

**AGGREGATES, RMX AND CEMENT MARKET INVESTIGATION
HANSON'S PROVISIONAL RESPONSE TO THE PROVISIONAL DECISION
ON REMEDIES**

5 NOVEMBER 2013

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1. INTRODUCTION AND EXECUTIVE SUMMARY

- 1.1 On 8 October 2013 the Competition Commission ("**CC**") published its Provisional Decision on Remedies ("**PDR**") in relation to its Market Investigation into the supply or acquisition of Aggregates, Cement and RMX ("**MIR**").
- 1.2 The CC also published its Addendum to the Provisional Findings: Further Analysis on Ground Granulated Blast Slag ("**GGBS**") and Granulated Blast Slag ("**GBS**") and provisional findings (the "**GGBS Addendum**") on 8 October 2013. The GGBS Addendum purports to augment the provisional findings published by the CC in May 2013 (the "**PFs**"). As far as GBS and GGBS are concerned, the CC states that it has provisionally found a GGBS-related adverse effect on competition ("**AEC**") for the supply of cement in Great Britain ("**GB**") (the "**GGBS-related AEC**"), as well as a new AEC in the market for the supply of GGBS in GB (the "**AEC in GGBS**").
- 1.3 This document constitutes Hanson's provisional response to the PDR¹. As explained further below, given the short response period and the fact that Hanson has had to review the data room and respond on the new GGBS theory of harm in the GGBS Addendum, Hanson reserves the right to make further representations. This provisional response focuses on the remedies proposed by the CC in relation to GGBS and any comments in relation to cement are mainly concerning the CC's flawed approach with regard to the calculation of detriments. It remains Hanson's view that there exists no AEC in relation to GBS and GGBS (whether in cement or in GGBS as a standalone market). This is explored further in Hanson's separate response to the GGBS Addendum, as well as its response to the PFs. This response should, where appropriate, be read in conjunction with Hanson's response to the GGBS Addendum.
- 1.4 The PDR indicates that the CC has reached an advanced and detailed stage in its thinking (if not its final formal determination) in respect of GBS/GGBS. For the reasons highlighted below and elsewhere, Hanson considers that it has been substantially prejudiced by the CC's procedure in relation to its investigation of GBS/GGBS. However, the issuance of a PDR and the refusal by the CC to alter its process means that Hanson has no choice, but to submit specific comments on the GBS/GGBS remedies set out in the PDR. This is, however, without prejudice to Hanson's view that no GBS/GGBS AEC arises and its recourse to other fora concerning the CC's procedures (see further below).

Outline of this Response

- 1.5 This response is set out as follows:
- 1.5.1 In Section 2, Hanson summarises the concerns that Hanson has already raised elsewhere (and in another forum) concerning the CC's failure to consult properly as regards GBS/GGBS. These failings undermine Hanson's ability to respond to the PDR (and the GGBS Addendum) making

¹ Hanson is also separately responding to (i) the GGBS Addendum (which also comments on the level of GBS stockpiles); and (ii) the CC's related questionnaire on the 'cost of remedies' (see Annex VII). As part of this provisional response to the PDR, Hanson has enclosed as Annex V comments on the practical difficulties generally that would arise from a divestiture of the GGBS plants, as currently proposed by the CC.

any response to the PDR extremely difficult in the context of the simultaneous data room exercise and the review of the CC's new theories on GGBS.² The CC should have spent a suitable period of time reviewing and considering Hanson's response on the APFs prior to deciding upon and devising the detail of the remedies. Hanson ought to have *then* been given a clear period of three weeks to respond on the PDR. None of this occurred, instead the CC attempted to run everything together some 90% of the way through the MIR, prejudicing the usual due process of a market investigation and denying Hanson's rights to engage in meaningful consultation. Therefore, whilst a response is submitted, as Hanson feels that the CC process leaves it no choice but to submit a response now in order to protect its legitimate interests, the process remains critically deficient.

- 1.5.2 Section 3 then explains that the CC's market definition (which states a clear separate market for GGBS, and indeed a market that was expressly excluded by the Office of Fair Trading at the time of the referral to the CC) means that the relevant statutes do not permit the imposition of structural remedies in GGBS, and that other failings in its jurisdictional analysis mean that all remedies in relation to GGBS remain outside the CC's powers.
- 1.5.3 However, given the CC's approach to date, Hanson is not confident that these jurisdictional points will be voluntarily taken on-board by the CC, and so Hanson goes on to address the proposed remedies against the backdrop of the statutory test for MIR remedies and the CC's findings (i.e. for these purposes, it is theoretically assumed that the CC is not estopped from imposing these remedies by jurisdictional considerations, and has established an AEC to a satisfactory standard of proof). Hanson does so without prejudice to the issues it raises concerning jurisdiction.
- 1.5.4 A reminder of the statutory test, i.e., the framework for the discussion in the remainder of the response, is provided in Section 4. It is in this context that the CC's intention of depriving Hanson of two thirds of its active GGBS plants (and [X] % of its active GGBS capacity), and the benefit of commercially negotiated agreements which have underpinned major investments, should be assessed.
- 1.5.5 Section 5 then shows that the proposed remedies are unlikely to be effective in addressing the alleged AECs. The CC seeks to undo the GBS supply agreements and introduce one or two new competitors into GGBS. Following the CC's reasoning on GBS and GGBS, the net effect of the remedies is likely to be:
- (a) the transfer of any perceived market power upstream (to the GBS supply level) and the significant increase in GBS prices upon liberating the steel and granulation industries from their current regime of price control (undermining the ability of GGBS supplier(s) to compete on price); and
 - (b) the limitation of Hanson's ability to compete in GGBS and the direct damage to Hanson as maintaining any position as a meaningful competitor (effectively transferring a perceived monopoly to an alternative supplier or, at most, creating a duopoly). The acquisition of GGBS assets by RMX/concrete products producers (highly likely given the general lack of interest in GGBS grinders) could lead to a critical lack of liquidity in the 'external' supply of GGBS to independents, thus undermining the supposed benefits of any remedies by damaging the current arrangements which enable Hanson to ensure a steady supply of

² Hanson's response to the GGBS Addendum submitted 3 November 2013

GGBS to the full range of players in the market and introducing foreclosure where it does not currently exist.

- 1.5.6 The potential loss of relevant customer benefits (RCBs) is covered in Section 6. The current supply arrangements provide an environment conducive to investment in GGBS as an alternative to cement, security of supply of GGBS and optimal quality of GGBS. These benefits would be lost through the implementation of the remedies. Quality is absolutely essential in GGBS production and delivery, and the CC would appear to be taking extraordinary and unknown risks in this respect in being prepared to transfer GGBS operations to operators without the experience and technical expertise.
- 1.5.7 Section 7 covers the critical issue of proportionality. Responding in relation to the remedies requires an assumption that one or more GGBS AECs arise. The CC's work on profitability in the cement industry has now fallen into a quagmire of confusion and inconsistent and forever changing methodologies, resting now on the inclusion of the unforeseen carbon revenues that have already disappeared from the industry. The CC's suggestion therefore that GGBS concerns are responsible for the alleged 'detriment' in cement are therefore extremely unclear. However, even on the CC making such assumptions regarding the existence of AECs, the lack of distortion of competition or customer detriment in this case shows that extensive remedies would not be proportionate. This section highlights how any benefits from imposing the proposed remedies would be speculative at best, and that there would be a substantial risk that the proposed remedies would remove the efficiencies created by the current GBS/GGBS supply structure, creating new concentration and new pricing pressures that did not exist previously, and reducing the level of discount GGBS carries relative to cement. The enormous costs to Hanson should be taken into account: not only the costs of the remedies themselves (which are grossly underestimated by the CC), but also in terms of the risks to its GGBS business which will have no security of supply of GBS nor the scale to be a major competitor in the GGBS sector.
- 1.5.8 The proportionality requirement requires the consideration of potential alternatives and the identification of the least intrusive remedy which would be effective in remedying the AECs. Section 8 sets out a non-exhaustive list of alternative remedies which the CC should have given proper consideration to. The CC would need to consider each of these (and other possibilities) in turn and provide cogent reasons for discounting them before determining that the remedies proposed are proportionate. It is not Hanson's contention that these remedies would be appropriate (Hanson considers that no remedies are required), merely that it is a requirement on the CC properly to analyse these remedies for the purposes of proportionality and then select the least onerous (if it is intending to impose any remedies).
- 1.5.9 In conclusion, since the CC's work on financial detriment is now shown to be so unsafe and the CC has not demonstrated any harm to consumers or competition in GGBS, Hanson does not consider that there is any case for imposing such severe and invasive remedies. This is particularly so given the likely ineffectiveness of such remedies in lowering GGBS or cement prices or creating further choice and the potential for the outcome of these remedies to be worse than the counterfactual. Such remedies would, in any case, not satisfy the test of proportionality, with the availability of other less intrusive remedies available (with the prospect of less damage to competition).

1.6 This response contains a number of annexes:

- 1.6.1 **Annex I (CC's Analysis of Cement Detriment)** sets out Hanson's comments on the CC's new approach to determining the alleged financial detriment in cement. This contains a confidential appendix, which has been prepared on the basis of data room information. It has not been shared with Hanson, and so Hanson has not had the opportunity to comment on this Appendix. Similarly, certain phrases/figures in the body of Annex I are also based on data room material and so have not been shared with Hanson. However, it is now clear that very serious questions apply to the entirety of the CC's work through the MIR in relation to cement profitability. Rather than carrying out a single assessment and then objectively assessing the results, the CC has worked through several methodologies in an attempt to find ROCE exceeding WACC, creating an enormous cost to the industry.
- 1.6.2 **Annex II (Lack of Jurisdiction in relation to GGBS)** sets out in detail the points made in relation to jurisdiction in Section 3 below.
- 1.6.3 **Annex III (Comments on documents in GGBS Data Room)** sets out comments prepared by external advisers concerning the documents contained in the GGBS data room to the extent that they are relevant to this response. In accordance with the data room rules and undertakings given, the detail of this Annex has not been shared with Hanson, and so Hanson has not had the opportunity to comment on this Annex. However, it is clear that key customers confirm that they are more than satisfied with the access and availability facilitated by the GGBS supply chain arrangements and that they see GGBS pricing as competitive. Evidence such as this would appear to counter the CC's conclusions on pricing.
- 1.6.4 **Annex IV (GGBS Pricing)** supplements the points made in Section 7 concerning the lack of detriment arising from the alleged AEC in GGBS and should be read in conjunction with Hanson's submission in response to the GGBS Addendum submitted on 3 November 2013.
- 1.6.5 **Annex V (in respect of GGBS) and Annex VI (in respect of GBS)** highlight a number of practical difficulties related to the CC's proposals and a number of essential minimum protections which would be required to retain any degree of viability for Hanson's business as a competitor. These protections would be critical if Hanson is to remain a meaningful competitor in this market. These Annexes are included strictly without prejudice to Hanson's views that GGBS remedies are not required generally and the remedies proposed would not satisfy the statutory requirements for remedies.
- 1.6.6 **Annex VII (Cost of Remedies)** sets out Hanson's views on the enormous cost of remedies and represents Hanson's response to the CC's cost of remedies questionnaire sent on 9 October.

Cement Remedies

- 1.7 This response inevitably focuses on the proposed GBS/GGBS remedies as these are likely to have the most significant impact on Hanson. As noted below, Hanson has been given limited time for the preparation of a response to the PDR and Hanson has had to review the data room, the CC's theories and analysis on GGBS and the PDR all simultaneously.
- 1.8 For the avoidance of doubt, it remains Hanson's position that:
- 1.8.1 The CC has not established the AEC relating to alleged coordination in cement. Hanson's response to the PFs explains why no cement coordination exists.

- 1.8.2 Even if it were to be accepted, hypothetically, that there existed a coordination AEC in cement, the CC has not provided any cogent analysis of the alleged detriment in cement, despite having undergone a number of contrary iterations of its detriment analysis. Hanson notes that the PDR contains yet another attempt at analysing the alleged detriment. Hanson sets out comments on this new analysis and approach in **Annex I (CC's Analysis of Cement Detriment)** to this response. Again, Hanson considers that the CC has failed to identify any financial detriment related to supposed cement coordination, and the CC's work has become so unsafe with regard to alleged profitability and detriment in cement that the CC's analysis on GGBS, which is contingent upon the GGBS market causing financial detriment in cement market, is now equally uncertain.
- 1.8.3 Hanson has grave concerns about the CC's findings relating to excess profitability in cement. These are set out in detail in Annex I. However, in particular the CC's conclusions now rely fundamentally upon the CC's decision to treat the profits from the sales of surplus carbon allocations, a gifted windfall to the industry, in the 'same manner as any other revenue' (while not recognising a matching asset in the capital employed). This would seem an extraordinary approach, in the light of:
- (a) The CC's own previous express acknowledgement that such profits were short term in nature and should necessarily be excluded from the key ROCE / profitability calculations;
 - (b) The fact such revenues were a surprise to industry, and especially to environmentalists and to government, who had all expected the carbon credits regime to generate cost as opposed to income; and
 - (c) The fact that such revenues have already fallen to [£] from a peak of approximately £[£] in 2008, with 2013 full year forecast revenues being [£], and Hanson's forecast for 2014 again being [£].
- 1.8.4 In such circumstances, it seems an egregious failure on the part of the CC to base its profitability assessment on the inclusion of such revenues. Moreover, and equally unusually, the CC expressly relies upon such 'findings' of express profitability as the stated rationale for it not needing to have undertaken an assessment of whether or not there is an absence of competition in the industry, claiming its work was "outcomes focused" in the context of the adverse outcome of profitability, thus the CC had expressly depended upon its 'outcomes' conclusions in order to justify omitting various critical aspects from its earlier investigation, including verifying the key question as to what extent strong competition existed at all or was absent from the market.
- 1.8.5 In the quantification of benefits from the cement remedy, the CC has used a 'net present value' calculation on the future 'excessive cement profits' that are (allegedly) avoided by the cement remedies. However, this approach is flawed, since the historic (alleged) excess profits depend fundamentally on the revenues from sales of unused carbon permits. These revenues have already reduced to [£] (current year 2013 and also 2014 forecasts) and purchasing permits become a direct cost to the business in future. This renders the value of an NPV calculation (in respect of supposed future profits but based upon historic profitability which no longer exists) uncertain and even misleading. The CC cannot rationally use this obsolete picture on profitability as the cornerstone for the justification for divestment.
- 1.8.6 Moreover, and equally unusual, the CC expressly relies upon such 'findings' of express profitability as the stated rationale for it not needing to have

undertaken an assessment of whether or not there is an absence of competition in the industry, claiming its work was more “outcomes focused” in the context of the adverse outcome of profitability (now it appears based entirely upon carbon sales).

1.8.7 The extent of the CC's failures in relation to such financial and profitability analysis raises serious concerns, in terms of the degree of adverse impact it has had on the MIR as a whole and upon the CC's findings and therefore the proposed remedies. It has resulted in the CC's incongruous conclusion that it is now [X], despite the CC's findings that Tarmac had behaved as a maverick on pricing and sat *outside* the CC's alleged model of coordination.

1.8.8 Even if one were to take at face value the CC's findings on profitability, the CC's own conclusion is that the cement market suffers adverse and excess profitability (allowing an 'outcomes dependent' study of coordination and also, more significantly, justifying the imposition of severe and invasive divestment remedies across the market) because, according to the CC, the industry ROCE has been 2.4% over the WACC midpoint for the reference period; but the CC has already stated that:

(a) It would be normal healthy competition for the cement market to be allowed to achieve financial capital maintenance (i.e. the CC has now stated that ROCE should not be below and should be at least equal to WACC);

(b) In the CC's vision of what a well-functioning market for cement should be, 'some degree' of excess profitability and positive ROCE (beyond WACC) is not inconsistent with competition – yet, the CC then mechanically treats every single £1 of ROCE above WACC as “financial detriment” representing the quantification of the AEC; counting every £1 in this manner is not justified, given the CC's statements that some degree of positive ROCE should exist above WACC; and

(c) Previous case precedent from the CC shows that the CC has elsewhere expressly concluded that a differential of four percentage points (of ROCE above WACC) was not considered excessive, causing Hanson to be uncertain as to why the CC is now suggesting only two percentage points are deemed to be excessive.

1.9 In short, the CC's profitability analysis is flawed in several critical respects; and yet the CC then uses such findings to justify the most severe of divestment remedies. It also uses these findings as the basis for it not having needed to have analysed the essential factor as to whether or not there exists competition within the market (preferring instead to state that the many emails and business reports before the CC in evidence across the industry, that all show healthy competition, can be classified and dismissed as 'competition within bounds' and do not merit close scrutiny as part of the MIR).³

2. STATUS OF THIS RESPONSE

This response represents Hanson's provisional response to the PDR. The CC has failed in procedural fairness and its duty to consult under s169 of the Enterprise Act 2002 in respect of the procedure it has operated in respect of GBS/GGBS. These failures have arisen in two critical respects (which have been highlighted elsewhere); the simultaneous issue of the PDR and the GGBS Addendum, meaning that consultation on the CC's assessment of GGBS is

³ PFs paragraph 8.176

being undertaken when its views are clearly no longer in a formative stage; and the lack of time allowed for responses to the PDR and the GGBS Addendum⁴. Even now the GGBS Addendum has been published, the CC's analysis contains a number of key gaps, undermining Hanson's ability to comment and thereby breaching the duty to consult.

- 2.1 First, the issue by the CC of the PDR at the same time as the GGBS Addendum, is in breach of the CC's basic duty to consult with Hanson. As noted in Hanson's response to the PFs and Hanson's GGBS Hearing with the CC of 23 July 2013, the PFs did not provide sufficient detail on, nor analysis of, GBS/GGBS to enable a proper consultation with Hanson on the CC's provisional finding of an AEC related to GBS/GGBS. Even if it were to be accepted that the CC's consultation on the GGBS Addendum did allow for proper consultation, as regards the CC's views on GBS/GGBS, the issue of the PDR (and the level of the detail in the PDR) indicates that the consultation is not being undertaken at the formative stage of the CC's thinking (a fundamental pre-requisite of any consultation process).
- 2.2 It is for this reason that Hanson has applied to the Competition Appeal Tribunal ("CAT") for an order setting aside the GGBS Addendum (and if thought appropriate by the CAT, setting aside the PDR so far as it relates to GBS/GGBS)⁵. Therefore, this response is being submitted without prejudice to any outcome of the CAT application, and the possibility that this may become moot depending on the CAT's decision.
- 2.3 Second, Hanson has also asked for an extension to the timetable for a response to the PDR. The CC has permitted only a small amount of further time. Hanson has already highlighted that the time given for consultation was wholly inadequate. In particular:
- 2.3.1 The fact that consultation on GBS/GGBS is now only underway after the PDR was issued;
- 2.3.2 The fact that the GGBS Addendum introduces significant analysis, theories and a new AEC for the first time;
- 2.3.3 The grant for the first time of access to data in relation to GGBS through a data room process, despite the previous refusal to grant access;
- 2.3.4 The fact that the data room was not opened until one week into the recent consultation process and after publication of the PDR itself; and
- 2.3.5 The fact, more generally, that the extent of the remedies proposed (and their detail) requires more time for detailed consideration.
- 2.4 In both cases, the CC has identified its statutory deadline as a reason for the procedures it is following. However, the existence of a statutory deadline can not be used as an excuse for failure to consult properly. It seems to Hanson that three critical factors ought to have been taken into account by the CC before proceeding to a PDR on GGBS:
- 2.4.1 The scale of the MIR, as acknowledged by the Panel Chairman, Professor Cave, with the challenges of managing "three major markets" already in investigation⁶;
- 2.4.2 The express exclusion by the Office of Fair Trading of the cement substitutes market at the time of referral to the CC and after having already brought in two further markets for review; and

⁴ In the Pinsent Masons letter to the CC of 25 October and in the application to the CAT of 28 October 2013.

⁵ Case No. 1223/6/8/13, *Hanson Quarry Products Europe Limited v Competition Commission*.

⁶ Hanson GGBS hearing 23 July 2013, Professor Martin Cave at page 11, paragraph 8-14

- 2.4.3 The clear constraint of the cement price on GGBS pricing. As the CC is already levying a remedy (in cement) that it *accepts* will serve to reduce GGBS prices, in accordance with the principle of proportionality; the CC ought to have completed this process first and then opened the possibility of considering the impact on cement substitutes at least a year later, i.e. at least until it had had the chance to ascertain whether or not the cement remedies were sufficient or not. That later review would allow for a proper timetable and due consultation, rather than attempting additional remedies in cement substitutes at the last minute and without a proper period for review and consultation, which is what characterises the CC's current procedure.
- 2.5 Hanson considers however that the CC process has given it no choice but to now seek to engage with the CC and provide responses to the GGBS Addendum and the PDR, despite the shortcomings highlighted above. However, it reserves its rights generally as regards these procedural deficiencies.
- 2.6 Hanson also reserves the right to submit further evidence in relation to the matters covered by the GGBS Addendum and the PDR.
- 2.7 Hanson assumes that the PFs (as far as they relate to GGBS) are to be read in conjunction with the GGBS Addendum. The CC notes that the GGBS Addendum presents further evidence and analysis since the PFs as well as "*augmented provisional findings on AECs related to the supply of GGBS in GB*"⁷. When set against the litmus test as to whether the PFs and the GGBS Addendum provide sufficient information to allow proper consultation⁸, Hanson retains significant concerns.
- 2.8 Not only does the fact that the CC's analysis appears to cover two documents (the PFs and the GGBS Addendum) leading to disjointed reasoning across the two documents and making it difficult to follow the CC's analysis, but there are also areas of the analysis where significant uncertainty now remains as to the CC's thinking.
- 2.9 One example includes the CC's analysis of PFA. The CC has, in the GGBS Addendum, recognised that the estimates of PFA volumes in the PFs were very significantly understated. It has not, however, presented the CC's analysis of the points put to it concerning the seasonality of PFA⁹ or the points put to it concerning the future of PFA. It appears that the CC has now spoken to the relevant PFA trade association, the UK QAA, but it has not presented the UK QAA's views on the future availability of PFA¹⁰. The CC has recognised the constraint on GGBS from PFA, but has defined the relevant market narrowly by reference to GGBS only (on the basis of the "cellophane fallacy"). Even if the CC's approach to market definition were to be accepted¹¹, it is an accepted economic principle that products outside the relevant market can impose a substantial constraint. However, whilst accepting that a constraint exists, the CC has not provided any analysis of the closeness of the constraint exercised by PFA (and how this impacts on its theories of harm). Without this important analysis, insufficient information is given on the precise scope of any AEC and on the harm which the CC considers is caused by the AEC (which is critical to the consideration of remedies).

