphalt can be produced in fixed plants or mobile plants. The drivers of demand for the three products are general commercial and private construction projects, government expenditure on road building and maintenance and large one-off projects.

6. In GB overall, five companies—Aggregate Industries, Cemex UK Operations Limited, Hanson and HeidelbergCement AG, Hope Construction Materials and Lafarge Tarmac Limited (collectively referred to as ‘the Majors’)—supply a substantial share of the aggregates, RMX and asphalt, but in north-east Scotland they have limited operations. Prior to the transaction, Breedon was the largest supplier of these products in north-east Scotland. Aggregate Industries was among the five largest suppliers of aggregates and RMX and the sixth largest supplier of asphalt. There are also a large number of local independent suppliers, some of which have shares of supply that are larger than the Majors in specific areas. Contract surfacing services are provided either by the producers of asphalt or by independent contractors.
7. We considered whether the transaction was a ‘relevant merger’ situation within the meaning of section 35 of the Enterprise Act 2002. We provisionally concluded that the acquired operations met the statutory definition of an ‘enterprise’, that the transaction met the share of supply test and provisionally concluded that a ‘relevant merger’ situation had been created.
8. We defined the relevant product markets in which we then assessed the effects of the transaction. In relation to aggregates, we considered whether different types and grades of primary aggregates; recycled aggregates; aggregates sold internally for the production of RMX, asphalt and other products; and decorative aggregates should be included in the same market. In relation to RMX, we considered whether product

specification could have an effect on the substitutability of different types of RMX; and whether RMX supplied through the use of volumetric trucks and RMX produced at mobile plants were substitutable for RMX produced at fixed plants. In relation to asphalt, we considered the demand-side substitutability between different specifications of asphalt, and between asphalt supplied from mobile plants and asphalt supplied from fixed plants. In relation to contract surfacing services, we considered whether internal supplies of the products used in the provision of these services should be included in the market.

9. We provisionally concluded that the transaction should be analysed in the following product markets:
  - (a) aggregates, including all types of primary aggregates (except decorative aggregates) and recycled aggregates, whether they are sold to external customers or used downstream for the production of RMX, asphalt or other products;
  - (b) decorative aggregates;
  - (c) RMX, including RMX supplied from fixed plants, mobile plants and volumetric trucks;
  - (d) asphalt, including asphalt supplied from fixed plants and mobile plants; and
  - (e) contract surfacing services.
10. Owing to high haulage costs and, in the case of RMX, the perishability of the product, the geographic markets for aggregates, RMX and asphalt are local in nature. For these three products, we have not defined local geographic markets. As a starting point for the competitive effects analysis, we defined catchment areas primarily based on the analysis of the destinations of the deliveries of the three products made by Breedon and the acquired operations in 2012. In reaching our provisional conclusions, we also took account of a range of sensitivity tests and other evidence from Breedon, other suppliers and customers. For our competitive assessment, we

therefore adopted two different catchment areas for each of aggregates and RMX and three different catchment areas for asphalt.

11. We also used the analysis of the destinations of the deliveries made by Breedon to assist us in defining the geographic market for decorative aggregates. For contract surfacing services, we relied on qualitative evidence provided by Breedon, its competitors and customers. We provisionally concluded that the geographic market for decorative aggregates is likely to be Scotland-wide and possibly wider. We provisionally concluded that the geographic market for contract surfacing services is likely to be wider than the immediate vicinity of centres of demand and to extend to other parts of Scotland.
12. We considered what would have happened in the absence of the transaction (the counterfactual). We examined three possible scenarios: whether Aggregate Industries would have closed the acquired operations; whether the acquired operations would have been bought by one or several alternative purchasers; and whether the operations would have continued to be owned and operated by Aggregate Industries. We provisionally concluded that it was likely that absent the merger, Aggregate Industries would have continued to operate in north Scotland broadly as it had done before.
13. We considered the nature of purchasing processes and competition prior to the transaction. We found that a range of methods was used to purchase aggregates, RMX, asphalt and contract surfacing services. This includes tenders which may be formal or informal, negotiations, which may or may not have been preceded by a formal tender process, and some framework agreements. The evidence showed that in the vast majority of cases, customers obtained quotations from a number of suppliers and that prices were negotiated. We also found that a number of criteria

were used in selecting suppliers but that the most important factors when purchasing aggregates, RMX and asphalt were the price quoted and the closeness of the production site to the delivery sites, due to high haulage costs. The evidence showed that Breedon and the acquired operations were perceived as competitors prior to the transaction and competed with each other for many contracts across regions of north-east Scotland. Evidence from our survey and other analysis showed that they also faced competition from many other suppliers in north-east Scotland overall.