⁷ GGBS Addendum, paragraph. 3.

⁸ The fundamental requirements of a proper consultation were described by McCullough J in *R v Camden LBC, ex parte Cran* [1995] RTR 346 at 373-374. One of the requirements was noted as follows: "*those consulted must be provided with information which is accurate and sufficient to enable them to make a meaningful response*".

⁹ Hanson has shown in its PFs responses of 18 June 2013 and 16 July 2013 that, even if PFA production tends to be seasonal, the ability to store PFA easily means that this does not affect PFA availability at times of peak cementitious materials demand.

¹⁰ Hanson has noted that the concerns over the future availability of PFA have been significantly overstated (see Hanson's PFs responses of 18 June 2013 (e.g. para. 6.3 et seq) and 16 July 2013 (e.g. para. 27.6 et seq).

¹¹ As has been noted in Hanson's response to the GGBS Addendum, Hanson considers that the CC's reasoning on market definition is not justified.

- 2.10 This demonstrates a further shortcoming in the CC's consultation in respect of GGBS. This response and the response to the GGBS Addendum are submitted on the basis of Hanson's understanding of the CC's analysis. However, it does feel that it has been disadvantaged by a failure to set out the analysis clearly, and the weight given by the CC to various factors (such as PFA noted above), with the result that its ability to respond fully is further damaged. Pending the outcome of the CAT application noted above, Hanson would request that the CC set out its provisional findings in relation to GGBS clearly in order to allow for a full and proper consideration (again before any provisional decision on remedies is reached).

3. JURISDICTION

Hanson considers that the procedural issues have been exacerbated by the CC's unclear, and apparently changing, approach on jurisdiction in respect of GBS/GGBS. The CC's belief that it has jurisdiction to investigate AECs in the GBS and GGBS markets themselves (despite the Office of Fair Trading seeing fit to expressly exclude such markets), and the power to impose contractual interference and divestment remedies in GBS/GGBS, has not been explained with any degree of clarity. Indeed, the CC's own analysis of GGBS means that it has created a situation where it is not capable of establishing jurisdiction to impose the remedies proposed. First, the UK market investigation regime prevents the CC from remedying anything other than Hanson's 'conduct' in the GGBS 'market', i.e. at most the exclusive GBS supply agreements. It may not impose structural remedies. Second, the natural conclusion of the relevant provisions of Regulation 1/2003 in the light of the CC's analysis¹² indicates that it may not prohibit the GBS exclusive supply agreements.

The CC is, in effect, seeking to assert jurisdiction over a product which was not part of the original reference to the CC and which, if the CC had had concerns, should have been the subject of a request for a variation to the terms of reference. Even then, EU law would most likely have prevented the inclusion of GGBS in the reference. The CC should adopt the logical and legally mandated course and exclude GGBS from its PDR.

- 3.1 As Hanson understands it, the current approach of the CC renders the CC incapable of imposing the remedies it is proposing, in light of the CC's view that GGBS represents a separate market¹³. For example, following the logic of the CC's thinking:
- 3.1.1 The Office of Fair Trading did not refer GGBS to the CC (specifically considering whether to do so, but then expressly deciding not to, presumably showing suitable awareness that with the MIR having already extended across three major sectors, extending yet further into cement substitutes and therefore the coal-fired power and steel industries would be likely to make the investigative process unmanageable for the purposes of a professional analysis within the statutory timetable);
 - 3.1.2 As the CC has defined a separate market for GGBS, it would have no jurisdiction to define the structure of the GGBS market as an AEC;
 - 3.1.3 The CC has sought to establish jurisdiction on the basis that the exclusive GBS supply agreements represent conduct which amount to an AEC;
 - 3.1.4 The CC also identifies the structure of GGBS supply as a structural feature of the GB cement market – this is irrational as such a structure might be

¹² In particular, the CC's assertion that Purfleet can be supplied by GBS from overseas suggests that it believes that the GBS supply arrangements may affect inter-Member State trade.

¹³ For the avoidance of doubt, Hanson does not agree with the identification of a separate market for GGBS, nor certain other aspects of the CC's provisional findings on which it bases its jurisdictional analysis. However, the section above is designed to demonstrate the point that the CC is lacking jurisdiction even if its substantive analysis is accepted.

deemed to be a feature of the GGBS market, but not the cement market (in particular, as the CC has identified a separate market);

- 3.1.5 Even if it were to be accepted that such long-term exclusivity amounted to conduct and that the identification of such exclusivity as an AEC (as the CC purports to do) is consistent with the relevant legislation, the CC could only, under the Enterprise Act 2002, impose remedies to remedy, mitigate or prevent *that* AEC or any detriment arising from that AEC (subject to mandatory EU law considerations – see paragraph 3.7 et seq below);
 - 3.1.6 The CC would not have the power to address the perceived AEC (conduct in GGBS) by imposing structural remedies in GGBS; and
 - 3.1.7 The CC could not seek to remedy any perceived detriment unless that detriment arises from the AEC (the exclusive agreement). The CC has not identified any perceived detriment in GGBS (or in cement) arising purely from the perceived conduct (the exclusivity) which gives rise to an AEC.
- 3.2 This is explained in more detail in **Annex II (Lack of Jurisdiction in relation to GGBS)**. This analysis shows very clearly that, based on the CC's current approach to market definition, the CC *may not* impose divestment remedies in GGBS¹⁴.
- 3.3 The CC is left in a paradoxical position whereby:
- 3.3.1 It has to define the market narrowly in order to avoid GGBS representing a small proportion of the cementitious products market (as suggested by Hanson) with the result that such extensive remedies would clearly be disproportionate and ineffective; but
 - 3.3.2 Such a narrow market definition limits the remedies the CC can impose.
- 3.4 The jurisdictional concerns (which Hanson has raised from the stage in the MIR when the CC first focussed on GGBS) seem to create the risk that the CC will "reverse engineer" its analysis to ensure that it has jurisdiction. This is liable to cast doubt on the CC's approach to GGBS.
- 3.5 The legislation provides a clear opportunity for the CC to address these concerns, enabling the CC to request a variation to the terms of reference. If GGBS had, indeed, been in view from the outset (as suggested by the CC¹⁵), the CC could have requested a variation if it had had concerns in relation to GGBS, but it has chosen not to do so. Indeed, it is clear that the inclusion of the power in the legislation for the Office of Fair Trading itself to vary the terms of reference means that the extension of market investigations to include a full analysis of different product markets, by way of variation of the terms of reference, was to be preferred to the approach taken by the CC in this case.
- 3.6 Therefore, not only are the divestment remedies proposed in the PDR clearly *ultra vires*, but the attempt to bring GGBS 'within scope' has led to some perverse effects (in terms of market definition and development of theories of harm), which have again undermined Hanson's procedural rights.

EC Considerations

- 3.7 Even if it were to be accepted that the Enterprise Act 2002 alone permitted the imposition of remedies interfering in the GBS exclusive supply agreements, the CC

¹⁴ Even if it is accepted that it may address the conduct in question – Hanson reserves its position on this.

¹⁵ Cf. Professor Cave, Hanson Remedies Hearing, 2 July 2013: "Okay; so, back to GGBS. I have two PFs-type questions and then a number of questions about remedies, but I do first note that **we have had GGBS in our sights from the word go**, as is clear from our original issues statement as published in March of last year [emphasis added]" (Hearing Transcript, p.73, para 23-26).

would need to satisfy itself that, in effectively prohibiting these agreements, it was acting in accordance with Regulation 1/2003¹⁶.

- 3.8 The CC appears to attempt this in Appendix 7 to the PDR, but does not reach a firm conclusion on this¹⁷. For the avoidance of doubt, Hanson is firmly of the view that the agreements are compatible with EU and UK Competition law. For example, Hanson disagrees with the CC's rejection of the fact that GGBS sits within a wider cementitious products market and apparent rejection of the efficiencies created by the GBS supply agreements: Hanson has submitted extensively on this, and reserves its right to submit further arguments on this point¹⁸.
- 3.9 However, as a matter of *principle*, the CC has failed to set out clearly how it would have jurisdiction to interfere in these agreements given the constraints of Regulation 1/2003. First, that regulation prevents the CC from imposing remedies in relation to these agreements (if they may affect trade between EU Member States¹⁹) if they either do not restrict competition within the meaning of Article 101(1) TFEU or they fulfil the conditions of Article 101(3) TFEU²⁰. The CC notes that it may have to reach a conclusion on Article 101, but fails to do so.
- 3.10 Its failure to do so effectively deprives Hanson of the rights it would have were such an investigation to be undertaken by an Authority which has the jurisdiction to apply Article 101. Examples of the rights being denied to Hanson include access to full provisional findings and access to the file (as opposed to the very limited access granted by the CC through the restricted data room process). The CC is purporting to make very serious allegations in respect of Hanson, but not applying the standards of proof required for an Article 101 investigation and not providing Hanson with adequate rights of defence in this respect.
- 3.11 The right decision would be for the CC to conclude either that the agreements do not fall within Article 101(1) or that they merit an exemption under Article 101(3). If it does this, but concludes that there may be an effect on trade between EU Member States, the CC can not take action against the agreements.
- 3.12 However, even if the CC were erroneously to conclude that it had the power to prohibit these agreements, it would then need to consider the position in respect of the ongoing European Commission ("**EC**") investigation into cement and related products. The CC has clearly *not* sufficiently considered this, as it is proposing the current remedies despite the fact the EC *is* currently assessing the compatibility of these

¹⁶ Council Regulation (EC) 1/2003, OJ 2003 L1/1.

¹⁷ The Appendix implies that Hanson seemed to agree that the GBS supply agreements fell within Article 101(1) TFEU. This is a misunderstanding of Hanson's point – the point is that, if the agreements fell within Article 101(1) (this is not Hanson's position, merely an extrapolation by Hanson of the CC's position), the CC would need to satisfy itself that there did not exist an Article 101(3) exemption.

¹⁸ At this stage, it is worth noting that Hanson disagrees with the statement that its arguments in relation to the GBS supply agreements "*appear to be directed at the application of Article 101(3) TFEU; we did not understand Hanson to argue that the agreements would not fall within Article 101(1) on the basis that they had the effect of preventing, restricting and distorting competition*" (PDR Appendix 7, para. 8). Hanson also considers that the agreements would not fall within Article 101(1). The limited role of GGBS within the wider cementitious products market demonstrates that any effects would be unlikely to be appreciable. Hanson has previously pointed the CC to the clearance received in respect of at least one of the GBS supply agreements under the Restrictive Trade Practices Acts 1976 and 1977 on the basis that "*any restrictions are not of such significance as to warrant reference to the Restrictive Practices Court*" (see Hanson Response to Remedies Notice paragraph 6.14; and Hanson's Response to the GGBS/PFA Working Paper (dated 27 March 2013) paragraph 6.22.2). This provides strong support for the proposition that the agreements would not fall within Article 101(1), particularly as this was an analysis undertaken **at the time the agreements were entered into** (when the scale of investment and the risks undertaken could have been understood) rather than the **ex post facto analysis** being undertaken by the CC.

¹⁹ When appearing to assess whether the agreements affect trade between EU Member States, the CC merely speculates in para. 8 of Appendix 7 of the PDR that "*the activities of Hanson and Lafarge Tarmac are predominantly domestic in nature (and there is accordingly some doubt as to whether the potential effect on trade between member states is sufficient for the agreements to fall within the Article 3 of the Regulation)*". This is, by no means, a full assessment. Indeed, the CC's thinking (as evidenced by the PDR) seems to be contradictory. For example, in assessing Hanson's ability to obtain sufficient supplies of GBS for Purfleet, it refers to the possibility of imports of GBS. It is for the CC to consider whether its responsibilities under Regulation 1/2003 are met.

²⁰ Cf. Regulation 1/2003, Article 3(3) and Article 11(6) read in conjunction.

agreements with Article 101 within the scope of its ongoing investigation. The initiation of proceedings by the CC in this investigation:

- 3.12.1 prevents the CC from engaging in a parallel examination of these agreements due to the risk of the CC coming to a different outcome to the EC (it would be inappropriate for the CC to prohibit the agreements (as it seems determined to do) in case the EC concludes correctly that these agreements do not restrict competition or benefit from an exemption);²¹ and
- 3.12.2 prevents the CC from imposing remedies in relation to these agreements, which adversely impact the flexibility of the EC as regards any remedies that it would seek to impose if it were to find a breach of Article 101²².
- 3.13 In Appendix 7 to the PDR, the CC goes as far as stating that "*there is a high likelihood that the agreements restrict competition within the meaning of Article 101(1) TFEU*"²³, despite the CC not being empowered to enforce Article 101. Whilst Hanson contests the application of Article 101(1), or non-application of Article 101(3), to the agreements, the fact the GBS agreement between Lafarge Tarmac and Hanson is covered by the EC's investigatory scope and the CC now seeks to impose the remedies *prior* to the conclusion of the EC's investigation, *prevents* the CC from imposing its proposed remedies in relation to the agreement.
- 3.14 Whilst the Office of Fair Trading and the CC have considered that the market investigation provisions under the Enterprise Act 2002 are different to Article 101 TFEU²⁴, it is now clear that the CC *has* made considerations under Article 101 as part of its investigation, which further demonstrates that, in its view, market investigations do *not* predominantly pursue an objective different from that pursued by Article 101 within the meaning of Article 3(3) of Regulation 1/2003. Indeed, both regimes are designed around avoiding restrictions of competition, i.e. essentially the *same* objective; and the CC itself recognises that "*the CC's market investigation regime sits within a broad spectrum of competition law, operating alongside other regulatory mechanisms such as the prohibitions under the TFEU and the Competition Act 1998*".²⁵
- 3.15 The fact that the CC is now making references to the application of Article 101 TFEU to agreements it claims are covered by the scope of the MIR also shows why it was inappropriate for the Office of Fair Trading in the first place to make the reference to the CC in contradiction with its own guidance, which states that the Office of Fair Trading "*will not normally refer a market to the CC when a significant feature of that market is being investigated by the European Commission under Articles [101] or [102]*"²⁶.
- 3.16 This is not a theoretical concern. The fact that the same arrangements are being investigated by multiple regulators gives rise to significant prejudice for Hanson, not only in terms of the time, cost and business disruption involved in multiple investigations, but also the genuine risk of double jeopardy.
- 3.17 Therefore, the CC has not explained its position clearly on the jurisdictional points, and must do so *before* it can purport to impose GBS/GGBS remedies - this is even before the clearance given by the EC in HeidelbergCement/Hanson (see below at section 7) is taken into account. Hanson is not being allowed the opportunity to

²¹ Regulation 1/2003, Article 11(6). Recital 17 cites the "consistent application of the competition rules" as one of the rationales for this "one-stop-shop" provision. What the CC is proposing runs counter to this principle.

²² Cf. OFT1358ref, para. 7.65.

²³ PDR, Appendix 7, para. 8(e).

²⁴ See for example OFT1358ref, para. 7.67.

²⁵ PDR, Appendix 7, para. 4, with reference to the CC's *Guidelines for market investigations: Their role, procedures, assessment and remedies* ("CC3"), para. 18.

²⁶ See OFT guidance "*Market investigation references - Guidance about the making of references under Part 4 of the Enterprise Act*", March 2006, para. 2.16.

comment on the CC's grounds for establishing jurisdiction and so reserves its position on this.

4. LEGAL PRINCIPLES APPLICABLE TO THE MIR REMEDIES

The CC's very intrusive proposals should be seen in the context of the legal duties imposed on the CC. The proposed remedies fail the test of effectiveness, reasonableness (proportionality) and their impact on efficiencies. A summary of legal principles is applied here, and the rest of this response shows how these criteria are not satisfied.

4.1 When proposing remedies, the CC must consider the need to achieve as **comprehensive** a solution as is **reasonable** and **practicable**²⁷ to:

4.1.1 Remedy, mitigate or prevent the AEC; and

4.1.2 Remedy, mitigate or prevent the detrimental effect on customers, as far as they have resulted from, or may be expected to result from, the adverse effect(s) on competition²⁸.

4.2 In taking remedial action the CC must also take into account any RCB that currently exists and may be affected by any remedy²⁹.

Reasonableness

4.3 The balancing exercise between effectiveness, reasonableness and practicability has come to be known as the proportionality test³⁰. As stated in the CC's Guidelines, "*in considering the reasonableness of different remedy options the Commission will have regard to their proportionality*"³¹.

4.4 This mirrors the CAT's statements in *Tesco Plc*³² that the CC must consider the overarching nature of "*the proportionality of a particular remedy as part and parcel of answering the statutory questions of whether to recommend (or itself take) a measure to remedy, mitigate or prevent the AEC and its detrimental effects on customers, and if so what measure, having regard to the need to achieve as comprehensive a solution to the AEC and its effects as is reasonable and practicable*".

4.5 Moreover, the CC must consider "*whether the adverse effect(s) or customer detriment(s) that it was designed to address are sufficiently serious for their removal or mitigation to justify whatever costs and disruption to businesses and others that will be involved in the implementation of that remedy* [emphasis added]"³³.

4.6 By way of further explanation the CAT states in *Tesco Plc* that the main principles of proportionality are that the remedy: "*(1) must be effective to achieve the legitimate aim in question (appropriate), (2) must be no more onerous than is required to achieve that aim (necessary), (3) must be the least onerous, if there is a choice of equally effective measures, and (4) in any event must not produce adverse effects which are disproportionate to the aim pursued* [emphasis added]"³⁴.

4.7 The CAT continued, stating that "*it may well be sensible for the Commission to apply a double proportionality approach: for example, the more important a particular factor seems likely to be in the overall proportionality assessment, or the more intrusive,*

²⁷ Enterprise Act 2002 s.134(6).

²⁸ Enterprise Act 2002 s.134(4).

²⁹ Enterprise Act 2002 s.134(7).

³⁰ *Barclays Plc v Competition Commission* [2009] CAT 27 (Case 1109/6/8/09) paragraph 19.

³¹ CC Guidelines for market investigations: Their role, procedures, assessment and remedies ("CC3"), para. 342.

³² *Tesco Plc v Competition Commission* [2009] CAT 26 (Case 1104/6/8/08) paragraph 135.

³³ Enterprise Act 2002, Explanatory Note paragraph 313.

³⁴ *Tesco Plc v Competition Commission* (Case 1104/6/8/08) paragraph 137, as cited from *R v Ministry of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte Fedesa* [1990] ECR I-4023 (Case C-331/88).

uncertain in its effect, or wide-reaching a proposed remedy is likely to prove, the more detailed or deeper the investigation of the factor in question may need to be [emphasis added]"³⁵.

- 4.8 The 'double proportionality approach' is a restatement of the 'common sense position' that "*the depth and sophistication of analysis called for...needs to be tailored to the importance or gravity of the issue.*"³⁶
- 4.9 The PDR proposes extensive structural remedies that would deprive Hanson of major assets, which it invested into over a number of years; and would interfere in freely negotiated commercial agreements. In effect, the CC is seeking to deprive Hanson of:
- 4.9.1 Two of its three operational GGBS grinders, in effect [X]% of its operational grinding capacity³⁷ (and over [X]% of its total theoretical grinding capacity)³⁸. This is over half of the business for which Hanson paid around £[X] for in 2006;
- 4.9.2 The only operational grinders with security of supply through the co-location of steel plants – this would leave Hanson with only one plant co-located with a steel works and this is mothballed (entailing additional cost to Hanson if it wishes to restart this plant); and
- 4.9.3 A termination of commercial agreements which have formed the basis for major investments by Hanson.
- 4.10 These are, in particular, options which should not be enforced without detailed and careful analysis which seeks appropriate levels of proof, and abides by appropriate standards of procedural fairness.
- 4.11 The proposed divestments would also amount to a serious interference with Hanson's property rights, engaging Article 1 of the First Protocol of the European Convention on Human Rights ("**ECHR**"). As a public authority, the CC is obliged under section 6(1) of the Human Rights Act 1998 not to act in a manner incompatible with these ECHR rights.
- 4.12 The CC must justify the interference with these property rights in order to strike a fair balance between the interests of addressing any perceived AEC and the requirement to protect Hanson's fundamental rights. The CC must therefore:
- 4.12.1 Identify the legitimate aim which it is seeking to achieve; and
- 4.12.2 Demonstrate, to a high standard of proof, that the interference with Hanson's property rights is a proportionate means of achieving that aim.
- 4.13 This is in addition to the proportionality test as set out in the *Tesco Plc* case, as recognised by the CC itself³⁹. Hanson has a legitimate expectation that the CC will give sufficient consideration to its fundamental rights.

³⁵ *Tesco Plc v Competition Commission* paragraph 139.

³⁶ *Barclays Bank Plc v Commission* (Case 1109/6/8/09) paragraph 21.

³⁷ As noted in Hanson's response to the GGBS Addendum, the current operational capacity of Purfleet is [X] tonnes pa, rather than the [X] tonnes pa quoted by the CC.

³⁸ This correctly discounts Llanwern which, as the CC appears to have accepted, is in effect a stranded asset due to property issues.

³⁹ In *Tesco v. Competition Commission* (Case 1104/6/8/08), Counsel for the CC stated at the hearing: "*The importance of all this is that the present case, unlike Pine Valley, is not concerned with proportionality in the context to an interference with fundamental rights when, on the authorities, a strict proportionality test applies. It applies because you have to justify an interference with the fundamental right, and that is a rather strong thing to do. It might have been different I can see if divestiture had been a remedy. There you would have an interference and you would get into Article 1 territory*". Transcript, Day 2, page 70, lines 3 -15.

- 4.14 Notably, the remedies would, if implemented, be only the second time under the Enterprise Act 2002 that divestment remedies would have been imposed in a Market Investigation. The previous case (*BAA Airports*) involved a successor to a state-owned enterprise which had acquired its position through the transfer of assets from the state. By contrast, Hanson's position in GGBS is as a result of the pioneering investments made by itself and its predecessor entity, Civil & Marine⁴⁰, and the free negotiation of supply agreements with other commercial trading parties. The bar is, therefore, set higher in respect of any proposed interference in Hanson's property rights and its contractual arrangements.

Relevant Customer Benefits

- 4.15 The CC must also consider the impact of any remedy on RCBs that exist on the market. An RCB is defined as one that creates lower prices, higher quality, a wider choice of goods or services or greater innovation in relation to goods or services in any UK market; and that such benefits are unlikely to arise in the absence of the market features concerned in the remedy decision⁴¹.
- 4.16 RCBs will impact the CC's analysis of whether a remedy is reasonable and proportionate and, in certain circumstances, the CC may not impose a particular remedy even where an AEC is found, if the consequential loss to market of the RCB is too great⁴².
- 4.17 The proposed divestment remedies are at the most severe end of the scale in respect of the range of possible remedies for GGBS, and so the level of analysis required of the CC is that much higher.
- 4.18 As will be shown in the following sections, the proposed remedies fail (for a number of interlinked reasons):
- 4.18.1 The test of effectiveness;
 - 4.18.2 The test of proportionality; and
 - 4.18.3 In that they are likely to undermine RCBs.

5. THE PROPOSED REMEDIES WILL BE INEFFECTIVE IN ADDRESSING THE PERCEIVED AEC AND/OR DETRIMENT IN CEMENT/GGBS

The CC seeks to undo the GBS supply agreements and introduce one or two new competitors into GGBS. Following the CC's reasoning on GBS and GGBS, the net effect of the remedies is likely to be:

- (a) ***the transfer of any perceived market power upstream (to the GBS supply level) and the significant increase in GBS prices as the steel and granulation industries are released from the price mechanisms under the existing contractual arrangements (undermining the ability of GGBS supplier(s) to compete on price); and***
- (b) ***a limit on the ability of Hanson to compete in GGBS (effectively replacing what is perceived to be a monopoly with an actual monopoly or a duopoly and new concentration). The acquisition of GGBS assets by RMX/concrete products producers (highly likely***

⁴⁰ The PDR seems to suggest (as previously suggested by the CC in Hanson's Response Hearing) that Hanson did not merit the protection of the exclusive supply agreements as it acquired Civil & Marine and, according to the CC, undertook limited direct investment itself (PDR, para. 6.121 et seq). This, however, misunderstands Hanson's position of the successor to Civil & Marine (and to the investments it undertook).

⁴¹ The Guidelines paragraph 356-357, *Store Cards Credit Services* market investigation report, March 2006, paragraph 10.7.

⁴² *Barclays Bank Plc v Competition Commission* (Case 1109/6/8/09).

given the general lack of interest in GGBS grinders) could lead to a critical lack of liquidity in the 'external' market supplying independents, creating new risks of foreclosure where they did not exist previously and undermining any supposed benefits of the remedies and effectively restricting the supply of GGBS. Such RMX producers would be likely to be focused on their own operations and supply, creating a new risk or likelihood of foreclosure, in the context of the limitations in the supply volumes of GBS.

The proposed remedies, therefore, are highly unlikely to be effective in achieving the CC's aims.

- 5.1 It is Hanson's contention that, even if it were to follow the CC's reasoning as to the existence of GGBS-related AECs, the remedies are likely to be ineffective in remedying the perceived AEC in GGBS and in cement, and on the balance of probabilities are likely to create new risks for customers.
- 5.2 The CC appears to believe that the introduction of one or more new players will lead to lower prices in GGBS and in cement. However, it presents no cogent evidence to this effect and indeed the CC suggests prices will fall in the national cement market (of c.10,000,000 tonnes p.a.) due to reducing demand and volumes in cement / CEM I caused by the extra new volumes of GGBS that would come to the market (despite the fact that more GBS was processed into GGBS during 2012 than was produced, thus restricting such new volumes of GGBS to a mere 100kt at the very most, or equivalent to only 1% of the CEM I market by volume).

GGBS Addendum Response

- 5.3 In exploring the reasons for the likely ineffectiveness of the proposed remedies, it is worth considering the following elements of Hanson's response to the GGBS Addendum as these are directly relevant.
- 5.4 The CC's analysis in the GGBS Addendum found that, at current prices, GGBS sits within a broad cementitious products market that includes CEM I, PFA, imported GGBS and other products with cementitious properties. Within this broader cementitious products market, Hanson's GGBS supply would account for a share of only around 10%, far below any relevant threshold from which to infer market power. On this basis, there is no need for remedies in GGBS (and, indeed, the issue of ineffectiveness would arise).
- 5.5 However, the CC seeks to dismiss extensive tangible evidence of substitution and competition by invoking the cellophane fallacy (also referred to as the "gingerbread paradox") to argue that the GGBS is its own narrow market. It also seeks to argue that to the extent customers consider a switch to the use of PFA or CEM I, it is only because they are forced into doing so artificially because of excessive pricing in GGBS itself, and not for other reasons of natural substitutability. The CC relies on two factors to justify its use of the cellophane fallacy:
- 5.5.1 First, the CC argues it has found evidence of excess profitability in Hanson's GGBS production. Hanson contests the CC's approach to profitability. However, even if a differential were to exist between Return On Capital Expenditure (ROCE) and Weighted Average Cost of Capital (WACC), this would be insufficient reason on its own to invoke the cellophane fallacy. The CC presumes the market is narrow for Hanson to occupy a "substantial part of the market", a pre-condition to excessive profitability data being used to indicate malfunction in the competitive process. It then bases its decision that the cellophane fallacy is in action, and hence the market is narrow, on this same profitability analysis. The reasoning is circular and self-fulfilling. There are, indeed, entirely benign and legitimate reasons why one may expect a GGBS producer, due to its superior efficiency relative to cement

production, to have ROCE above WACC even within a well-functioning cementitious products market. Further, what the CC is interpreting as *ex post* excessive returns would not have been so *ex ante* when the original risky investments in GGBS production were undertaken.

- 5.5.2 Second, the CC argues that, if there were more domestic GGBS producers (rather than one), the competitive price would be lower than the current price. However, this speculation is merely theoretical and makes no consideration of the binding supply constraints on GGBS production. These constraints mean that it is both natural and expected that, where demand for cementitious product exceeds GGBS production (as it does), prices would rise to the level of the next best alternative irrespective of the number of producers. In fact, the CC's own analysis of a well-functioning market in cement recognises this issue: *"Since cement producers' production capacities are limited, prices can rise above the marginal plant's unit operating costs due to customers competing for limited quantities. On the face of it, such situations appear to be non-competitive in the sense that firms are selling at prices above marginal or average incremental cost. This would seem at odds with price competition – usually one would expect there to be an incentive to gain additional business by under-cutting rivals' prices. However, this assumes that firms can expand output without incurring high incremental costs. If all plants are operating at full capacity, this is clearly not the case"*⁴³.
- 5.6 The CC argues that Hanson's presence in both the cement and the GGBS markets may weaken Hanson's incentive to lower GGBS prices (at the risk of cannibalising its own cement sales). The CC has failed to demonstrate this effect exists beyond the theoretical plane or is significant. Indeed, the evidence suggests that this effect is likely to be weak (if any such effect exists at all).
- 5.7 The CC asserts that prices would be lower if there were more GGBS producers. However, the binding supply constraints on GGBS production mean that this speculation is far from certain. It is likely that the two producers of GGBS would have exactly the same incentives as a single producer in pricing at a level where cement/PFA/imported GGBS was the competitive constraint. Indeed, were the CC's narrow GGBS-only market definition correct, then the CC would have created through divestment only two players and this market would remain highly concentrated with limited prospect of downward pressure on price.
- 5.8 Furthermore, the divestment may actually raise costs in the industry as the synergies of running a portfolio of three production facilities would be lost.
- 5.9 The CC has not presented any evidence that breaking up the current supply arrangements (steel producers/Lafarge Tarmac and Lafarge Tarmac/Hanson) will lead to a better outcome by comparison. The CC makes a simplistic assumption that an increased number of market participants will increase competition, but has performed little or no developed analysis of the actual impact of its remedies.
- 5.10 As with the CC's exploration of its theories of harm (see above), the CC's analysis of the likely benefits of the proposed remedies is speculative.

No evidence that introduction of additional GB Producers of GGBS will lead to lower prices

- 5.11 The CC appears to assume its remedies will in fact create a wider and more competitive market in GGBS. The CC alleges that this will be created by a wider availability of both GBS and GGBS to the open market, which *"will, or will be likely to, result in a greater choice for customers, typically RMX and other concrete producers,*

⁴³ PDR, Appendix 1, paragraph 36.

to source GGBS, and result in a new entrant into GGBS production that would be incentive to compete vigorously to enhance the performance of its own GGBS operations"⁴⁴.

5.12 The CC considers that "*Hanson...has an incentive to set prices of GGBS at the level at which CEM I and/or a mixture of CEM I or PFA are substitutes to GGBS*"⁴⁵. It speculates: "*If there were several competing producers of GGBS in GB, we would expect these to be more focused on competing between themselves for selling GGBS to GB customers, rather than on competition with CEM I and PFA*"⁴⁶. It considers that such competition would lead to GGBS not being priced up to the level at which it is attractive to substitute CEM I and/or CEM I/PFA. However, the CC does not analyse effectively whether such competition would occur after the implementation of its remedies and, if so, how this would lead to lower GGBS prices.

5.13 The commercial and economic reality is that there are only a limited number of GB GBS and GGBS plants, and, as noted above, there are significant capacity constraints. If the CC's theory that GGBS imports pose a limited constraint (which Hanson does not agree with, but is required to accept in order to discuss remedies – if imports represent a constraint as Hanson contends, there is no need for remedies), the theory that the divestment of Hanson's plants could lead to increase price competition and consumer choice involves a number of incorrect assumptions:

5.13.1 The CC's assessment of the potential levels of GBS and GGBS available to the open market is based on the unrealistic assumption that all the plants will work at 100% capacity⁴⁷. Not only is this commercially impossible, it also assumes that there will be sufficient quantities of GBS to allow GGBS grinders to operate at this rate. Hanson has explained on numerous occasions that GGBS operations are capacity constrained from the availability of GBS⁴⁸. The CC uses language such as if Port Talbot "*produced to its maximum capacity*" and "*if the Scunthorpe GBS plant decided to increase the proportion of GBS produced from BFS*". Both Lafarge Tarmac and Hanson have, like any business, been committed to maximising its profits but are not able to run production on full hypothetical capacity. Hanson has demonstrated for example that for the last full reported year (2012) Hanson processed more GBS than was produced that year, with Scunthorpe and Port Talbot having to use volumes from the stockpiles, and any surplus GBS at Teesside (only [X] if pellite is included) being more than offset by the stockpile volumes used at Scunthorpe and Port Talbot. Those numbers remain valid and acknowledged by the CC, and yet the limitation on GBS volumes is, for some reason, ignored by the CC in its analysis, instead preferring to rely on mere hypothetical volumes that are fanciful, not produced in practice and ignore the industrial realities and the issues that commonly arise at the level of blast furnace production and granulation.

5.13.2 The CC has already concluded with regard to GGBS imports that at 10% of the GGBS market such volumes could not have material impact on GGBS pricing and indeed would be "very limited". And yet the CC is claiming that the additional GGBS volumes created by the GGBS remedies (which the accepted numbers for 2012 now show to be either negative, zero or at the most 100kt in view of the limited supply of GBS) would somehow bring down the price of CEM I itself by reducing CEM I demand and volumes, despite the fact that at a maximum of 100,000 tonnes of additional GBS / GGBS, that volume only represent c.1% of the annual 10,000,000 tonne cement market. Hanson views the CC's contention on price reduction in CEM I

⁴⁴ PDR paragraph 3.333.

⁴⁵ GGBS Addendum, paragraph 42

⁴⁶ Ibid

⁴⁷ PDR paragraph 3.367-3.370.

⁴⁸ See Hanson's Addendum to the GGBS hearing transcript.

(which is the CC's primary basis for the GGBS remedy) as flawed and contrary to the accepted numbers with regard to possible additional GBS volumes.

- 5.13.3 The CC has also based its remedies on the theoretical assumption of higher steel production and higher GBS volumes and has rejected Hanson's suggestions regarding the fragility of the steel industry. Tata Steel has however on 29 October 2013 announced that it is to cut hundreds of jobs from its Scunthorpe site. Tata is reported to have blamed the cuts on prolonged weak demand in the construction industry, suggesting the market is half what it was in 2007 with proper recovery not expected for a decade. The job losses at Scunthorpe have been seen as a shocking blow to Scunthorpe and the associated steel community and represent exactly the uncertainty and fragility at the level of the GB steel industry that the Office of Fair Trading foresaw in the context of its own consideration with regard to the possibility of remedies in the GGBS industry.
- 5.13.4 The Scunthorpe works now use only 2 of its 4 blast furnaces. Although the company had announced a plan to reline one of Scunthorpe's two operational blast furnaces (the Queen Anne, which work could have served to preserve and even boost production) the work scheduled to commence October 2013 has not materialised.
- 5.13.5 Thus the CC hypothetical suggestions regarding much higher steel and GBS volumes are not borne out.
- 5.13.6 The CC also incorrectly assumes that the quality and reliability of all the GGBS produced by multiple participants will be of an adequate standard for all applications (see Section 6 below).
- 5.13.7 The CC's model assumes that Hanson will continue to operate as an effective competitor in the "external" market. However, there are a number of factors which cast doubt on Hanson's ability to supply GGBS externally post-divestment:
- (a) The remedies currently proposed reduce Hanson's GGBS capacity to a level where there may be a limitation on its external supplies. A significant proportion of Hanson's remaining supplies could be committed internally. Hanson's current internal supplies of GGBS are around [redacted], compared with a maximum operating capacity of Purfleet of [redacted]⁴⁹. Even if the Teesside plant were to be restarted, Hanson's maximum operating capacity would only be [redacted]. This is even before BFS and GBS supply constraints are taken into account (supply constraints may arise in respect of the inability of Hanson to obtain sufficient supplies or the high price of GBS supplies – see below);
 - (b) One of Hanson's two plants (assuming it retains and operates a second plant, e.g., Teesside) will not have a co-located GBS/GGBS plant, substantially increasing its cost of production in comparison to any new competitors. The [redacted] already has the highest costs of production of Hanson's plants [redacted]. Based on the CC's reasoning as to import costs, this would undermine Hanson's ability to compete; and
 - (c) If, as currently proposed, Hanson was left with the Purfleet plant as its only active grinder and it had no exclusive supply agreements,

⁴⁹ As noted in the response to the GGBS Addendum, the maximum operating capacity of Purfleet ([redacted]) is considerably lower than the nameplate capacity [redacted], and major investment would be required before the nameplate capacity could be achieved.

this would effectively remove Hanson's secure GBS supply lines. Any purchaser of the Teesside GBS granulator (or Lafarge Tarmac) would have no obligation to supply the Purfleet plant with any GBS, [REDACTED]

- 5.13.8 Therefore, there would remain relatively limited scope for Hanson to remain a major player [REDACTED]
- 5.13.9 Even if Hanson were to remain a major participant in the 'external market', one new entrant would create a duopoly. There is no reason to suspect in such a situation that GGBS suppliers would be anything other than price takers in respect of the price of other cementitious alternatives (e.g. cement).
- 5.13.10 Hanson has significant doubts over its ability to find more than one buyer of a GGBS plant (see further below and in **Annex VII (the Cost of Remedies)**)⁵⁰. However, even if it did and there were two "new entrants", the dynamic is unlikely to change. [REDACTED] and the remaining domestic GGBS suppliers would in effect act as a duopoly (or price takers of the cementitious price).
- 5.13.11 This is even before the potential for internal supplies by these "new entrants" is taken into account. In Hanson's view, potential purchasers are more likely to be attracted to GGBS assets if they have downstream businesses (indeed, the only expression of potential interest in GGBS is from Breedon, a major RMX producer). Indeed, the CC recognises that the most likely interest for GGBS assets is from participants with significant RMX businesses⁵¹. It notes that two of the most likely, non-vertically integrated potential purchasers, CRH and CPV, have already rejected the possibility of purchasing the assets⁵².
- 5.13.12 If a purchaser has an existing downstream business, it is likely to have even less capacity to supply external markets (in particular, the independent RMX sector). If one were to rely on the CC's theories of harm in this area, this would create a real risk of *foreclosure* compared with the current situation. If the impact of the remedies is to create a number of vertically integrated players with limited capacity or willingness to supply external customers, the industry will have lost a supplier (Hanson) with the capacity and willingness to supply external customers.
- 5.13.13 The third party comments received by the CC suggest a further risk (whether or not a buyer has a downstream business) that a buyer may view the GGBS grinders as a 'flexible' resource, i.e. one which could be converted to the grinding of cement if market conditions dictated⁵³. This could lead to GGBS capacity being removed from GGBS production and a *lessening of GGBS supply* as opposed to an increase in GGBS competition.
- 5.13.14 The CC speculates that the removal of the exclusive GBS supply agreements will encourage new entry. However, this is internally inconsistent with its views that the divestment of GGBS plants is required in addition to the removal of domestic GBS exclusivity. Therefore, based on the CC's reasoning, this can be discounted as a factor encouraging *further competition*.
- 5.14 Therefore, the proposed remedies will leave Hanson with limited ability to supply GGBS externally (after catering for its internal demand). This will mean that the

⁵⁰ [REDACTED]

⁵¹ PDR paragraph 3.447

⁵² The CC suggests potential interest from Private Equity. As described in **Annex VII (Cost of Remedies)**, this is an unrealistic assumption.

⁵³ [REDACTED]

remedies will result in only one competitor - or two at the most - focusing on external supplies. This would result in either a monopoly; or, according to the CC's own theories, a potential collective dominance scenario (see above); again a new form of concentration that the Office of Fair Trading expressed its own concerns about in the context of possible remedies.

- 5.15 Finally, the CC's work ignores the prospect of the operators of the blast furnaces and the granulators immediately increasing their own sale prices for BFS and GGBS, [X] This will serve to increase and ratchet up the input costs for the GGBS operators, negating the opportunity for price reduction in GGBS.
- 5.16 Indeed, if the cement price is reduced as a result of the CC's *cement* remedy (the Lafarge Tarmac divestment) as well as by the CC's earlier introduction of Mittal / HCM into the GB cement market (which the CC expressly implemented at the beginning of 2013 as a means of countering the CC's findings of tacit coordination in cement) then the combination of the constraint provided by a reducing cement price and the inevitable input cost increases (which would be likely to be many times more than inflation) would serve to exert new pressures on the level of discount GGBS offers relative to the cement price. The pressures on that discount (at each of the input and output ends) would be likely to reduce the discount and so prove materially and extremely adverse to customers, relative to the current situation where input costs are constrained for the long term and the GGBS discount (relative to the cement price) is preserved. The CC's remedies would appear to be designed to remove this altogether, potentially halving the discount that has been preserved by Hanson under the benefit of the existing contractual arrangements to the satisfaction of its customers in recent years.

Transfer of Perceived Market Power to the Upstream Level

- 5.17 Due to the limited transfer of GBS to the various GGBS grinders (particularly to those that are co-located) the remedies are likely to transfer any (alleged) 'monopoly power', as far as it exists, upstream from the GGBS level in the supply chain. The CC's proposed remedies in GBS/GGBS will only address the CC's identified "features" (GGBS plants ownership and the exclusivity agreements) that it claims lead to the GGBS-related AEC in cement.
- 5.18 However, they **would not address the perceived detriment of the GGBS-related AEC**, which the CC seeks to address, i.e. high prices in GGBS leads to high prices in cement/RMX), as the remedies will rather (if the CC's reasoning that there exist market power in the GBS/GGBS supply chain, leading to excessive prices at the GGBS level is to be adopted):
- 5.18.1 Remove the exclusivity agreements (steel producers/Lafarge Tarmac and Lafarge Tarmac/Hanson) and, [X] which results in prices for GBS being, in theory, competitive⁵⁴;
 - 5.18.2 Potentially raise prices for GBS instead – if the CC's reasoning is correct, the impact of creating two, or a maximum of three, GBS suppliers without any control on GBS prices could mean that these suppliers would seek to exploit the perceived value of GGBS by increasing prices at the upstream level;
 - 5.18.3 The CC has already assumed that certain GBS supplies will be supplied to a co-located plant (e.g. Scunthorpe), creating a natural supply relationship. This could further weaken the availability of GBS supplies not tied up through 'co-location vertical integration' and increase the power of GBS suppliers;

⁵⁴ The CC's own calculations identify that Lafarge Tarmac is not excessively profitable in GBS. No assessment of BFS profitability is undertaken.

- 5.18.4 Such concerns could be exacerbated by creating a vertically integrated player in steel/BFS, GBS and/or GGBS, as the CC does not rule out:
- (a) the GBS assets being divested to a steel producer; and
 - (b) divesting the GBS and GGBS assets to the same buyer (i.e. possibly the steel company); and
- 5.18.5 Vertical integration between the GBS and GGBS supply levels could merely exacerbate any concerns over GBS supply (through, in theory, tying up GBS supplies) and increase the ability of GBS suppliers to charge supra-competitive prices for GBS.⁵⁵
- 5.19 As a result, the CC's proposed remedies would simply transfer the alleged market power of Hanson in GGBS one stage further up the supply chain to the GBS suppliers, or two stages further up the supply chain to the steel producers, which means the proposed remedies are, on the CC's own reasoning, *not effective*.
- 5.20 The CC itself appears to be aware of this concern, as it states that "[f]o **ensure the effectiveness of this remedy** in addressing the underlying causes of these AECs, and to **ensure that the remedy does not simply result in Hanson's current market power being exercised by Lafarge Tarmac one stage further up the supply chain**, we have also required divestitures at the GBS level from Lafarge Tarmac [emphasis added]"⁵⁶; and that "under (...) cessation of the GBS agreements, the AECs and resulting customer detriment that we have identified would not be removed. Instead, the **market power in GGBS** currently exercised by Hanson downstream would **simply be moved up the GGBS supply chain** and exercised by Lafarge Tarmac in the supply of GBS"⁵⁷. However, the CC fails to recognise that the proposed remedies, including the GBS/GGBS divestments, cause the alleged market power to move two stages further up the supply chain, which ought to be just as much an issue of concern.
- 5.21 As an example of the above scenario, Hanson has previously referred the CC to the example in the **German market** where similar arrangements were broken up and resulted in the GBS price and stockpiles increasing significantly.⁵⁸ The unavoidable reality, as occurred in the German market, is that any fundamental structural alteration to such a complex industry is increased costs, increased prices and substantially less choice to consumers. The intervention of the German regulator was proven to be materially adverse to customers. In the PFs, the CC relied heavily on the German (and Bulgarian) GBS market example⁵⁹. However, following Hanson's submissions, in neither the PDR nor the GGBS Addendum do the CC show any renewed consideration of this (or the Bulgarian) market. Indeed, up until this summer 2013, a key part of the CC's analysis with regard to GGBS appears to have been with regard to these two cases in Bulgaria and Germany. Hanson therefore refers the CC to its response to the CC Remedies Notice in this regard.