14. As the markets for aggregates, RMX and asphalt are local in nature, we carried out our assessment of the effects of the transaction at the local level. Starting with Breedon's 23 pre-existing sites and the 12 acquired sites in north-east Scotland, we first filtered out sites which were unlikely to lead to competition concerns. To do this, we first examined the distances between the sites to identify sites which we considered were close enough to each other to be able to compete with each other ('overlap sites'). Second, for each of these overlap sites for each of the three products, we used high-level indicators of local concentration (Breedon's post-transaction share of production and number of remaining competitors) within the catchment areas we had defined in order to begin filtering out the overlap sites which were unlikely to give rise to competition concerns. Having carried out this two-stage process, we grouped the remaining sites based on their proximity to each other and to population centres, and thus identified areas for which we carried out a detailed competitive assessment for each of the three products.
15. At the end of this process, we had identified nine areas (including the relevant sites) and product combinations for further investigation:
  - (a) aggregate sites near Montrose: Capo and Edzell;
  - (b) aggregate sites near Aberdeen: Corennie, Craigenlow and Tom's Forest;
  - (c) aggregate sites near Peterhead: Stirlinghill;

- (d) RMX sites near Montrose: Capo and Edzell;
- (e) RMX sites near Aberdeen: Bridge of Don, Craigenlow, Deeside, Dyce, Inverurie, Tom's Forest, Tullos and Westhill;
- (f) RMX sites near Peterhead: Peterhead and Stirlinghill;
- (g) RMX sites near Inverness: Inverness and Beauly;
- (h) asphalt sites near Aberdeen : Tom's Forest and Stirlinghill; and
- (i) asphalt sites near Inverness: Daviot, Mid Lairgs and Netherglen.

16. For each of the nine local area and product combinations, we carried out a detailed analysis of the competitive constraints that the relevant Breedon pre-existing sites and relevant acquired sites exerted on each other; examined measures of local concentration resulting from the transaction; and assessed the likely competitive constraints exerted by other suppliers on the relevant Breedon pre-existing sites and the relevant acquired sites. Our analysis drew upon a data set with information gathered systematically for each product and area, but also information that was relevant to the particular circumstances of a given area and product. At the end of this process, we provisionally concluded that, absent countervailing factors, the transaction could be expected to lead to competition concerns in the following product markets and local areas:

- (a) RMX in the Aberdeen area;
- (b) asphalt in the Aberdeen area, extending to the north of Aberdeen;
- (c) RMX in the Peterhead area; and
- (d) asphalt in the Inverness area.

17. For each of these remaining four product and local area combinations, we considered whether entry or expansion could be expected to mitigate the effects of the transaction. We provisionally found that the barriers to potential entry for RMX were low. They were higher for asphalt. In order to establish the likelihood and timing of

entry, we gathered information on entry and expansion plans we were aware of. We received evidence from three suppliers of plans for entry or expansion in the market for RMX in the Aberdeen area. Two of the suppliers had firm plans, which they were progressing, while the plans of the third one were on hold. Given this evidence and the demand characteristics of the Aberdeen area, we provisionally concluded that in this area and in relation to RMX, entry and/or expansion was likely to occur in a timely manner and would be of sufficient scale to mitigate the competition concerns that we had identified. We did not consider that entry or expansion was sufficiently likely, timely and of a sufficient scale to mitigate any of the other competition concerns we had provisionally identified.

18. We also considered whether buyer power could be expected to mitigate the effects of the transaction, and provisionally concluded that no customer buying materials from Breedon was likely to have significant buyer power in the absence of a greater selection of alternative suppliers. In addition, we provisionally found that the ability of larger customers to negotiate favourable terms will not result in price protection for smaller customers because prices are individually negotiated allowing suppliers to price discriminate.
19. With regard to the markets for decorative aggregates and asphalt surfacing services, we provisionally concluded that the transaction was unlikely to lead to competition concerns.
20. We have therefore provisionally found a substantial lessening of competition leading to prices that would be higher than might otherwise be the case in the following product markets and local areas:
  - (a) asphalt in the Aberdeen area, extending to the north of Aberdeen;
  - (b) RMX in the Peterhead area; and
  - (c) asphalt in the Inverness area.