The indirect effect on any cement AEC

- 5.22 The CC "expect that the overall impact of these measures will be to put downward **pressure on GGBS prices**, driving them towards competitive levels. This in turn would **address the distortion** caused by the current operation of the **GGBS supply chain** in the GB cement markets and hence would also be **expected to reduce the price of cement** [emphasis added]"⁶⁰.

⁵⁵ [X]

⁵⁶ PDR, paragraphs. 6.11.

⁵⁷ PDR, paragraphs 3.321-322.

⁵⁸ GGBS hearing summary transcript paragraph, p.6, para 18-26.

⁵⁹ Appendix 7.6 of the PFs, para. 53 et seq.

⁶⁰ PDR, para. 6.12.

- 5.23 There is no attempt in the PDR to estimate the extent to which its remedies would lead to lower prices in cement. The CC has made little attempt generally to quantify its assertion that the GGBS supply structure leads to a detriment in cement. For example, it has noted that: "(...) *customer detriment that we have provisionally found to be associated with high cement prices (...) may be attributed to the competition shortcomings in the GGBS supply chain and their consequent distortion of cement markets, rather than from coordination in cement. While we cannot separate the effect of coordination from the effect arising because shortcomings in competition in the GGBS supply chain, we consider that most of the detriment as measured by our cement profitability analysis is likely to result from the coordination AEC which is the more direct effect on cement profitability. The impact of higher GGBS prices on cement profitability is, in our view, less substantial, although nonetheless significant [emphasis added]*"⁶¹. This makes it clear that the CC's theories concerning the impact of GGBS are not capable of substantiation or quantification. Similarly, Hanson would expect any quantification of cement benefit arising from the GBS and GGBS remedies to be entirely unsupported.
- 5.24 Conversely, the GBS/GGBS remedies could also risk **reducing the competitive constraint of GGBS overall** on cement, which the CC argues currently exists, by:
- 5.24.1 Weakening Hanson as a GGBS supplier by, for example, reducing its capacity and cutting its GBS supply (see above); and
- 5.24.2 Removing the current GGBS arrangements' guarantee that GGBS is widely **available at a cheaper price than cement**.
- 5.25 Therefore, the CC remedies would risk potentially *increasing* cement (and/or RMX) prices, thus defeating the purpose of the proposed remedies.
- 5.26 In addition, the CC has itself recognised the potential limited impact which the proposed GGBS remedies could have on the cement market:
- "However, we were not persuaded that an effective intervention to open up the GGBS supply chain to more competition....would be sufficient to undermine the sustained problems that we have observed as arising from coordination in the GB cement markets. In this context, we noted that the GGBS market is significantly smaller than the GB cement markets, that GGBS is only a partial substitute for cement and concluded that the impact of one or more new GGBS producers on competition in cement was likely to be significantly less disruptive than having a new GB cement producer."*⁶²
- 5.27 Indeed, the CC's proposition that the GGBS remedies would have an impact on cement prices relies on the assumption that there is significant spare capacity in the GGBS supply chain. Otherwise, it is unrealistic to suggest that a reduction in prices of GGBS, which currently represents (and could *at most* represent) a mere 10% of the cementitious products market, could have a material impact on cement prices. In making this assumption, the CC must either rely on the availability of the very significant stockpiles of GBS suggested to it by Lafarge Tarmac and/or significant spare capacity for GGBS production in the GBS supply chain.
- 5.28 As regards stockpiles, Hanson has already shown beyond all doubt (in Annex B to its response to the GGBS Addendum) that the stockpile numbers of 1.5mt referred to and relied upon by the CC (and by Lafarge Tarmac) for such purposes are now shown to be fanciful, the true number having been accepted by all to be only 500kt (with no explanation having been provided to Hanson as to why those numbers have suddenly reduced so drastically).

⁶¹ GGBS Addendum, para. 102.

⁶² PDR, para. 6.66

- 5.29 Furthermore, no recognition has been made by the CC of the proportion even of those lower volumes that may be aged or low quality and therefore beyond reasonable industrial processing. This is again explained in the response to the GGBS Addendum.
- 5.30 Furthermore, Hanson's figures have also proved that more GBS was processed into GGBS last year than was produced from the Lafarge Tarmac granulators. Hanson's figures have again been shown to be accurate and reliable, whilst the CC (and Lafarge Tarmac) have continued to refer to the very significant volumes of GBS/GGBS that will flood the market and bring down the CEM I price.
- 5.31 Even giving the CC the benefit of the doubt and allowing for a surplus of c.100kt of GBS p.a. (based on the last full year numbers for available GBS), it is impossible to see how such a small volume (100kt) could bring down the price of CEM I, whose market size is close to 10,000,000 tonnes pa. The CC has concluded that in the context of GGBS imports, volumes representing 10% of the market are 'very limited' and cannot constrain GGBS prices. And yet in the context of GGBS affecting the price of cement itself, the CC appears to have concluded that the falling demand/reducing volumes for CEM I caused by the making available of additional GBS/GGBS volume (of only c.100kt) will somehow constrain and temper the price of CEM I itself, when that new volume (of only 100kt) accounts for a mere c.1% (one percent) of the cement market. The CC's conclusions in this respect, therefore, appear to be egregious, and yet the CC is depending upon such analysis in order to conclude that its remedy in GGBS is appropriate, in the context of alleviating the CC's stated GGBS-related AEC in cement.
- 5.32 Further detail on the capacity constraints inherent in the GGBS supply chain has been provided in Hanson's response to the GGBS Addendum. This clearly shows that there is very little capacity in the supply chain for the expansion of GGBS production in GB. This further underlines the fact that changes to the GGBS supply structure can be expected to have minimal impact on cement.

CC claims regarding GGBS Remedy being likely to temper tacit coordination in cement

- 5.33 Since the CC's case for a model of tacit coordination in cement is founded upon such a large degree of errors, incorrect application of economic methodologies, omissions and selectivity in assessing evidence, implementing a remedy in GGBS supposedly to undermine a remedy in cement cannot be a safe objective for the CC, as claimed in PDR paragraph 3.286(c) (where the CC claims it is a principal reason for necessitating a remedy at the level of cement).

6. IMPACT ON CUSTOMER BENEFITS OF THE PROPOSED REMEDIES

The current supply arrangements provide an environment conducive to investment in GGBS as an alternative to cement, security of supply of GGBS and optimal quality of GGBS. These benefits would be lost through the implementation of the remedies. These are key customer benefits arising from the current market structure, and these would be lost permanently if the proposed remedies are implemented.

- 6.1 The CC has presented no compelling evidence of its proposed remedies resulting in benefits to customers. However, the highly probable result of the GGBS remedies will in fact be to *reduce* the availability of GGBS supply, causing a direct *increase* in GGBS prices; and, if, as the CC assumes, GGBS prices affect cement prices to any significant degree (which Hanson contests) also on cement prices and the price of concrete for the construction industry and to consumers.
- 6.2 The current structure effectively *benefits* consumers as it provides a supplier with security of supply of GBS at a reasonable price committed to supplying GGBS as an

alternative to cement and PFA. As we have shown above (see Section 5), a fragmented supply chain could equal a loss of a committed GGBS player, and a loss of GGBS as a real alternative to cement and PFA.

- 6.3 The CC's analysis of the RCBs arising from existing GGBS arrangements⁶³ currently underestimates the significance of Hanson's submissions. The CC does not accept that the current arrangements produce any RCBs.

Investment and commitment

- 6.4 The CC does not consider that Hanson's ability to invest and commit to promoting GGBS is a RCB, and that there is no 'compelling reason' to suggest the creation of greater competition in the supply of GGBS would result in less investment into and the promotion of GGBS⁶⁴.
- 6.5 However, the CC has not given due weight to the fact that the current arrangements create a degree of *security of demand*. Unlike PFA production, GGBS production requires ongoing investment at the GBS and GGBS levels. Unlike cement, GGBS has no 'captive' or committed demand: it may be fully substituted by alternative products in the vast majority of applications. In addition, developing customer demand requires the promotion of GGBS as an alternative to cement.
- 6.6 The current market structure creates a degree of committed market demand in order to underpin such investment. This security of demand is created by Hanson's downstream RMX and concrete products production, as well as, to a certain extent, that of Lafarge Tarmac (which is incentivised to purchase due to its involvement in the supply chain).
- 6.7 Unless a purchaser has its own significant downstream demand (in which case, the concerns about the lack of available external supply would arise, as noted above), such security would not exist. In contrast to the current situation, where Hanson's ability to supply internally and to Lafarge Tarmac, which supports a national GGBS business, purchasers would not necessarily be incentivised to undertake the necessary investments to become long-term and committed competitors in the market. They would either focus on internal supply only (if applicable) or would hold off from the necessary investments required to maintain a long-term presence in the market (if, as expected and highlighted below, the GGBS assets are acquired at a substantial discount, this would encourage purchasers to behave opportunistically).

Security of GBS supply leading to security of GGBS supply

- 6.8 The CC considers that breaking up Hanson's ability to rotate supply around its three plants depending on whether GBS availability is threatened would be 'neutral or even beneficial to consumers'. The CC states this is because it will encourage GGBS customers to source from multiple providers, and for GGBS producers to source their GBS from multiple sources in order to mitigate such perceived risks, consequently encouraging more competition in prices between providers.
- 6.9 Whilst claiming that the ability to rotate supply around its plants is not a material benefit, the CC then contradicts itself by saying that Hanson will retain (post-remedies) three plants which it can use for rotation purposes. This is, in fact, incorrect as it assumes that Hanson would undertake the expenditure necessary to bring Teesside back on-line (despite the fact that, by virtue of the CC's remedies, Teesside will have no guaranteed supply of GBS) and that Llanwern could be brought back on-line. Hanson has [redacted]⁶⁵. Therefore, the CC is greatly overstating Hanson's ability to rotate

⁶³ PDR paragraph 5.21-5.28.

⁶⁴ PDR paragraph 5.23.

⁶⁵ It appears that Tata Steel has provided comments to the CC on its future willingness to grant Hanson a lease at Llanwern, but that the relevant details have been redacted (even from the Data Room). This makes it difficult for

supply around its plants post-divestment. Indeed, the CC would appear to have confused the need of Hanson to rotate GBS sources (in view of the risks in the steel industry) with the ability to rotate GGBS grinding itself. The CC for example refers to Llanwern in this respect, stating that Hanson has the ability to rotate, but Llanwern has no GBS supply and so Hanson could not possibly rotate a GBS supply to Llanwern. The CC has elsewhere acknowledged the supply constraints in GBS, but has omitted the factor from consideration in the context of Hanson's need to rotate GBS supplies in the face of the uncertainties in the steel industry. The CC would also appear to have concluded that there is no risk in the steel industry, although the closures at Llanwern and previously at Teesside itself do not bear out this view, nor do the ongoing cuts at Scunthorpe or the decision not to proceed this autumn with the scheduled capex and re-lining of the Queen Anne blast furnace.

- 6.10 Currently, Hanson's GGBS business is capable of withstanding the inherent risk of steel closures and/or interruptions in BFS or GBS supply. The CC dismisses this risk as simply stating "*we were inclined to place significant weight on the views and actions of the GB steel producers in forming our own view...the risks of major discontinuity of GBS supply were relatively modest*"⁶⁶. Naturally, GB steel producers are an important commentator on this matter, but equally naturally Hanson would expect them to suggest a positive outlook for GB steel production as a matter of course. However, the CC cannot dismiss the inherent risk outright. History shows that the GB steel supply is far from predictable.⁶⁷ Furthermore, merely limited changes of the steel supply due to temporary strategy, or mid-term furnace closure could significantly reduce the availability of GBS.
- 6.11 The CC has also concluded that there are no material risks to take into account with regard to the UK steel industry. In contradiction to the CC's assumptions, Tata Steel has on 29 October 2013 announced that it is to cut hundreds of jobs from their Scunthorpe site. Tata Steel is reported to have blamed the cuts on prolonged weak demand in the construction industry, suggesting the market is half of what it was in 2007 with proper recovery not expected for a decade. The job losses at Scunthorpe have been seen as a shocking blow to Scunthorpe and the associated steel community.
- 6.12 The Scunthorpe works now use only two of the four blast furnaces. Although the company had announced a plan to reline one of Scunthorpe's two operational blast furnaces (the Queen Anne, which work could have served to preserve and even boost production) the work scheduled to commence October 2013 has not occurred, despite the industry having stated previously that it was proceeding this October.
- 6.13 Furthermore, as noted in Hanson's response to the GGBS Addendum, it is not purely the closure of mothballing of steel plants which creates systemic risk. Temporary interruptions to supply of GBS or BFS (through breakdowns, planned maintenance etc), along both quantity and quality dimensions, can raise supply risk. The huge variations of the level of GBS stockpiles represents evidence of the 'famine or feast' nature of the business.
- 6.14 It is only through access to a national chain of GGBS grinders co-located with BFS/GBS sources, together with the Purfleet plant which is able to take excess GBS supply from other sources, that Hanson is able to offer consistent national coverage in respect of GGBS supply. This creates security of supply in the GBS/GGBS supply chain, and confidence in customers concerning secure supplies of GGBS as an alternative to cement and PFA.

Quality

Hanson to comment, other than to assume that the grant of a one year lease only and the development around Llanwern means that it is highly unlikely that Hanson will be able to reopen Llanwern in future.

⁶⁶ PDR paragraph 3.364.

⁶⁷ [X]

- 6.15 The CC claims its remedies will allow quality and reliability of GGBS produced to be one 'area' for future competition⁶⁸. First, the GGBS produced by Hanson is of the highest quality, and is expertly mixed and controlled through its [X]. GGBS has to meet stringent technical specifications, and given the fundamental nature of quality to any construction project, it is unlikely that many customers will accept lower quality grade GGBS. Hanson has explained to the CC in great detail that there is a variable quality of the GBS produced at each granulator⁶⁹. This is regulated only by virtue of Hanson's ownership and access to these varying qualities.
- 6.16 Although the CC envisages wide and free exchange of GBS and GGBS between market players this simply will not be the case. The CC must accept that the ability to blend GGBS will not be as practically or commercially available as it is for Hanson under current arrangements. The remedies will make it significantly more difficult for Hanson (and any new market player) to ensure the quality of its GGBS, due to the reasons set out above. Indeed, as confirmed by third parties, experience and understanding of the steel industry is required for a GGBS operator to be efficient.
- 6.17 Therefore, there is a threat that the remedies will undermine RCBs through the removal of a dedicated GGBS supplier with national coverage, better able to withstand steel industry shocks and to provide high quality GGBS as an alternative to cement and/or PFA.
- 6.18 Without the exclusivity in the long-term supply agreements, there is a risk that parties at the GBS or GGBS levels will not undertake necessary investment or re-investment in assets that are 'relationship-specific', i.e., their value depends critically on maintaining the relationship with the specific trading partner. [X] This benefit would be lost in a scenario where there is no exclusivity or comfort on continued supplies of GBS. This would damage the market over the longer term⁷⁰.
- 6.19 As noted above, the current supply arrangements should also be considered as giving rise to RCBs through the efficiencies created by the fact that:
- 6.19.1 [X] and
- 6.19.2 The steel industry (or another acquirer of the GBS assets) will naturally aim to maximise its/their profits – it is conceivable that the BFS and/or GBS suppliers would raise their prices to the level at which GGBS suppliers remain price takers in respect of the cement price (i.e., raise the effective GBS price to a level where GGBS suppliers can only make a margin by following the cement price).

7. THE PROPOSED REMEDIES ARE NOT PROPORTIONATE

Hanson has shown above that the proposed remedies would be ineffective. The risks for efficiencies arising from the current arrangements have also been highlighted.

In addition, as highlighted below, even if AECs are found to arise, the CC has found no distortion of competition or customer detriment.

Therefore, there is no case for imposing remedies in GGBS. This should be set against the costs and risks to Hanson. These include:

- (a) *The divestment/impairment costs to Hanson, which are greatly underestimated; and***

⁶⁸ PDR paragraph 5.26.

⁶⁹ Hanson's Addendum to the GGBS Follow-up Questions.

⁷⁰ See for example Joskow, the American Economic Review (available at <http://www.webssa.net/files/joskow.pdf>).

- (b) **The costs and risks to Hanson's GGBS business associated with the loss of the majority of its active GGBS production capacity, a lack of security supply of GBS, the loss of national coverage, the loss of its ability to withstand GBS supply shocks and the potential grant of pricing power to GBS suppliers.**

GGBS represents a small part of the overall cementitious products market. The GGBS remedies would have a disproportionate and unfair impact on Hanson when considered in the context of this wider market. Any benefits from GGBS remedies in this wider market would be uncertain; any pressure on GGBS pricing from lower cement prices is accepted. Any measures already implemented (such as the introduction of HCM into the market by the CC itself) and/or any future increase in competition from the CC's proposed cement remedy would, in itself, be effective in remedying any perceived AEC in GGBS without the need for separate GGBS remedies.

The CC's analysis relies heavily on Hanson's presence as a cement player. HeidelbergCement's invested in Hanson on the understanding that this overlap had been specifically approved by the EC and that other Competition Authorities would not seek to undo what had already been given the unconditional clearance at EU level. This further undermines the CC's case as to proportionality.

The impact of divesting two of Hanson's three operational plants, [X] % of its active capacity and undermining the security of supply upon which its business has been built represents an unprecedented level of intrusion into Hanson's business. The measures appear to have the nature of punitive measures where considerations of proportionality appear to have been ignored. A proper consideration of reasonableness would require other (less intrusive remedies) to be given preference.

- 7.1 The proposed remedies are in any case *disproportionate* to address the alleged AECs and any alleged detriment arising from it.

The lack of harm to customers or competition

- 7.2 Before turning to the issue of proportionality, it is first necessary to assess the 'harm' which the CC is seeking to address.

- 7.3 Whilst the CC appears to argue that Hanson has market power and that its presence in both GGBS and cement is undesirable (given its market power in GGBS), the CC has *not* provided any evidence that these alleged 'features' prevents, restricts or distorts competition. In particular:

- 7.3.1 The CC has not presented, or, as far as Hanson is aware or received, any evidence that Hanson has leveraged such 'market power' into downstream RMX or concrete products markets, either through *vertical foreclosure or margin squeeze strategies*⁷¹. Indeed, the response of Breedon Aggregates, a major downstream competitor, seems to indicate an absence of such an exclusionary strategy, as it told the CC that it bought GGBS from Hanson and believed that "*it got a competitive price for GGBS from Hanson*"⁷²;

⁷¹ In the *HeidelbergCement/Hanson* decision (Case COMP/M.4719), the EC considered the risk of the HeidelbergCement/Hanson vertical integration giving rise to any risks of foreclosure of cement producers, who may need GGBS, and/or downstream competitors in RMX that are not vertically integrated, but concluded that the **risk of any GGBS foreclosure was unlikely**, as there would be no ability or incentive to do so (para. 94-117). It is notable that the factors relied upon by the EC in reaching that conclusion in its decision, e.g. availability of alternative products and possibility of imports, have not been adequately refuted by the CC with any evidence or explanation of how the market would have changed since the EC's decision.

⁷² Appendix 7.6 of the PFs, para. 10.

- 7.3.2 The CC has not presented any evidence of an attempt to leverage Hanson's 'market power' in GGBS into the cement market (for example, through tying cement sales to GGBS sales or bundling sales), something which Hanson would only have the ability to do if Hanson had significant market power in GGBS⁷³. Indeed, the EC's decision in *HeidelbergCement/Hanson* specifically excluded the risk of such leveraging taking place by approving the very cement/GGBS overlap which the CC now objects to (the EC referred to factors such as buyer power and the substitutability of other materials for GGBS – these are factors that have not been refuted by the CC with any clear evidence)⁷⁴;
- 7.3.3 The CC has not presented any compelling evidence that Hanson has withheld supplies of GGBS; and, as the EC explained, GGBS is *not* an essential input for concrete production, as it can be substituted by cement or PFA⁷⁵, which thus removes the possibility for such withholding to prevent/restrict/distort competition in any case. Again, the CC has not presented any evidence to refute this. Hanson is responding separately on the CC's allegations regarding stockpiles of GGBS, and has shown that these concerns are unfounded; and
- 7.3.4 The CC has not proven that customers have been charged too high a price for GGBS. Hanson's **response to the Addendum** and **Annex IV (GGBS Pricing)** to this response to the PDR sets out an analysis of the CC's case in respect of its contention that prices for GGBS are 'too high' and shows that there is no evidence that prices are too high.
- 7.4 These factors indicate that there is no clear evidence of consumer harm, or harm to competition, arising from Hanson's position in GGBS. Even if it were to be accepted that an AEC existed (which Hanson does not), the lack of any exercise by Hanson of 'market power', in a manner damaging to competition or consumers, indicates that there is **no** compelling need for any remedies. This is a critical consideration for the consideration of proportionality.
- 7.5 The CC has, however, sought to make the case for remedies by identifying alleged detriments in relation to GGBS:
- 7.5.1 A detriment through higher prices in GGBS than would have otherwise have been the case – as noted in Hanson's response to the GGBS Addendum, the evidence presented by the CC does not clearly demonstrate a detriment. As noted above, there is also no clear evidence of excessive prices being charged to customers; and
- 7.5.2 A detriment through higher prices in cement. The CC itself recognises that this is speculative, as noted in paragraph 5.22 above, and is unable to quantify the detriment. This theory of detriment must therefore be discounted. The CC's calculation of detriment in cement is itself overstated and flawed as shown in Hanson's separate response in this regard.
- 7.6 The remedies proposed by the CC would result in a substantial alienation of a large proportion of Hanson's GGBS business and contractual arrangements; and would be highly disproportionate when set against:
- 7.6.1 The lack of adverse exercise of alleged 'market power' by Hanson, and the lack of detriment identified;

⁷³ Even if it were to be accepted that Hanson would not want to leverage its position in GGBS for the benefit of its cement business when competing with Lafarge Tarmac and Cemex for fear of destabilising any perceived coordination (which Hanson does not accept), this would not explain why there is no evidence of Hanson targeting importer's customers with bundled offers (or similar).

⁷⁴ Case COMP/M.4719 *HeidelbergCement/Hanson*, para. 122-128.

⁷⁵ Case COMP/M.4719 *HeidelbergCement/Hanson*, para. 107.

7.6.2 The lack of evidence that the remedies will be effective in achieving the CC's stated aims; and

7.6.3 The potential impact on RCBs.

7.7 Further elements of proportionality are considered below.

[REDACTED]

7.8 The CC has also underestimated **cost of remedies** massively [REDACTED]. **Annex VII (Cost of Remedies)** sets out Hanson's response to the CC's questions on the cost of remedies, and shows how significant the costs are likely to be.

7.9 [REDACTED]

7.9.1 [REDACTED];

7.9.2 [REDACTED];

7.9.3 [REDACTED]; and

7.9.4 [REDACTED].

[REDACTED]

7.10 This shows that, even when one-off costs are taken into account, there is a very significant underestimate, casting doubt over the CC's proportionality analysis. These costs are before any of the other one-off costs referred to in Annex VII (which are difficult to quantify).

The weakening of Hanson's GGBS business

7.11 This response has already highlighted above the elements of the remedies package which will weaken Hanson's GGBS business (in the context of the effectiveness of the remedies and RCBs). These factors also impact on proportionality.

7.12 It is worth repeating the key threats to Hanson's future as a meaningful GGBS competitor (these are explored in more detail above):

7.12.1 The loss of two of its three active GGBS production plants, representing around [REDACTED]% of its currently active capacity;

7.12.2 The lack of security of supply of GBS resulting from the break in the current supply arrangements, in particular through the loss of two 'co-located' GGBS plants. The CC highlights that both Port Talbot and Scunthorpe are ideal for divestment as they are co-located plants, which would leave Hanson with only the Purfleet and Teesside plants. Hanson would have no guaranteed supply arrangements;

7.12.3 The risk that, even if Hanson could obtain supplies, [REDACTED]. Hanson would have particular vulnerability through only having one plant co-located with a steel plant (thereby, reducing its ability to exercise customer bargaining power by virtue of being the 'natural' purchaser of GBS from sites co-located with its production facilities);

7.12.4 The inability of Hanson to withstand GBS supply shocks (caused, for example, by the closure or shutdown of steel plants); and

7.12.5 The loss of national coverage for Hanson enabling it to provide a consistent quality for its customers throughout the UK.

- 7.13 Indeed, if both divested GGBS plants were sold to a single buyer (and the CC were correct that the GGBS-market constituted a separate market), then that buyer would, under the CC's assumptions, likely obtain unilateral market power, as it would occupy over 60% of the available supply.

GGBS represents a small part of the cementitious products market and any remedies would be disproportionate

- 7.14 Hanson considers that the relevant market is broader than that suggested by the CC, covering all cementitious products (please see Hanson's response to GGBS Addendum) and, accordingly, **GGBS only represents a small part of the overall market**. GGBS supply represents approximately 10% of the GB supply of cementitious materials.

- 7.15 It would be, as matter of principle, highly disproportionate to impose remedies requiring divestment and in respect of a product representing such a small proportion of the market where, as noted above, there is no indication that such remedies would have the effect of lowering prices to any significant degree.

- 7.16 The CC has recognised that cement pricing at least provides an upper limit on the GGBS price (through its analysis of the cellophane fallacy in the GGBS Addendum). The CC considers that GGBS is priced up to the level where alternative products (including CEM I) become attractive substitutes. It follows from this that any decrease in the cement price would reduce the GGBS price.

- 7.17 The CC has itself recognised, in principle, that any 'improvement' in competition in cement would be likely to lead to a reduction in GGBS prices. For example, in relation to the potential effect of its cement remedies on GGBS, it noted:

"We considered that measures that reduced the extent of coordination in the GB cement markets could also be expected to mitigate the AEC in GGBS and the GGBS-related AEC, in that the downward pressure on cement prices that would result from more competitive cement markets would, in turn, constrain Hanson's ability to exercise market power in GGBS."⁷⁶

- 7.18 Such 'downward pressure' could result from incremental competition resulting from recent market changes in cement or from the introduction of a new competitor in cement proposed under the CC's PDR.

- 7.19 Hanson believes that, even if there are concerns over the current levels of competition in cement (which it disagrees with), these are unlikely to endure. As highlighted in Hanson's response to the PFs, the introduction of Hope Cement and CRH can be expected to have a significant impact on the cement market. As GGBS is, in effect, a price taker, any reduction in prices resulting from an improvement in competition in cement⁷⁷.

- 7.20 Even if the CC fails to acknowledge the impact of new entry into cement, it must accept that a divestment of a cement plant as proposed in the PDR should be sufficient and proportionate as a remedy, it is accepted that any increase in cement competition results in lower prices in GGBS. As the CC's only theory of harm in relation to GGBS appears to be that prices are too high (see above), surely a remedy in cement would, following the CC's thinking, represent an adequate remedy.

- 7.21 The CC has rejected the possibility of its cement remedies being sufficient to remedy any perceived GGBS AEC, but it has not undertaken any analysis in this case. Indeed, such an analysis appears contrary to the fundamental proposition suggested

⁷⁶ PDR, para. 6.69.

⁷⁷ Hanson already gave some examples of Hope Construction Materials competing aggressively for customers in its PFs response.

by the CC that cement prices act as a constraint (in the CC's terminology, a 'ceiling' on GGBS prices).

- 7.22 Throughout the MIR, the CC has mainly focused on a theory of harm based on tacit coordination. It would be entirely disproportionate for the CC to now order significant structural remedies to address an alleged AEC that the CC has only sought to genuinely substantiate in the GGBS Addendum, which was issued on 8 October 2013.
- 7.23 The CC also admits itself that "[t]he **divestiture of GBS plants (...)** would **also address** our concerns relating to the **structural link between the GB cement and GGBS markets that arise from Lafarge Tarmac's extensive participation in both GB cement and GBS production** [emphasis added]"⁷⁸. If the CC is correct in that statement, a GGBS divestment remedy would be unnecessary and disproportionate.
- 7.24 This point is also amplified by the CC's conclusion that the CC's "expectation that the GB cement markets will also become more competitive, as a result of the introduction of our proposed package of **remedies to the Coordination AEC, increasing the competitive pressures facing GGBS providers** [emphasis added]"⁷⁹.
- 7.25 Consequently, further to the above, the CC has not demonstrated to the adequate standard of proof that the proposed cement divestment and the behavioural remedies would not be sufficient in addressing the alleged AECs.
- 7.26 When considering the package of remedies, the CC MIR Guidance notes that the CC should consider the criteria for assessing remedies against particular remedies *within the context of a package of remedies*: "The CC will apply these principles to the evaluation of individual measures within a package of remedies as well as to the package taken as a whole"⁸⁰. This includes assessing whether, within the package, each remedy is: "(a) effective in achieving its legitimate aim; (b) is no more onerous than needed to achieve its aim; (c) is the least onerous if there is a choice between several effective measures; and (d) does not produce disadvantages which are disproportionate to the aim"⁸¹.
- 7.27 Given the speculative benefits of any GGBS remedy, the real risk of harm to the availability GGBS as an alternative to cement resulting from the proposed GGBS remedies, the limited impact on the cementitious products market likely to result from a GGBS remedy, but the likely impact on GGBS resulting from any effective cement remedy and the costs/risks to Hanson's GGBS business, there is no justification for the package of remedies also to include a GGBS remedy. The CC must, therefore, if it persists with cement remedies, desist from extending its remedies further into GGBS.

The disproportionate impact on Hanson

- 7.28 As mentioned above, *the proposed divestment remedies infringe Hanson's property rights, as set out in Article 1 of the First Protocol of the ECHR. As a public authority, the CC is obliged under section 6(1) of the Human Rights Act 1998* not to act incompatibly with these ECHR rights. However, as regards GGBS, despite an insufficient investigation (see above), the CC opts for such serious remedies without sufficiently considering less onerous alternatives. Moreover, the proposed divestments of GGBS plants would disproportionately affect one company in a competitive market for cementitious products where those plants have been established through investments by Hanson and its predecessor, Civil & Marine (see above, para. 4.14). This is distinctly different to the only previous case where the CC has imposed divestments, *BAA Airports*, which involved a successor to a state-owned

⁷⁸ PDR, para. 3.335.

⁷⁹ PDR, para. 6.23.

⁸⁰ CC Market Investigations Guidance, para. 346

⁸¹ *Ibid.*, para. 344

enterprise, which had acquired its position through the transfer of assets from the state.

7.29 GGBS plant divestments and the removal of Hanson's GBS supply lines are very significant remedies and the alleged **detriment in question is too low to justify** such remedies. The disproportionality of the proposed divestment is shown by, for example, the following facts:

7.29.1 The CC has stressed that, through a market investigation, it does not target any individual company conduct or claim that any individual company has been found to be in breach of competition laws but rather seeks to address AECs in the market as a whole. The CC's own guidelines also recognise that the "*market investigation regime [allows] the competition authorities the opportunity to assess whether competition in a market is working effectively, where it is desirable to **focus on the functioning of the market as a whole rather than on a single aspect of it or the conduct of particular firms within it***"⁸²;

Nevertheless, the CC's remedies unfairly impact on only two companies as regards divestments (Lafarge Tarmac and Hanson), thereby distorting competition itself through a form of state intervention which results in a benefit to other competitors (e.g. Cemex, AI and Hope), which is an issue the CC has not fully considered when proposing the remedies. The CC briefly discusses in the PDR the issue of "*whether the measures to increase competition in the GGBS supply chain would have a disproportionate impact on Hanson.*"⁸³ The CC concludes that:

(a) this is "*inevitable*" and admits that it "*will have a greater impact on (...) Hanson*"; but

(b) the CC then concludes this is proportionate, as only Hanson is active in GGBS and as "*Cemex and HCM are not present in the GGBS supply chain [they] do not benefit directly from the shortcomings of competition in the GGBS supply chain*".⁸⁴

This conclusion lacks in reasoning, however, as the CC is inconsistent in claiming that Cemex and HCM do not benefit from alleged shortcomings of competition in GGBS just because they are not supplying GGBS, as the CC in parallel argues that 'features' in GGBS have an effect in cement where Cemex and HCM are present. In other words, had the CC been correct in their tacit coordination theory of harm (which Hanson does not concede), then the CC cannot also suggest that high GGBS prices, that allegedly drive up cement prices - thus establishing an AEC *in cement* - would not benefit all co-ordinating cement players in the market. The point is, that any AEC *in cement* inevitably benefits *all* cement players (insofar the CC cannot distinguish between beneficiaries in a GGBS-related AEC *in cement*).

7.29.2 Despite a lengthy investigation having focusing largely on cement, the CC concludes at a very late stage that GBS/GGBS remedies of this magnitude are appropriate, recommending a divestment of between two and four GBS/GGBS plants and only one cement plant; and

7.29.3 The CC admits that "*(...) **most of the detriment as measured by our cement profitability analysis is likely to result from the coordination AEC which is the more direct effect on cement profitability***" and claims that "*[t]he **impact of higher GGBS prices on cement profitability is, in our view, less substantial, although nonetheless significant***" [emphasis added]" – in other

⁸² CC3, para. 18.

⁸³ PDR, para. 6.50.

⁸⁴ PDR, para. 6.51-52.

words, despite concluding that the cement-coordination-AEC causes *most of the detriment* and admitting that the *impact* of higher GGBS prices is *less substantial*, the CC still opts for *more serious divestments* in GBS/GGBS than in cement, which is highly questionable from a proportionality point of view.

- 7.30 Moreover, the CC itself acknowledges that its proposed remedy in cement will be sufficient, as it expects "*that effective **remedies to address coordination in the GB cement markets** are likely to put downward pressure on cement prices. This in turn would **constrain** the extent to which it is possible for **GGBS prices** to exceed competitive levels, given that at current GGBS prices, we have found cement prices to provide a 'ceiling' for GGBS prices* [emphasis added]"⁸⁵.
- 7.31 Although the CC does **not** consider that "*measures aimed at **remedying coordination in the GB cement markets** would directly **address the causes of the AEC in GGBS** or the **GGBS-related AEC**, or be sufficient to remove fully the customer detriment resulting from these AECs, they would nonetheless support the measures to **increase competition in the GGBS supply chain** and increase the likelihood of a comprehensive and lasting solution to these AECs* [emphasis added]"⁸⁶. It is not surprising that the CC concludes that the cement remedy would not address the causes of the alleged AEC in GGBS or the GGBS-related AEC, as these 'causes' are structural. Nevertheless, the CC has only indicated one detriment resulting from the alleged AECs related to GGBS, namely *high prices* in GGBS. Therefore, as the CC concludes that the *cement remedy would constrain* the extent to which *GGBS prices* could exceed competitive levels, there would be no need for any remedy in relation to GGBS and, given the requirement for proportionality, certainly not structural ones.

Comparison with other Divestment Cases

- 7.32 In the context of proportionality and the cost of remedies, it is also important to consider the fact that the CC's proposed remedies effectively is equivalent to ordering a demerger of an asset integration (cement/GGBS) that had previously and recently been unconditionally cleared by the EC (see below, paragraph. 7.34 et seq). When considering whether it would be appropriate to impose divestment remedies against a company that previously had acquired those assets in question, the CC itself has stressed the importance of the timing of that acquisition. In its BAA Airports decision, the CC stresses that the acquirer of BAA (*ADI/Ferrovial*) chose to complete the acquisition of BAA after the Office of Fair Trading had announced a market study of BAA, in which continuing common ownership of BAA's airports had been flagged as an issue. Therefore, in deciding to proceed with the acquisition of BAA, the CC considered that *ADI/Ferrovial* had taken on the regulatory risk of potential divestiture.⁸⁷
- 7.33 However, in this case, the transactions in question (Hanson/Civil & Marine in 2006; and HeidelbergCement/Hanson in 2007) were completed *before* the market study/MIR. The CC does not appear to have sufficiently considered this issue, if at all, which further puts in question whether the CC has appropriately carried out its proportionality test in this case.

The CC's potential breach of the European Union Merger Regulation (EUMR)

- 7.34 As Hanson also explained in its response of 18 June 2013 to the CC's Remedies Notice, HeidelbergCement/Hanson's vertical integration of cement/GGBS was expressly cleared by the EC⁸⁸ and for the CC to now force a divestment:

⁸⁵ PDR, para. 6.13.

⁸⁶ PDR, para. 6.13.

⁸⁷ CC decision, *BAA Airports*, 19 March 2009, para. 10.97.

⁸⁸ Case COMP/M.4719 *HeidelbergCement/Hanson*.

- 7.34.1 Removes adequate predictability of the (EU) merger control rules; and
- 7.34.2 Breaches the EC's exclusive jurisdiction over a (previous) concentration under the EU Merger Regulation.
- 7.35 During the course of its investigation, the EC specifically reviewed and discussed the potential for coordinated effects between cement and GGBS⁸⁹ and unconditionally granted clearance at a Phase I review.
- 7.36 Pursuant to the EUMR "*in application of a 'one-stop shop' system and in compliance with the principle of subsidiarity⁹⁰...The Member States should not be permitted to apply their national legislation on competition to concentrations with a Community dimension, unless this Regulation makes provision therefor...The Member States concerned must act promptly in such cases [emphasis added]*"⁹¹.
- 7.37 This is reflected in Article 21(3): "*No Member State shall apply its national legislation on competition to any concentration that has a Community dimension*".
- 7.38 The Office of Fair Trading had the opportunity to request a reference back to the UK, if it considered at the time that the merger was either of significant importance to the UK⁹², or that it had some other 'legitimate interest' in doing so⁹³. It is this referral mechanism that should "*operate as an effective corrective mechanism in the light of the principle of subsidiarity; these rules protect the competition interests of the Member States in an adequate manner and take due account of legal certainty and the 'one-stop shop principle'*".⁹⁴
- 7.39 Furthermore the right of appeal to EC merger decisions is well established and has been successfully applied in numerous cases.⁹⁵ As the Office of Fair Trading did not use either of these options, or in any case 'act promptly', it can only be assumed that the Office of Fair Trading did not have any significant objections to the alterations to the degree of vertical integration on cement and GGBS markets. Consequently, the Office of Fair Trading's comments to the CC with regard to any remedies in the area of GGBS should therefore be disregarded.⁹⁶
- 7.40 The application of structural remedies at this time would, in effect, allow the CC to apply national competition legislation to a concentration already expressly approved by the EC. Therefore it would be a perversion of the EUMR if the UK, as an EU Member State, could circumvent the 'one-stop-shop' principle (and its underlying principles of subsidiarity and legal certainty) through the application of the market investigation regime. In other words, the CC should not be permitted to apply a structural remedy that is equivalent to an action explicitly prohibited by the EUMR (see the provisions quoted above).
- 7.41 The CC could, in principle, seek to revisit the analysis if changes in market conditions warranted this. The only changes the CC could point to since the date of the *HeidelbergCement/Hanson* decision relate to changes which can reasonably be concluded to be reflective of an increase in competition and/or lower likelihood of coordinated effects and/or vertical integration concerns arising, i.e.:
- 7.41.1 An increase in the relative share of independent RMX;

⁸⁹ Case COMP/M.4719 *HeidelbergCement/Hanson*, para. 86-89.

⁹⁰ EUMR Recital 8.

⁹¹ EUMR Recital 18

⁹² EUMR Recital 15.

⁹³ EUMR Recital 19 and Article 9.

⁹⁴ EUMR Recital 11.

⁹⁵ Case T-229/08 *Impala v Commission*; Case T-3310/01 *Schneider Electric v Commission* [2002] ECR II-4071; Case T-5/02 *Tetra Laval v Commission* [2002] ECR II-4381; Case T-342/99 *Airtours v Commission* [2002] ECR II-2585.

⁹⁶ Cf. PDR, para. 3.285.

- 7.41.2 An increase in the relative share of non-vertically integrated importers (and recent CRH developments); and
- 7.41.3 The entry of Mittal Ghent replacing Lafarge Tarmac with a player long in cement and with greater incentives to increase competition in the market place.
- 7.42 The CC has in response stated that it "*disagreed that Hanson had a legitimate expectation that the CC would not intervene in the event that it found any AEC in relation to the operation of the GGBS supply chain with related consequences for the GB cement markets*" because:
- 7.42.1 the "*Commission took the decision in the context of a merger inquiry, strictly assessing: (i) the possible input foreclosure as regards cement producers, RMX producers and other concrete products; and (ii) a possible link between the sales of cement and GGBS ('bundling' effect)*";
- 7.42.2 "*[t]he European Commission did not consider the issues now being considered by the CC*"⁹⁷;
- 7.42.3 "*the European Commission assessed the market in 2007*"; and
- 7.42.4 "*the CC's current market investigation pursues an objective different from that pursued by the European Commission in 2007*"⁹⁸.
- 7.43 In trying to disregard the EC's precedent and by making these statements, the CC applies an inadequate and erroneous reasoning, given the following facts:
- 7.43.1 Merely because the EC evaluated evidence and risks of any lessening of competition in the market in the context of a merger investigation does *not* remove the precedent value of that decision or the evidence assessed, as:
- (a) Similar to merger investigations, the CC must, in the context of a market investigation and when considering appropriate remedies to address any AEC, assess the market features in the *future* - such as vertical integration of companies - and, hence, a merger control decision is *highly relevant*, particularly when it concerned:
 - (i) the same market as that being assessed by the CC;
 - (ii) the same companies being investigated by the CC and affected by the CC's remedies; and
 - (iii) the same alleged/potential competition issues, such as vertical integration;
 - (b) The EC's own econometric evidence cannot be dismissed simply because it was used in the context of a merger investigation;
 - (c) Unlike the CC, the EC at least assessed evidence of any past or potential future restrictions of competition, such as (not "strictly" as the CC suggests) possible input foreclosure or cement/GGBS bundling – both of which were dismissed by the EC⁹⁹ – and that evidence was gathered through a market investigation from, e.g., third parties, who submitted their *views of the market* regardless of whether there was a merger in contemplation or not; and

⁹⁷ PDR Appendix 7, para. 5.

⁹⁸ PDR, 6.40(c).

⁹⁹ Case COMP/M.4719 *HeidelbergCement/Hanson*, para. 117 and 122 et seq.

- (d) the CC has not even presented any evidence of any actual theory of harm in the context of GGBS but appears to have merely concluded that there are AECs arising in the area of GGBS based on Hanson's and Lafarge Tarmac's vertical integration and exclusivity agreements *de facto* and alleged "high prices" in GGBS, which in itself does not affect competition (see Hanson response to the GGBS Addendum and Annex IV to this response to the PDR).
- 7.43.2 The CC is wrong in claiming that the EC did not consider the issues now being considered by the CC. The CC, in relation to its alleged AECs with regard to GGBS, mainly has raised concerns about the "structural link" between GGBS and cement, which the EC examined in detail and then unconditionally cleared;
- 7.43.3 The fact that the CC is examining the market six years after the HeidelbergCement/Hanson merger does not remove the precedent value of the EC's merger decision, particularly as:
- (a) Six years is not a particularly long time in this context¹⁰⁰;
- (b) The CC *itself* has, in its own decisions, referred to precedents that were *at least six years old* when relying on e.g. market definitions and market characteristics – see, for example:
- (i) CC's reference to the Bulgarian Competition Authority's decision of July 2006 in Appendix 7.6 of the PFs¹⁰¹;
- (ii) CC merger decision of 1 May 2012 in *Anglo American/Lafarge* where the CC relies on the OFT's decision in *Lafarge Cement UK/Port Land Cement Company Ltd* from 2005¹⁰²;
- (iii) CC market investigation decision of 15 October 2013 in *Statutory audit services for large companies market investigation* where the CC relies on the EC's decisions in Case M.1016 *Price Waterhouse/Coopers & Lybrand* from 20 May 1998; and Case M.2810 *Deloitte & Touche/Andersen UK* from 1 July 2002¹⁰³;
- (iv) CC merger decision of 10 October 2013 in *Imerys Minerals Limited/Goonvean Limited* where the CC relies on the EC's decision in Case M.1381 *Imetal/English China Clays* from 26 April 1999¹⁰⁴;
- (v) CC PFs report in the *Private Healthcare* market investigation, 28 August 2013, where the CC states that it has "*considered previous CC and OFT decisions as well as EU merger investigations*" and then referring to the OFT's market study in which it relied on the EC's decision in M.4367 *Apax Partners/Nordic Capital/Capio AB* from March 2007¹⁰⁵; and

¹⁰⁰ For example, in the context of mergers, it is worth noting that a concentration which is not to last for more than three years is not even considered to operate on a sufficiently lasting basis to constitute a concentration under the EUMR in the first place (see Case COMP/M.3858 *Lehman Brothers/Starwood/Le Meridien*).

¹⁰¹ PFs, Appendix 7.6, para. 60 et seq.

¹⁰² *Anglo American/Lafarge*, para. 2.4.

¹⁰³ Market investigation decision in *Statutory audit services for large companies market investigation*, para. 6.25.

¹⁰⁴ *Imerys Minerals Limited/Goonvean Limited*, para. 4.28.

¹⁰⁵ CC PFs report, *Private Healthcare*, para. 5.15.

- (vi) the CC is also itself, in the *current* market investigation, relying on the [X] document, which is from 2006.
- (c) The market has not transformed to such a great degree since 2007 to render the EC's conclusions irrelevant (especially not if one assumes that the cementitious market, which GGBS and PFA form part of, is relatively stable¹⁰⁶); and
- (d) In any case, the CC has not presented any evidence to rebut the EC's findings in 2007, especially not with regard to GGBS;

7.43.4 The CC's current market investigation could not be considered to pursue an objective materially different from that pursued by the EC in 2007, as both investigations sought to ensure that competition is safeguarded in the market (see e.g. the CC's guidelines, which states that "*the focus of an investigation is always on competition*"¹⁰⁷);

7.43.5 The EC's merger clearance still sets a precedent for which the merging parties were entitled to rely on and Hanson notes that the CC has not commented on the EC's exclusive jurisdiction over concentrations that fall within the scope of the EUMR (see above); and

7.43.6 By stating that it "*disagreed that Hanson had a legitimate expectation that the CC would not intervene in the event that it found any AEC in relation to the operation of the GGBS supply chain with related consequences for the GB cement markets*"¹⁰⁸, the CC is also missing the crucial point that Hanson raised in its response to the GGBS WP, namely that, even if the CC had been entitled to *investigate* the market as a whole:

- (a) The EC's unconditional clearance of the HeidelbergCement/Hanson merger meant that the CC **cannot undo** that **transaction** and **impose** any **divestment remedies** with regard to assets that the EC specifically assessed, such as the GGBS assets; and
- (b) At the very least, such a divestment remedy would be disproportionate.

7.44 The point Hanson is seeking to explain to the CC and which the CC has failed to understand, is that, due to the EC's exclusive jurisdiction (as explained above), where a transaction that falls under the scope of the EUMR has been approved by the EC, a national competition authority, such as the CC, cannot order that transaction to be *demerged*. This does *not* prevent the Office of Fair Trading /CC from *investigating* the market as such; and/or individual companies' conduct in the market under, e.g., antitrust rules (such as the Competition Act 1998) or other provisions of competition law (such as the Enterprise Act 2002). However, due to legal certainty and the EUMR provisions, it *does* prevent a national competition authority, such as the CC, from imposing an obligation on the merging party to undo that transaction in question, through a divestment remedy, when the divestment is targeting assets that have specifically been examined under the EC's assessment and *cleared*.

¹⁰⁶ See e.g. PFs, para. 7.10, 7.146, 7.206, 8.49, 8.59, 8.61, 8.160, 8.168, 8.178 and 8.226. We note that the CC has not concluded on whether its recently alleged separate market for GGBS is as stable as the alleged market for cement but the CC's lack of reasoning ought not impact negatively on Hanson in this respect.

¹⁰⁷ See para. 19, CC3.

¹⁰⁸ PDR para. 6.40(c)

8. ALTERNATIVE REMEDIES

Hanson continues to contest that any remedies are required. However, even if the CC concludes that remedies are required, it must consider alternative and less intrusive remedies under the requirement of proportionality. A number of options for consideration are set out in this Section.

8.1 The test in *Tesco* set out above clarifies the duty on the CC in this respect:

8.1.1 Any package of remedies must be *no more onerous* than is required to achieve that aim. The potential substantial impact of the current remedies on Hanson, both in terms of the cost of remedies and the weakening of its competitive position through the removal of its network of plants and its security of raw material supply is highlighted as critical above.

8.1.2 Any remedies must not produce *adverse effects which are disproportionate* to the aim pursued. There is a real risk of adverse effects, linked again to the weakening of Hanson, the limiting of the ability of the GGBS supply industry to withstand demand shocks, the possible increase in GBS prices, the potential reduction in GGBS quality and the loss of a player able to provide an alternative to cement on a national basis. This militates strongly against the remedies suggested.

8.1.3 The remedies must be *effective*. For the reasons highlighted above, the current package is likely to be ineffective, go much further than necessary and indeed is likely to prove damaging to customers. The CC has not identified any exploitation of customers or distortion of competition through its investigation into GGBS. The remedies relate a product which represents a small part of the cementitious products market. Therefore, in assessing effectiveness, the CC should take into account the limited detriment (if any) arising from its perceived concerns.

8.2 Within this framework, the CC must consider if there is a choice of remedies, and, if so, it must choose *the least onerous*.

8.3 When assessing the need for a GGBS remedy and dismissing less intrusive remedies, the CC appears to do so on grounds that ignore their other remedies that they propose to impose (e.g. the proposed termination of the GBS supply exclusivity).¹⁰⁹ The CC goes on to claim that it was "*not able to identify an alternative package of measures that would be less onerous and effective in remedying the AECs*"¹¹⁰ but this is incorrect, as the CC did not even consider alternatives.

8.4 When considering whether the remedies related to GGBS are no more onerous than they need to be, the CC lacks reasoning, merely stating that it "*sought to avoid imposing costs and restrictions on parties that go beyond what is needed*"; and "*sought to avoid unnecessary restrictions on the specification of the divestiture [of] GGBS (...) plants*" without providing any explanation of how it 'avoided' imposing such costs/restrictions¹¹¹.

8.5 In order to satisfy its statutory duties, the CC must give due and proper consideration to alternative remedies, including the following:

8.5.1 The termination of the exclusive supply agreement at one plant only would also be an adequate remedy. There are three supply agreements, each linked to a particular steel production plant, and the termination of *one* of these could introduce the possibility of further competition into GGBS supply (in addition to imports). This would limit the threat to Hanson's supply route

¹⁰⁹ See in particular PDR, para. 3.296, 3.300, 3.302-303 and 3.307.

¹¹⁰ PDR, para. 6.77.

¹¹¹ PDR, para. 6.72.

and its ability to offer GGBS of a consistent quality on a national basis as an alternative to cement and PFA;

- 8.5.2 Price control and/or loss of exclusivity in a number of years time (five years) would be proportionate and adequate to address the perceived GGBS-related AEC (see above) - this remedy would introduce an *immediate* solution to the CC's only concern (perceived high prices), whilst allowing a suitable time for Hanson to obtain new secure supplies of GBS. The certainty created by the termination of the exclusivity at a certain future date would allow potential new entrants into GBS grinding a lead time in which to develop new facilities and/or take over mothballed facilities;
- 8.5.3 Any surplus GBS not required by Hanson at a GBS plant would be released to the market. It is Hanson's view that it fully maximises available GBS supplies. However, to the extent that the CC retains concerns, this would ensure that any additional GBS material would be available to the market to compete with Hanson material and imported GGBS; or
- 8.5.4 If divestment of a GGBS plant was to take place, it should be sufficient to divest one plant, not two, with reference to the fact that the CC's desired new entry in GGBS can be proportionally achieved with one plant, as few real entrants would do so with two plants – indeed, in merger control investigations, the CC considers that to be "*considered a competitive constraint, entry or expansion should be of sufficient scope to deter or defeat any attempt by the merged firm to exploit any lessening of competition resulting from the merger*"¹¹². Whilst the CC usually examines the investment required for a new entrant to gain a much more limited share of supply, here the CC appears to require that the new entrant gain a 45-55% market share (where Port Talbot alone would represent 20-30% and still not be enough in the CC's view¹¹³). [
- 8.6 Although Hanson does not necessarily consider that price control would be a viable option, it is concerning that the CC has not sufficiently considered that option – e.g., it considered putting price control mechanisms in relation to GBS but not in relation to GGBS.¹¹⁴ When considering price control as a remedy in relation to GBS, the CC dismissed this option of remedy, partly with reference to the fact that "*a behavioural remedy would also bring with it a number of potential risks, e.g., in relation to the specification of such, measures to prevent circumvention, as well as costs of monitoring and enforcing the remedy*"¹¹⁵. However, these concerns appear exaggerated (and unsubstantiated), as:
- 8.6.1 If the CC is comfortable in concluding that GGBS prices are "too high", which Hanson challenges (see Hanson response to the GGBS Addendum and Annex IV to this response to the PDR), the CC also ought to be able to deal with the "specification" of what is not a 'too high price'. Indeed, given the lack of exclusionary or exploitative behaviour associated with Hanson's supposed market power, a price control remedy would seem more appropriate than divestment and interference in key contracts; and
- 8.6.2 No monitoring or circumvention prevention measures would be required in the case of price control in this market, as customers could be expected to effectively monitor this themselves.
- 8.7 A full consideration of these alternative remedies would be essential before the CC can show that any remedies it ultimately imposed satisfied the key tenets of the Tesco

¹¹² CC2 (Revised), para. 5.8.10, September 2010.

¹¹³ PDR at 3.411.

¹¹⁴ PDR, para. 3.330.

¹¹⁵ PDR, para. 3.330.

test. Hanson would be prepared to discuss these possible alternatives further with the CC (on a without prejudice basis).

ANNEX I

CC's ANALYSIS OF CEMENT DETRIMENT

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Proportionality of remedies in cement

1. INTRODUCTION

1.1 The proportionality of remedies depends fundamentally on the evidence of consumer detriment from the (alleged) AECs. To be clear, Hanson disputes the presence of a tacit coordination AEC. However, even if tacit coordination had occurred, this section will explain why the CC has formed an unreasonable and unsafe conclusion on the scale of alleged consumer detriment that results.

1.2 Appendix 2 of the PDR sets out the two approaches through which the CC estimates the scale of detriment for cement:

i) **Approach 1: Profitability-based approach.** The CC uses its analysis of economic profitability for the four majors to estimate that customer detriment from high cement prices is around £30 million per year on average for the period 2007 to 2012. The CC, however, considers this estimate “*substantially underestimates*” the harm given the severe and prolonged economic downturn¹¹⁶.

ii) **Approach 2: Cost-based approach.** The CC constructs its view of a well-functioning cement market with “*effective competition*” (i.e. no AEC), all firms as price takers (i.e. none with market power), and models the benchmark competitive prices at which the competitive supply curve fulfils market demand. On the basis of this model the CC estimates that in 2011 the overcharge in cement prices was around £10.50 per tonne, which translates to a customer detriment of £92 million in 2011. The CC, however, caveats this by saying “*we think that this estimate is likely to represent an overestimate of the customer detriment, because the model we use to derive this estimate is a relatively short-term model of competition which considers costs of capital as sunk, and because the model we use does not take into account the possibility of oligopoly competition*”¹¹⁷.

1.3 The CC’s two approaches and conclusions are, however, unreasonable, inconsistent (with each other and with economic theory) and flawed.

1.4 The flaws include:

i) The CC’s approach to constructing a well-functioning market in the cost-based approach is conceptually flawed. The approach, for example, suggests some firms will behave irrationally in accepting that they will not achieve financial capital maintenance (“FCM”); despite the CC expressly stating in the Provisional Findings (“PFs”) that firms must achieve FCM. The model constructed by the CC sets a yardstick for a well-functioning market that is unattainable and unsustainable – in simple terms, it sets a benchmark for a market that would not only not function well, but would not function at all in reality. This is unreasonable. It calls into question the CC’s previous analysis on the AEC and also the CC’s desire to attempt to create this unsustainable marketplace through invasive remedies.

ii) Despite the flaws in the CC’s construction of a well-functioning model, what it does serve to illustrate is that in a well-functioning market, where all firms are

¹¹⁶ PDR, Appendix 2, paragraph 2.

¹¹⁷ PDR, Appendix 2, paragraph 88.

price takers, more efficient players have the potential to earn supernormal profits even at the competitive price. So evidence that some firms in a market earn excessive economic profits is not at odds with effective competition, nor is it necessarily evidence of consumer detriment (as price is at the competitive level). Yet, in the profitability-approach the CC has mechanically assumed that all returns for firms above cost of capital translate immediately and in full into customer detriment. The CC's cost-based approach significantly undermines the conclusions of the CC's profitability approach (and the CC's reliance on profitability as proof of tacit coordination).

- iii) The CC recognises that its cost-based approach will overestimate detriment. However it offers no explanation of the scale of the overestimation. Our analysis suggests that the overestimate is highly likely to be very significant. An entirely plausible variation of under 0.5 percentage points in key assumptions in the CC's model results in the import-parity price being predicted as the competitive price in the well-functioning market. The CC argued in the PFs that the import price was at or near the current price level observed in the market. Therefore, with a tiny change to a single assumption in the CC's model, the estimated detriment would disappear.
- iv) Looking beyond the conceptual issue of whether supernormal profits result in detriment *per se*, the CC's profitability-approach also has significant risk of overstating the alleged detriment. This is due to its erroneous treatment carbon revenues, impairments, and the cost of capital. The results of the CC's profitability analysis are also acutely sensitive to its modelling assumptions. We note that the CC has fundamentally changed its approach to profitability between the PFs and the PDR. Had the CC corrected errors in its approach at the PFs stage (e.g. in treatment of impairments), as it has now in the PDR calculations, there would have been no excess profits identified at that stage.
- v) There is inconsistency between the CC's view of a well-functioning market and its proposed divestment remedies. The CC is proposing the divestment of a Lafarge plant, where both of the plants proposed as options are amongst the more efficient cement plants. In the well-functioning market constructed by the CC, these efficient plants would have no incentive to undercut the market price (which is determined by the costs of the marginal plants). Therefore, it is unclear why the CC believes that changing the ownership of one of these plants would have any immediate effect on market prices.

1.5 Hanson has previously explained to the CC its significant concern at a wider case law precedent level (i.e. with impact beyond this particular investigation) about the CC's reasoning in what constitutes a "*well-functioning market*". The CC's proposed well-functioning market is divorced from reality and not sustainable over the long term. If this benchmark for 'well-functioning' is what the CC is seeking to achieve, then it is highly unlikely that any market in the UK would pass the CC's test. This would discourage investment and customers would be deprived of the benefits of goods, innovation and growth. Therefore, in our view, the CC's yardstick is inconsistent with the purpose of the CC in protecting competition so as to promote growth and innovation to the benefit of consumers.

1.6 Finally, we note that throughout this investigation the CC has been working to reiterate and justify already published views about tacit coordination and detriment in the industry (views formulated by the CC in the *Lafarge/Tarmac* JV on which the key members of the case team all worked)¹¹⁸. This confirmation bias also extends to the alleged evidence of detriment. Hanson has previously, at the PFs and Working Papers stages, raised its significant concerns about the approaches applied by the CC in

¹¹⁸ Hanson has repeatedly noted its concerns about this confirmation bias, and Hanson's previous requests for a fresh case team were flatly refused by the CC, despite the CC's earlier confirmation that the case team would be new and independent in order to ensure proper objectivity.

calculating profitability and detriment. The CC's responses to these concerns as set out in its PDR are either unsatisfactory or absent.

2. THE CC'S APPROACH TO A WELL-FUNCTIONING MARKET

2.1 As context to the discussion on the flaws in the CC's approach and analysis, we summarise briefly the approaches the CC has used.

Cost-based approach

2.2 The cost-based approach seeks to estimate the detriment – "*the overcharge*" in price – caused by the alleged AECs in the cement market. To do this, the CC's models the hypothetical price that would prevail in "*a well-functioning market*" where competition is effective and all firms are price takers.

2.3 The CC posits that a hypothetical well-functioning market for cement can be modelled by building a "*competitive supply curve*" and then finding the competitive market price where this curve intersects with market demand. The CC explains: "*Between them, the supply curve and the demand for cement will pin down a market-clearing price of cement. Since the supply curve was derived based on the assumption of cement suppliers acting competitively, the market-clearing price gives a reasonable indication of what would constitute a competitive price of cement*" (para 15).

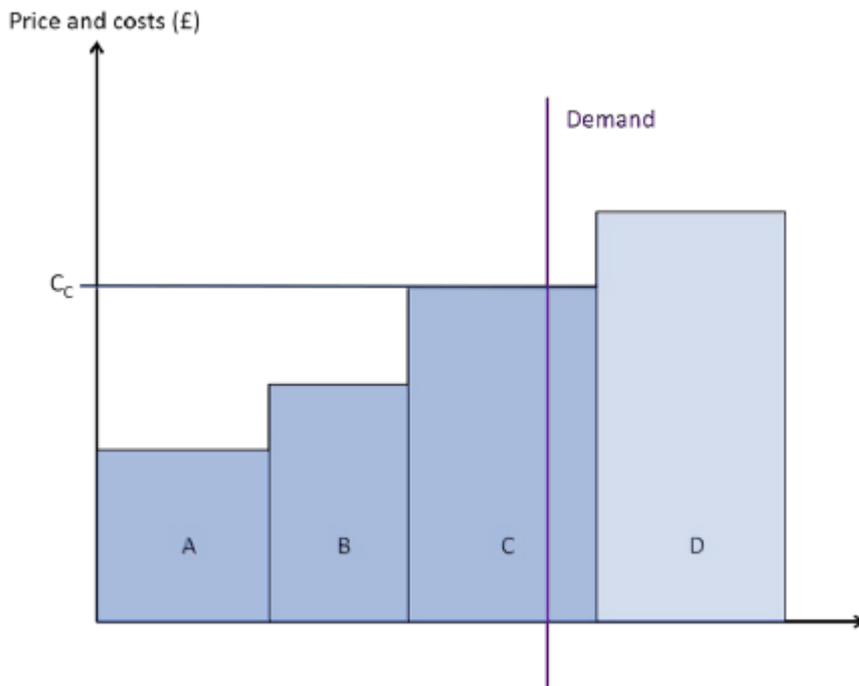
2.4 To build the 'competitive supply curve' the CC makes the assumptions:

- i) Each cement plant in the GB is considered on a standalone basis and decides whether to operate or not depending on whether the prevailing market price is higher than, what is referred to as, that plant's 'unit operating cost'. The CC constructs the plant's 'unit operating cost' as including the plant's variable costs, site fixed costs and distribution costs divided by the plant's maximum production capacity¹¹⁹.
- ii) Critically, the CC assumes that the plant will not take into account all its costs in its decision to operate – the returns on and of the capital invested in the plant are specifically excluded as are sunk costs and the actual costs of switching the plant on or off¹²⁰.
- iii) The plants are then stacked in order of unit operating costs, as depicted in Figure 1 below, to form the competitive supply curve. The height of the column is the plant's unit operating cost and the width of the column is the plant's maximum production of cement. In the diagram, Plant A is the most efficient plant as it can produce a tonne of cement at a lower cost than other plants.

¹¹⁹ The CC assumes that when a plant operates it seeks to do so at full capacity so that costs are spread over the maximum number of units (i.e. the plant's unit costs are as low as possible).

¹²⁰ Appendix 2, paragraph 27: "*In deciding whether to produce or not, an operator of an existing plant will not take sunk costs into consideration since these costs have by definition already been incurred or will be incurred regardless of whether the plant is used for production or not We also considered depreciation and cost of capital as being sunk for the purpose of this analysis, since these costs would be incurred regardless of whether the plant were used for production or not*" (para 18).

Figure 1: A supply curve, a demand curve and the marginal plant¹²¹



Source: CC.

- iv) In building its competitive supply curve the CC has to make a number of further highly-stylised assumptions such as: there is a single, observable market price for cement; there is perfect information (and no uncertainty) for market participants; carbon allowances do not impact short term decisions; plants can turn on and off often and with little cost; and the geographic distances between plants that exist in reality can be adjusted away.
- v) The CC then looks for the intersection of observed market demand and the CC's modelled competitive supply curve. The price given by the intersection of the two curves is the CC's benchmark price in a well-functioning market. The marginal plant's unit operating cost sets the lower bound for the market price (in Figure 1 the marginal plant is C). This is the amount of production capacity needed to fulfil observed demand. All plants that have unit operating cost lower than the market price would run at full capacity and any plants that have unit operating costs higher than market price are mothballed (e.g. D in the diagram).

2.5 There are three important conceptual results that arise immediately from this model:

- i) The unit cost of the marginal firm is in fact only the lower bound of the market clearing price. In the diagram, the binding constraint on the price is actually the unit operating costs of Plant D because, with a vertical (inelastic) demand curve, Plant C can price up to just beneath the point that D decides to enter and still be assured of selling its output.
- ii) There is an area of "producer surplus" between the market price and the supply curve. In standard economic models with upward sloping supply, the most efficient plants (infra-marginal plants) can earn profits in excess of normal profits, with only the marginal firm earns normal profits; unless there are entry barriers which prevent Plant D from entering and so allows the marginal Plant C to price well above its unit operating costs. Therefore, **a supernormal profit for some (infra-marginal) firms in the market is not inconsistent with well-**

¹²¹ Working Paper, page 10.

functioning competition. The CC's construction of the market does not allow this, however, because, even more severe than perfect competition, it expects the marginal firm to operate without any confidence it will recover its capital costs.

- iii) When a plant hits its capacity constraint, it has little incentive to further undercut price (as it cannot further increase its production). It will simply price at the level of the next best alternative. This behaviour is completely rational and not a symptom of market abuse (as the market price is competitive), a point clearly recognised by the CC:

"Since cement producers' production capacities are limited, prices can rise above the marginal plant's unit operating costs due to customers competing for limited quantities. On the face of it, such situations appear to be non-competitive in the sense that firms are selling at prices above marginal or average incremental cost. This would seem at odds with price competition – usually one would expect there to be an incentive to gain additional business by under-cutting rivals' prices. However, this assumes that firms can expand output without incurring high incremental costs. If all plants are operating at full capacity, this is clearly not the case. Thus, no plant would have an incentive to expand its output and thereby depress the market price" (para 36).

The modelled result

- 2.6 In constructing its competitive supply curve, the CC focuses only on 2011 data arguing this was a "stable" year so as to avoid the disequilibrium caused by the recession shock in earlier years. The CC also models it only on annual average figures thereby avoiding considering the seasonality and uncertainty in demand that exist within a year.
- 2.7 In the **Confidential Appendix**, we set out data from the Data Room that summarises the CC's results. Some key high-level results are:
 - i) The CC ranks the 10 cement plants in GB and finds that in terms of relative efficiency, the least efficient plant has unit operating cost approximately 50% higher than the most efficient plant. The supply curve, therefore, is steeply upward sloping (meaning there is opportunity for producer surplus for the most efficient plants).
 - ii) At the market demand observed in 2011, in the well-functioning market eight plants would have operated at their maximum capacity with a ninth operating at approximately 99.9% of its capacity. Therefore, the marginal plant is Plant 9 which is able to price all the way up to just beneath the unit operating costs of Plant 10. Plant 10 has a unit operating costs of £69.50 per tonne, which is the basis of the CC's finding of the theoretical benchmark price in a well-functioning market (on which it calculates detriment).
 - iii) As demand could have been fulfilled fully by the GB cement plants, there would have been no importers present in the market at this benchmark price.
 - iv) However, had market demand been just 0.1% higher in 2011 than actually observed by the CC (or the 9 active plants had run at less than maximum capacity), Plant 10 would have been activated. It would have been able to price all the way up to the level at which importers would enter, and the competitive price would have been the import parity level. This would have happened if any of the following, we consider very realistic situations, occurred:

(1) There was measurement error in observed market demand of less than 0.5%; or

(2) There was any uncertainty on market demand during the year. The point estimate used by the CC on actual demand in 2011 benefits from perfect hindsight; had, in reality, there been uncertainty that outturn may actually be higher in the year (which is possible given the recovery in the UK during 2011) then a higher market price would have resulted; or

(3) Any of the 9 active plants had not run at maximum production capacity during the year, for example, due to an unexpected shut-down for maintenance; or

(4) The market price was not perfectly observable.

v) The CC's result is, therefore, highly susceptible to even a very small change in circumstances.

vi) The CC offers no explanation about what it would expect the owner of plant 10 to do during the period during which it is inactive.

2.8 The above suggests that, even if the CC was correct in the construction of its well-functioning market model there is (a) tension between the findings of this model and the interpretation of excess profits in the profitability-approach, and (b) there are plausible outcomes under which the calculated detriment in the cost-based approach would disappear.

2.9 We now turn to the conceptual concerns with the cost-based approach.

Why use this model of a well-functioning market?

2.10 It is striking that the CC does not explain in any detail why it believes the way it models the well-functioning market is a best fit for the cement industry. In particular, the CC fails to explain why it rejected other competitive (i.e. non-collusive) oligopoly models which may be more appropriate since they more closely mirror the existing market structure, rivalry, sunk costs and entry barriers, and would equally have removed the alleged AEC of collusion.

2.11 While building a competitive supply curve may *in principle* provide an academic hypothesis on how a market *might* function, it is a far greater leap to conclude that this is the way a market *should* function if it is to function well. The CC has failed to explain why it has made this leap.

2.12 The choice of model is critical because it directly impacts the quantum of alleged overcharge. The CC's competitive supply curve approach will estimate a lower short-run price, and so a higher overcharge, than other standard 'competitive' oligopoly models (i.e. models where the alleged AEC was removed). Indeed, we explain below that the CC's modelled price would, in certain circumstances, be lower even than that implied by perfect competition.

2.13 Both Hanson and Lafarge made this point to the CC at the working paper stage (see, for example, paragraphs 68). The CC simply concedes:

"We agree that the benchmark we used for competition in this approach is not the only possible benchmark ... GB producers may have a degree of unilateral market power even in the absence of coordinated behaviour. If this were the case, the price that would prevail absent coordination may be higher than the price we estimate here. Therefore, in this respect, the competitive price that we estimate with the cost-based approach can be interpreted as a lower bound for the price that would prevail had we allowed for oligopolistic competition and kept other features of the model unchanged" (para 72).

- 2.14 Given the importance of this analysis to remedies, we consider this to be wholly unsatisfactory justification or engagement with the parties' material concerns.
- 2.15 Indeed, Hanson notes that the CC's model is very close to perfect competition. Indeed, it would be equivalent to perfect competition if the plants had homogenous cost functions and did not have semi-variable costs. A list of highly stylised (theoretical) assumptions that are common with perfect competition include:
- 2.15.1 Firms are price takers;
 - 2.15.2 There is perfect information;
 - 2.15.3 There is one market price and no price discrimination;
 - 2.15.4 It is a one-shot game, which means that capacity and price are determined simultaneously
- 2.16 Further, like perfect competition, the CC's model has no process of rivalry between firms (as would by contrast occur in standard oligopoly models such as Cournot). Firms simply accept the price and volume given to them¹²².
- 2.17 Therefore, the CC's model includes a number of attributes and assumptions that underpin the highly theoretical and idealized world of perfect competition. We accept it is not exactly perfect competition, but it is very close (and as discussed below is even harsher than perfect competition in some respects). This, however, immediately raises concerns about whether the CC's model should be the appropriate benchmark as the CC's own Market Investigation Guidelines say: *"the CC uses the term "a well-functioning market" in the sense, generally, of a market without the features causing the AEC, rather than to denote an idealized, perfectly competitive market"* (emphasis added, para 30). We note also the CC's statement in the PFs that: *"we do not think perfect competition is the appropriate benchmark against which to assess the effectiveness of competition in the GB cement markets"*¹²³.
- 2.18 Given the CC's model is so close to perfect competition (a model too idealized to be a relevant benchmark) there is an even greater responsibility on the CC to explain why its model is the 'best estimate' of a well-functioning cement market and why other standard oligopoly models are rejected.
- 2.19 Indeed, we note that what makes the model different to perfect competition is that plants have different cost structures and are assumed to enter (sink costs) but be content not to recover them, which also means plants have different levels of profitability. In perfect competition, firms are identical and allowed to earn "normal" profits (these normal profits mean that firms cover their total costs over the long run). By contrast, in the CC's model:
- 2.19.1 some plants are more efficient than others, so these plants are able to make a contribution to their capital costs and may even earn supernormal profits (once FCM had been achieved). The most efficient plants in the market may in fact make supernormal profits despite being price takers i.e. excess profits for that plant do not necessarily imply the plant has market power.
 - 2.19.2 some plants, by the CC's model design, do not make normal profits. This is a fundamental flaw in the CC's reasoning, as these plants would not participate in the market over the long term. The CC's model therefore asks firms to act irrationally.

¹²² For rivalry to exist firms must have a degree of excess capacity – which is costly – and means that firms do not just accept what the Walrasian auctioneer offers them but they rather go out and compete for business.

¹²³ PFs, Section 8, footnote 2.

The yardstick is not sustainable or achievable in the long run

2.20 In the CC's model, some firms will not achieve FCM. Therefore, investors would not enter (or re-invest in) this market, meaning this market would not function "well", or indeed at all, over the long-run.

2.21 The CC decision not to allow FCM is inconsistent with its stated approach in the profitability analysis. Indeed, it explains in the PFs:

"However, no commercial competitors would come into an industry if they did not expect to be able over the longer term to recover the decline in value of their assets [i.e. depreciation], as well as earn a normal profit (the opportunity cost of capital). They would measure their return on investment after recovery of funds sufficient to maintain the real value of the financial capital they had invested. Therefore when assessing whether capital invested at the beginning of the period has in fact been maintained by the end of the period, it is important that all changes in the value to the business of its fixed assets have been charged to the profit and loss account. This system of accounting is called financial capital maintenance (FCM)" (emphasis added).

2.22 Yet, by design in its competitive supply function model, the CC does not allow firms a *return of* (replacement of depreciated assets) and a *return on* (a return to investors in line with the cost of capital) capital:

"We also consider depreciation and cost of capital as being sunk [and so not taken into account] for the purpose of this analysis, since these costs would be incurred regardless of whether the plant were used for production or not" (emphasis added, para 27).

"We defined a plant's operating costs to include the plant's site fixed cost, the plant's variable cost and the cost of distributing the plant's output (i.e. distribution cost). The operating cost thus excludes divisional and central fixed costs, depreciation and cost of capital. The operating cost excludes costs which are avoidable only in the long term and are therefore considered sunk. The operating costs are thus the relevant costs in deciding whether to use a plant or not in the short term" (emphasis added, para 28).

2.23 By excluding these costs from the operating costs the plant considers, the marginal firm would not be guaranteed of achieving FCM (in the short or long term)¹²⁴. In the long-run it would exit. All mothballed plants would also not cover FCM – they would also exit in the long-run. And no firm would wish to enter if it did not expect to have a prospect of recovering these significant, industry-specific and long-lived investments. Indeed, as the CC itself noted above, no commercial competitors would come into the industry. The industry would not exist.

2.24 So the CC's model is not a long-run equilibrium model. It may be market-clearing in the very short-run, but the price delivered by the model will be 'too low' for firms to continue participating. So the short-run price is not a sustainable benchmark¹²⁵. To achieve a long-run equilibrium, prices need to be sufficiently high that firms can expect to cover all their costs – including sunk costs – over the long term. In the CC's model the price cannot be a long-run equilibrium price as the marginal plant does not have sufficient revenues to cover its average total costs - in 'equilibrium' it will exit, resulting

¹²⁴ Infra-marginal plants earn a margin between their operating costs and the market price but there is no guarantee this will cover their investment costs. As the operating costs of cement plants are similar, the supply curve proposed by the CC is likely to be relatively flat. This means that even the margin earned by infra-marginal plants – the difference between their operating cost and the market price – is likely to be slender.

¹²⁵ It would seem the only way that such a low price could be long-term sustainable is if the CC allowed there to be periods during which price would be higher than the competitive level to allow firms to compensate/cross-subsidise for losses during the bad times.

in prices rising (due to capacity shortfall). By definition, the price currently estimated by the CC's model understates the cost of supply and so overestimates the alleged detriment.

- 2.25 Hanson (and others) noted these concerns to the CC at the Working Paper stage. The CC's response on this critical concern is again wholly unsatisfactory – it states:

“With respect to Hanson’s comments, we note that in the benchmark we use, some firms (those with plants which are more efficient than the ‘marginal plant’) would earn a return on capital. However, we acknowledge that, because the benchmark we use is based on a relatively short-term model of competition, some of the less efficient plants may not be able to recover cost of capital in equilibrium. We note that our approach of calculating the customer detriment on the profitability approach allows firms to make a return on capital” (para 73).

- 2.26 The CC, therefore, concedes its benchmark for a well-functioning market, the type of market it is seeking to create through invasive remedies, is not sustainable. Its only response to this fundamental concern is to say its profitability analysis, conducted on a different (and clearly inconsistent) methodology, should provide Hanson with comfort on the reasonableness of its approach. This is unsatisfactory – if the CC's well-functioning market is flawed, it is flawed regardless of what the profitability analysis says. And, as we have noted above, the fundamental concerns raised with the profitability analysis itself makes this reliance unsatisfactory.

Using 2011 data only limits the analysis significantly

- 2.27 The CC only models one year of data. This creates several significant problems, each of which was pointed out to the CC at the Working Paper stage:

2.27.1 The CC uses only 2011 data. It gives two reasons for this: (i) 2011 was the most recent year for which the CC had detailed data; and (ii) *“In 2011, supply conditions appeared to be stable, and we also note that demand for cement stabilised in 2010 and 2011”*. The latter point is key – the CC avoids earlier years in the reference period (years for which it had the data) as being too unstable to model given the *“GB cement producers closing or mothballing cement production capacity in 2008 to 2010”*. The CC, therefore, dismisses from its analysis the real financial distress experienced by cement producers and the competitive actions they took to remove capacity during the recession. This creates bias – the CC is deliberately selecting data only to look at part of the story, namely that portion that more readily fits its model.

2.27.2 By using only one year (a single data point), and a year in which market dynamics were different from earlier years, the CC cannot extrapolate from its 2011 data into these earlier years that the alleged tacit coordination has caused any detriment to customers.

2.27.3 The 2011 figure does not have predictive value of alleged detriment that could arise in the future and so provides no justification for forward-looking remedies. For example, the CC notes that in Phase III of the EU ETS, starting 2013, a plant can lose carbon allowances if it is mothballed for a period (‘the partial cessation rule’). This would significantly change the incentives of plants at the margin of being mothballed and the ability of mothballed plants to switch on again if demand increased (as these may have lost access to necessary allowances).

2.27.4 It may be appropriate to select a stable year ahead of unstable years if during that year the plants operating could cover FCM. However, this is not the case in the CC's model. The plants must be able to price at least at Long

Run Avoidable Cost, not Short Run Marginal Cost, in a stable year. And as by implication and set out elsewhere they did worse in the recession, arguably 2011 should be an “excess price” year in which these losses are recovered. So ‘LRAC plus’ pricing would not be unreasonable to expect in 2011 in a well-functioning market (yet the CC’s model prevents this).

2.28 In response to these significant concerns, the CC notes only:

“We note that this [the cost-based approach] is one of two approaches to estimating the customer detriment, and that the profitability-based estimate of the customer detriment ... takes into account the whole of the period 2007 to 2012 and would therefore take account of the years with lower demand and actions to remove capacity by the cement producers” (para 17).

2.29 The CC makes no effort to engage with the concerns raised about the approach and instead again side-steps to rely on the profitability-based approach. This is unsatisfactory. The CC has failed to explain how its analysis of 2011 is either balanced or representative. This again calls into question the calculated detriment.

Carbon is relevant but still omitted

2.30 The CC is incorrect in not including the effects of carbon in its analysis; a point Hanson and others raised at the Working Paper stage.

2.31 Carbon credits create an opportunity cost for the plant – if it produces cement it will forego the revenues it could have earned from selling the unused carbon credit on the open market. Alternatively, it could be described as a tax on cement output. As with all opportunity costs in standard economic theory, these affect production decisions. Indeed, the explicit purpose of the Carbon credits regime in Europe is to create an incentive for CO₂ producers to reduce their production by making each extra unit of CO₂ production more costly. Indeed, the CC’s own independent expert, Professor Geoffrey Whittington, says in his expert report:

“The Government’s emissions trading scheme is basically an attempt to restrict emissions by pricing them through a traded permit system. It is designed to affect the ongoing costs (or revenues if emissions are lowered) of the business and there is no obvious reason why it should not be treated like any other cost or revenue item, i.e. it should be included in the profit and loss account”.

2.32 Yet the CC says in its cost-based approach:

“We do not think it is appropriate to include the costs of CO₂ as an opportunity cost because, once a cement plant is active and had incurred the fixed costs of producing cement, the relevant trade-off is between, on the one hand, producing cement and, on the other hand, selling the corresponding allowances. Since we assume price-taking behaviour and a constant variable cost, the producer faces a choice between either producing cement up to capacity or selling all its allowances” (para 62).

2.33 This thinking is flawed. To illustrate, consider the decision of the marginal plant about whether or not to commence producing cement as price rises to a level that just covers its unit operating costs (in Figure 1 this would be Plant C’s decision to operate as market price rises to C_c). At the moment that market price is at or minutely above unit operating costs, the CC’s thinking suggests that the plant will immediately turn on and produce at full capacity (or as much capacity as needed to fill demand). However, this decision would come at a cost – the plant would lose the revenues it was assured of getting from selling its unused carbon credits. The CC estimates that this revenue would have been around €13.50 per credit in 2011. If Plant C does not produce, it gets revenue of €13.50 per credit across its capacity with minimal trading costs. So it

makes a surplus. If it does produce, and prices at unit operating cost as hypothesised by the CC, it makes no surplus as revenue and cost are identical. So it would either not produce, and with a vertical demand curve there would be unsatisfied demand, or it would charge a price that reflects the opportunity cost of foregone credit sales.

- 2.34 Therefore, we believe that the presence of carbon does in fact influence the marginal firm's decision about whether or not to produce. As such, the market price could rise well above C_c before Plant C would decide to switch on. This logic would apply to each plant in the stack, which is why Hanson has consistently argued to the CC that the opportunity cost of carbon is a production cost, should be included in variable costs and impacts production decisions (both in reality and in the CC's hypothetical well-functioning market).
- 2.35 Indeed, the only logical extension of the CC's thinking in excluding carbon is that the carbon regime would have had no impact (and so been entirely unnecessary) on the function or performance of a well-functioning market in cement. This is at odds with reality and Government policy.
- 2.36 It is an opportunity cost irrespective of whether or not the cement manufacturers have been gifted credits. If Hanson had to buy credits it would be clear that there was an increase in marginal cost. But this applies equally where the cement producer has been given credits, as now making emissions prevents the opportunity to trade. The fact they have been given them means that the €13.50 extra comes to the cement firms rather than the EU or whoever they would have purchased credits from. So carbon credit costs would always be in the MC and hence affect production and price. There has been a transfer to the companies. This does not create excess profits because the gifted credits are an asset of equivalent value for ROCE purposes (see further below).
- 2.37 The CC's decision to not include carbon in variable costs has undermined the CC's analysis throughout the MIR – for example, the CC relies heavily on its cement variable profit margins analysis as evidence for tacit coordination, where Hanson has consistently argued that this measures margin incorrectly by excluding carbon entirely. This calls into question a fundamental piece of evidence relied upon by the CC in establishing its cement AEC in the first place.
- 2.38 The CC's position on carbon in the cost-based approach, in particular, appears at odds with its now revised treatment of carbon in the profitability-based approach, where it includes carbon revenues on the basis of Professor Whittington's comments. This again creates fundamental inconsistency between the CC's approaches.

Summary

- 2.39 In a well-functioning market, with firms of different levels of efficiency, a producer surplus can be made. Supernormal profits, therefore, are not immediately evidence of market malfunction or customer detriment.
- 2.40 The CC's representation of a well-functioning market, however, is conceptually flawed and unsubstantiated. Its construction has the effect of maximising overcharge.
- 2.41 Hanson struggles to believe that the CC wishes to set a standard for a 'well-functioning' market that in effect asks businesses to act irrationally and would ultimately result in the market disappearing entirely. If this is the benchmark for the cement industry that the CC has had in its mind throughout this investigation, then the CC must re-evaluate all evidence it has to this point considered incompatible with a well-functioning market¹²⁶. As the benchmark the CC was apparently applying is now

¹²⁶ The CC's Market Investigation Guidelines make clear the need to identify a relevant benchmark: "*In identifying some features or combination of features of the market that may give rise to an AEC, the CC has to find a benchmark against which to determine how the market may be judged to be performing*" (emphasis added, para 320).

shown to have been unreasonable and poorly specified, the CC's previous conclusions, since they were formulated on such a basis, are unsafe.

- 2.42 The conceptual failings highlight that despite the fact that we are now at the final stage of the two year MIR, the CC still has no sound view on what a 'well-functioning' market in cement would be.
- 2.43 The fact that the CC is willing to go to such lengths to produce an abstract model to justify (and indeed overstate) its position is evidence moreover of the approach taken by the CC in this MIR. This would seem to be to justify a conclusion of coordination and detriment 'at all costs' irrespective of an objective assessment.

3. THE CC'S PROFITABILITY-BASED APPROACH

- 3.1 The CC has substantially re-engineered its profitability analysis between the PFs and the PDR. This was due to unreasonable or contentious errors and assumptions in the CC's approach at the time of PFs; in particular, in relation to the treatment of impairments and the shape of the depreciation profile. In fact, had the CC corrected its treatment on these two variables alone at the PFs stage, there would have been no evidence of excess profits at the PFs stage. This would have undermined both the CC's case on tacit coordination and its finding on detriment at the PFs stage (which was based only on its profitability figures). Therefore, one of the reasons that the CC continues to pursue its theory of harm is because of its own unjustified approach at the PFs stage.
- 3.2 Given the importance of this analysis, it is remarkable that the CC has changed its approach so substantially so many times. As early as the Updated Issues Statement, and before any substantive analysis had been undertaken, the CC declared excess profits in the cement industry. It did so only on the basis of the Historical Cost Accounting (HCA) approach that was inappropriate and from which the CC has since walked away. However, since publicising its finding of excess profits, the CC has had to work to confirm its published view, with each iteration of its profitability work seeking to find a new way to confirm its earlier conclusions.
- 3.3 Indeed, it only commissioned an independent expert, Professor Geoffrey Whittington, to assess its approach after the PFs¹²⁷. When Professor Whittington identified incorrect or "contentious" assumptions in the CC's approach the CC substantially revised its approach without any consultation with the parties.
- 3.4 Further, we consider it surprising that a competent authority would, after publishing its PFs in which it expressed its opinion on the differential between ROCE and WACC and on the function of the market seek to ask questions in the expert's Terms of Reference¹²⁸ such as:

[REDACTED]

This already acknowledged the difference was "*small*" and difficult to interpret. We note the differential is now much smaller: at the time of the PFs it was 3.3 percentage points on the CC's preferred basis, it is now only 2.4 percentage points. Professor Whittington does not answer this question directly in his published report.

[REDACTED] *driving the overall results of the profitability analysis? ... the other cement producers, Cemex and Hanson, either do not earn their cost of capital or not consistently so".*

¹²⁷ The Terms of Reference for Professor Whittington is dated 1 July 2013, which is after the publication of the PFs.

¹²⁸ Professor Whittington, Terms of Reference, 1 July 2013.

The CC had already expressed its view on this in the PFs – saying there was tacit coordination with Lafarge in the leader role – yet this question reflects the lack of confidence in that conclusion.

- 3.5 It is unreasonable that so late in the investigation (after the CC has published PFs and proposed invasive remedies) that the centre-piece of the CC’s case against the cement Majors remains in such a state of flux. That flux is demonstrated by how much the levels and rankings of the profitability of individual firms’ has changed between the PFs and the PDRs and how the CC has fundamentally changed its approach to certain components (e.g. carbon credits). As a simple illustration – Table 1 shows the ranking of the Majors by level of profitability, on the CC’s preferred approach, at the PFs stage and then at the PDR stage. Every single player changes ranking, and in some cases by a very material amount e.g. Hanson moves from making significantly below cost of capital to suddenly making excessive returns.

Table 1: CC’s ranking based on its preferred measure of profitability at the relevant stage

[✂]

Notes:

* No precise ROCE figures, other than those of Hanson, are shown due to confidentiality of the data. Further analysis is included in the **Confidential Appendix**.

- 3.6 These substantial changes cast doubt on the CC’s entire approach, earlier findings, and the rights of the parties to understand the case against them.
- 3.7 This section shows that even if the CC’s current approach in the PDR to profitability were correct (which it is not), there would be insufficient evidence to conclude that significant detriment had occurred and that invasive remedies were proportionate.

The CC’s modelled results at PDR stage

- 3.8 Appendix 1 of the PDR sets out the CC’s revised profitability calculations. We summarise these briefly here.
- 3.9 The CC calculates ROCE and compares this against the cost of capital (“WACC”).
- 3.10 In the PFs, the CC suggested a representative WACC may lie in the range between 8.2% and 11.5%. The CC chooses to use 10% as the benchmark, which is around the midpoint of its range. It is noteworthy that, in fact, most of the WACCs provided to the CC by the Majors fall in the range 9.5% to 11.5%.
- 3.11 In calculating returns, the CC makes six very significant departures from its approach in the PFs¹²⁹:
- i) The CC moves away from profitability on a ‘continuing costs of supply’ basis (which excluded carbon revenues and impairments), what the CC described as its best estimate of profitability at the PFs stage¹³⁰, to what it now calls ‘the comprehensive income’ approach.
 - ii) The CC includes revenues from carbon permits in its calculation of profits, having previously ruled these out of the continuing costs of supply at PFs. This step inflates ROCE.

¹²⁹ The CC had already revised its profitability analysis following the PFs when it discovered an error in its treatment of one of the parties’ carbon revenues. The CC later revised its original estimate of total detriment of £180 million for the five years to only £106million. This meant that the published detriment at the PFs stage was overstated by around 70%. This error alone casts significant doubt over the robustness of the CC’s analysis.

¹³⁰ PFs, paragraph 7.138: “*profits measured on a continuing cost of supply basis is] the best measure of profitability for our purposes as it governs how prices would be set in a competitive market*”.

- iii) The CC drops the reducing-balance depreciation curve it used in the PFs, as the pattern and rate of this curve was regarded by the CC's own adviser as "contentious"¹³¹, in favour of the more standard straight-line depreciation profile.
- iv) The CC changes the way in which it calculates impairments. From its approach to modelling impairments in PFs, it now records impairments only when plants were permanently retired during a year and/or where firms have impaired the assets in their own financial statements. This leads to a dramatic reduction in the impairment losses of the Majors over the period – inflating ROCE.
- v) The CC corrects the error it made in the treatment of impairments at the PFs stage (where it compared profits before impairments against capital employed after impairments) to ensure consistency between the presentation of profits and capital employed – either both taken before impairments or both taken after impairments. Had this error been corrected at the PFs stage there would have been no further case to answer on excess profits or detriment for the parties.
- vi) The CC increases its estimate of the modern equivalent asset value for a cement plant from £170 million in 2007 to around £192 million.

3.12 The CC calculates the ROCE for the four Majors – Lafarge, Hanson, Cemex and Tarmac – over the period 2006 to 2012. Table 2 below sets out the CC's estimate for ROCE before and after impairment under the two scenarios shown by the CC; although to be clear the "after impairment" value is the meaningful measure. The differential between ROCE and WACC has, therefore, narrowed significantly to just 2.4 percentage points. We present more detailed tables for individual firms, based on information in the data room, in the **Confidential Appendix**. The CC also presents a scenario in the PDR's where it calculates impairments on the same basis as it did in the PFs (but this time, correctly, includes them in both the numerator and denominator of the ROCE). This scenario shows industry average ROCE (after impairments) to be below the WACC midpoint.

Table 2: ROCE for GB cement producers based on CCA basis (modified approach)

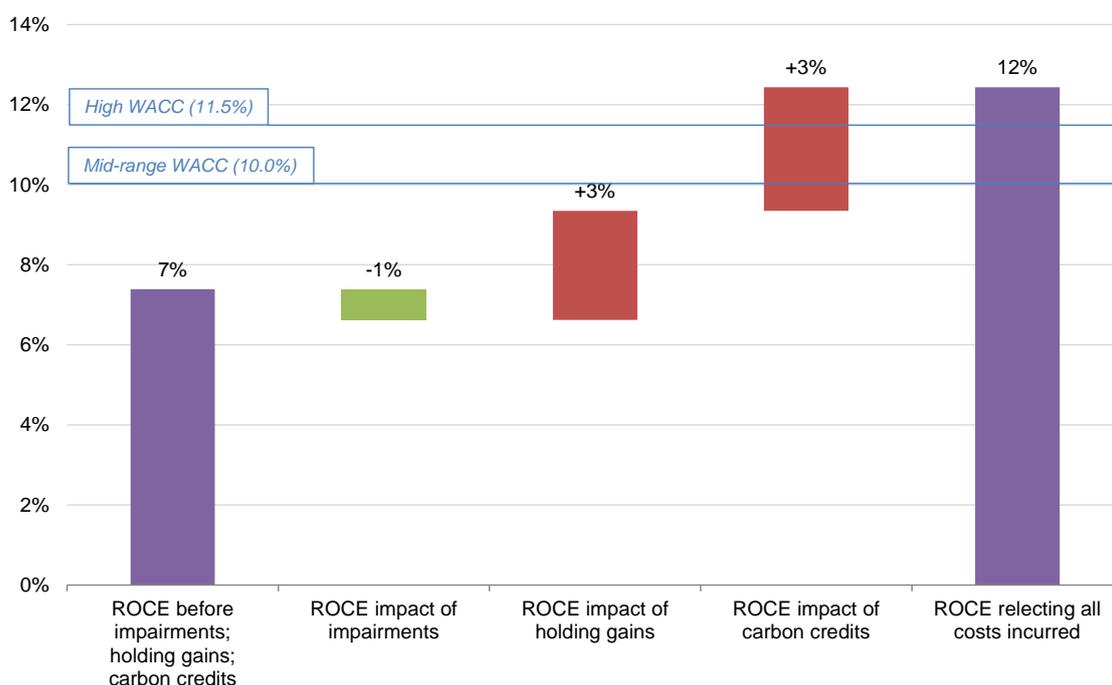
	2007	2008	2009	2010	2011	2012	Avg.
Before impact of impairment	11.9%	12.5%	11.0%	13.1%	15.6%	13.0%	12.8%
After impact of impairment	11.9%	6.7%	11.7%	14.0%	16.7%	14.0%	12.4%

Source: CC

¹³¹ Report by Professor Whittington: "The cost is then depreciated using 3.5% annual reducing balance depreciation: again, both pattern and rate are contentious".

3.13 Figure 2 presents a breakdown of the key drivers of the average industry ROCE based on the CC's modified CCA approach.

Figure 2: Key drivers of ROCE based on CCA basis (modified approach)



Source: Hanson analysis

3.14 Some key implications of the CC's analysis are as follows:

- i) The CC's best estimate of profitability is now an average ROCE of 12.8% before impairment and 12.4% after impairment. The CC uses the latter in its calculation of detriment. We note that this differential between ROCE and WACC is unprecedentedly narrow for declaring excess profitability, although the CC argues that its findings are underestimated due to the recession. Further, the differential is narrowed *to less than a percentage point* if a WACC at the top of the range is considered (i.e. 11.5%). A WACC at the top of the range cannot be ruled out as being unreasonable, given (i) the uncertainties inherent in WACC estimation and (ii) that the CC is an ex-post competition authority determining whether an outcome is compatible with a competitive market, as opposed to a sector regulator picking a best estimate ex ante from a plausible range (where a more specific WACC estimate may be appropriate).
- ii) Over 3 percentage points of the 12.4% relate to revenues from carbon credits. Had these profits been excluded, as was previously the CC's approach in PFs, there would be no excess profits or customer detriment. The CC's finding, therefore, now relies on its revised treatment of carbon. And, as carbon revenues are not expected to persist in future, indicates that remedies may have unintended consequences in a market with low profitability.
- iii) In its alternative scenario (see Figure 3 below), when the CC calculates impairments on the same basis as PFs (and uses straight-line depreciation over 50 years), the ROCE after impairments is below cost of capital at 8.9% (and before impairments would have been 11%). Therefore, under this alternative scenario, consistent with the CC's approach at PFs, there is no detriment. If carbon credits are excluded from this calculation, the average ROCE falls to 6%, which is below even the low end of the CC's WACC range (8.2%).

- iv) Impairments in the CC's modified approach account for only £14 million per annum on average where they would have been £50 million per annum under the CC's approach in the PFs.
- v) Tarmac, on the CC's analysis the only Major not involved in the tacit coordination, is actually making the highest profits of the four Majors in the PDR approach. This is itself counterintuitive and calls into question the CC's thinking on tacit coordination, or profitability, or both.
- vi) Under the profitability-based approach, the CC estimates annual consumer detriment of £30 million. Had the CC used the upper-end of its WACC range (11.5%) then detriment falls to only £11 million per annum on average (a 63% reduction in estimated detriment).

Figure 3: Key drivers of ROCE based on CCA basis (PFs approach with SL depreciation)



Source: Hanson analysis. ROCEs rounded to nearest percentage point.

3.15 The CC's results, and so finding of detriment, depend critically on:

- i) Is the CC justified in relying on such a small differential between ROCE and WACC as evidence of excess profits and detriment?
- ii) Is the CC justified in relying on only six years of data?
- iii) Is the CC justified in its revised treatment of carbon profits?
- iv) Is the CC justified in its revised calculation of impairments?
- v) Is the CC justified in using the mid-point of the WACC range rather than the upper bound?
- vi) Is the CC justified in relying on Tarmac's excess profits to pull up the average ROCE?
- vii) Is the CC justified in arguing that the recession has led to an underestimate of profitability?

3.16 Were the CC incorrect on any of the above questions, its evidence of excess profits and customer detriment is thrown into doubt. This would make it highly uncertain that invasive remedies are required or proportionate.

3.17 In fact, Hanson believes that the CC cannot sustain its position on any of the above issues, and certainly not all, making the CC's position unsafe and unreasonable. We take each question in turn.

Is the CC justified in relying on such a small differential between ROCE and WACC as evidence of excess profits and detriment?

3.18 The CC concludes there is excessive profitability based on a differential between the average industry ROCE and the midpoint of the WACC range of approximately 2.4 percentage points (the gap is less than a percentage point if the top end of the CC's WACC range is used). This is an extremely narrow gap, especially when the sensitivity of the figures is considered. Hanson notes that previous market investigations have identified larger differentials, in equally concentrated markets, and yet concluded that profitability was in no way excessive.

3.19 The CC's final report into the Supply of Groceries in Great Britain, for example, found that the multiple grocery retailers had "*received average returns over the period 1993 to 1999 of 4.0 percentage points above their cost of capital*"¹³² yet concluded "*that the overall profitability of the multiple grocery retail industry cannot be considered excessive now, or to have been excessive since 1996*"¹³³.

3.20 The CC's own instructions to its independent expert reflect this doubt in that the CC asks (when at the PFs stage the differential was 3.3 percentage points): "*What should we [the CC] make of the "small" difference ... ?*"

3.21 The CC has also shown through its well-functioning market model that supernormal profits ("producer surplus") for some firms may not be incompatible with a well-functioning, competitive market. Therefore, the CC cannot simply assume that every firm in the market would earn exactly in line with normal returns and there is detriment if this is not the case. There is clear evidence that some cement plants are more efficient than others; therefore, some level of supernormal profits cannot be ruled out at a competitive market price. Further, the CC acknowledged in the cost-based approach a benchmark for the market without the AEC (of tacit coordination) could also have been oligopolistic models. These models would also predict some degree of supernormal return for cement plants.

3.22 Therefore, it seems very unlikely that at such a narrow differential the CC can, on a balance of probabilities, distinguish excessive profits (detriment) from the performance of a well-functioning market. Even if it could, it would be incorrect to label the entire differential as customer detriment as the CC has done. This is particularly the case where the results are so finely-tuned to the CC's assumptions, meaning small changes could erode the differential further.

¹³² "*Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom*", Competition CC, 2000, paragraph 2.152. Profitability in the supermarkets market investigation was measured using IRR rather than ROCE, but both measures are comparable to the cost of capital.

¹³³ *Ibid*, paragraph 2.154.

3.23 In fact, Hanson believes that the long-lived nature of cement assets and their significant investment costs further suggest that a market would not function if investors could expect only ever to earn normal profits. Investors are taking a significant risk at the point of investment as it is not possible to forecast the likely ups and downs of the business cycle over the asset's life, the changes in production technology, or the changes in competitive tension in the market (new entry and exit etc.). The CC actually acknowledges these challenges in explaining why it has itself not undertaken asset-specific valuations for each cement plant:

"It is not feasible for us to undertake asset-specific valuations for each of the ten GB cement plants at each balance sheet data to perform this analysis. This would be a significant challenge even for the firms themselves to undertake. For the same reason that it is not feasible to undertake asset-specific valuations, it is also not feasible to develop asset-specific depreciation profiles which involve forecasting, among other things, the impact of future new technology and the impact of changes in the future relative prices of inputs in the cement production process, on the evolution of the decline in value of long-lived assets to the business" (para 14).

3.24 The CC's expectation to observe normal returns and no more, therefore, appears unrealistic and unworkable. Were investors only ever to expect to earn normal returns and no more, yet face significant uncertainty *ex ante* on the likely success of their significant investment, then it would seem highly unlikely they would sink the capital in the first place. The CC's benchmark, therefore, allowing no margin for error, would seem at odds with creating a functioning market in the first place.

3.25 The CC has also made no allowance for 'survivorship bias'. Recent experience shows that some assets can and do exit before the end of their useful lives. It seems reasonable to assume that such plants would earn less than normal profits in a competitive market. For the industry to be sustainable, overall the population of plants must earn normal profits. Therefore, sampling only surviving plants as the CC does may be expected to give supernormal profits, all else equal.

3.26 We note three further issues that may suggest the CC overstates the differential in its estimate:

3.26.1 At the PFs stage, where the CC had found a differential of 3.3 percentage points, it did caveat in the footnotes that:

*"This calculation of the five-year average ROCE does not allow for general inflation between 2007 and 2011. Allowing for this factor would reduce overall ROCE by approximately 0.7 percentage points, a reduction of 0.3 percentage points in continuing profits, an increase of impairment losses of 0.5 percentage points, and an increase in carbon credits of 0.1 percentage points. There is a trade-off here between transparency of calculation and technical accuracy of approach"*¹³⁴.

The CC makes no comment about how it has resolved this in its revised approach, and so presumably some reduction continues to apply.

3.26.2 In the PDR profitability analysis the CC adopt a revised inflation assumption of 3%, compared to the 2.5% used at the PFs stage. However, no associated adjustment is made to the CC's nominal WACC estimate i.e. it continues to rely on the mid-point estimate of 10% used at the PFs stage. If a nominal WACC of 10% was assumed to be appropriate at a 2.5% rate of inflation, then it follows that a WACC of 10.5% is consistent with a 3% rate of inflation. Similarly, the high-end WACC estimate of 11.5% should now increase to 12%. This inconsistency is also important as the inflation

¹³⁴ PFs, Appendix 7.7 footnote 3, page A7(7)-3.

assumption drives the “holding gain” income under the CC’s approach – see Figure 2.

- 3.26.3 The CC did not capitalise leases, which would reduce ROCE, despite Hanson’s arguments that this was the appropriate treatment from an economic perspective. The CC’s expert, however, notes to the CC: *“For future reference, it is worth noting that the IASB currently has an exposure draft that proposes that all leases be reported on the same basis, capitalising all measurable rights and obligations, as in the current finance lease model”*. Capitalising leases would again lower the differential.

Is the CC justified in relying on only six years of data?

- 3.27 The CC’s period of analysis covers only six years. This is very short when taking into account the long lived nature of cement plants and the extra-ordinary market volatility that took place during this period.
- 3.28 The CC recognises that cement plants can have lives of 50 years or more. Therefore, the six year reference period covers, at most, performance over only 12% of a plant’s life. Anticipating that over the course of an asset’s life there will be periods of above normal returns and periods of below normal returns, means that it is very difficult to say definitively, based on at best a 12% window, that invasive permanent structural remedies are required.
- 3.29 Hanson notes that the Market Investigations Guidelines recommend that the period over which profitability is assessed should consider the unique circumstances of the industry in question. In particular, the Guidelines state that *“[w]here investment is characterized by large one-off expenditure...it may be desirable to consider profitability over a relatively long period of time”*¹³⁵. At the profitability working paper stage the CC acknowledged the size and lumpiness of investment:

*“The analysis has highlighted the fact that in order to compete successfully in this market, a very large lumpy investment, currently of the order of £200 million, is required in an asset with a potentially very long asset life which is ideally operated at full capacity”*¹³⁶.

- 3.30 Furthermore, the actual reference period chosen by the CC covered a time of extraordinary economic volatility, which is not representative of normal trading conditions in the GB cement industry. The CC has recognised this in the PFs:

*“We therefore consider that the period of review (FY07 to FY11) has not been fully representative of either the competitive conditions which had been sustained prior to the downturn in 2007 or the competitive conditions in this mature market which may exist under more stable demand conditions.”*¹³⁷

- 3.31 Indeed, the CC accepts in Appendix 1 of the PDR that its time period is not ideal:

“In circumstances like these it would be more ideal to assess profitability over a much longer period of time than we have been able to ... one which at a minimum covered a whole business cycle, so a relatively longer period of results could be reviewed” (emphasis added, para 24).

- 3.32 Given these significant doubts accepted by the CC that the period is less than ideal and *“not ... fully representative of either competitive conditions ... prior to the downturn ... or competitive conditions in this mature market which may exist under more stable demand conditions,”* it is remarkable that the CC would base its case for the proportionality of remedies on this analysis.

¹³⁵ The Guidelines, Annex A, paragraph 10.

¹³⁶ CCA Profitability Working Paper, paragraph 14.

¹³⁷ PFs, Appendix 4.1, paragraph 4.1.

Is the CC justified in its revised treatment of carbon profits?

- 3.33 The CC's finding of excess profitability and detriment depends critically on it including the revenue earned by the Majors during the recession from selling unused carbon permits. If these revenues are excluded, then the average industry ROCE falls to under 9%, below even the mid-point WACC.
- 3.34 The CC has changed its position fundamentally since the PFs where the calculation of profitability on a continuing cost of supply excluded carbon revenue. At the PFs stage, the CC excluded carbon revenue explaining:

*"We ... distinguish between returns established on the continuing costs of supply and those elements of return during the period which are unexpected or temporary in nature."*¹³⁸

*"There are two sets of costs and/or income in the time period of review which fall into the 'temporary' and 'unexpected' categories, namely income from the sale of carbon allowances and impairment losses arising from the emergence of permanent spare capacity following the demand slump."*¹³⁹

*"The sale of carbon allowance has proved a non-trivial source of income for all the GB cement producers: the scale back in production following the demand shock has allowed them to sell unused carbon allowances allocated for free to them by the EU based on historical production levels...These revenues are unlikely to persist to the same extent in future as the EU tightens the carbon emissions scheme."*¹⁴⁰

*"[W]e agree with Hanson that this [carbon] income is unlikely to be reflective of forward-looking profitability (in our terminology profitability based on continuing costs), at least not nearly to the extent that would be suggested by its prevalence during the period 2007 to 2011."*¹⁴¹ (emphasis added)

- 3.35 The CC has reversed its position on carbon revenues, apparently based on two paragraphs of advice from Professor Whittington:

"Emissions Permits

The Government's (sic¹⁴²) emissions trading scheme is basically an attempt to restrict emissions by pricing them through a traded permit system. It is designed to affect the ongoing costs (or revenues if emissions are lowered) of the business and there is no obvious reason why it should not be treated like any other cost or revenue item, i.e. it should be included in the profit and loss account.

The scheme might be regarded as an extraordinary windfall item if it was unexpected at the beginning of 2007 and not expected to continue in the future, so that it was not a continuing cost of supply. However, I do not believe that either of these conditions holds".

- 3.36 First, we note that Professor Whittington's report specifically says that "*the author is not qualified to comment*" on "*the details of the cement industry*". The functioning and implications of the EU ETS together with the expectations of cement producers in 2007 would, in our view, be details on which Professor Whittington has himself accepted he is not best placed to comment. Therefore, it is surprising that the CC

¹³⁸ PFs, Appendix 7.7, paragraph 10.

¹³⁹ Ibid, paragraph 164.

¹⁴⁰ Ibid, paragraph 14.

¹⁴¹ Ibid, paragraph 166.

¹⁴² The Emissions Trading System is administered by the European Union, not the domestic UK government.

appears to have relied on his advice entirely – it is reproduced almost word for word in Table 1 of Appendix 1 – to replace the CC's previous approach.

- 3.37 That said, Hanson agrees with Professor Whittington that the intention of the carbon allowances programme was to encourage CO₂ producers to restrict emission production by introducing an additional variable unit cost of production. The scheme created a tax on producing cement. It was intended to affect production decisions – and this is what it has done.
- 3.38 Producing a tonne of cement would cost the cement producer the permit that is used up. This permit had value to the owner either because the producer had to buy it on the market or, if the producer had been gifted an allowance of permits, because the producer lost the opportunity to sell that permit to someone else (at the market price for permits). Clearly, in the case where the producer had to go to the market and buy a permit, there would be a direct and very visible new input cost of production. It would appear directly in the variable costs of producing cement (like the cost of a megawatt of electricity). As the cost of buying the permit would increase variable costs, it would impact production decisions. Variable costs rise, output falls, and in a fully competitive market, the end price to consumers would rise by the price paid for permit (there would be full pass through of the additional marginal cost).
- 3.39 However, even in the case where the permit was gifted to the cement producer (i.e. the producer did not have to buy it on the market), the permit would immediately affect the producer's production decision in the same way as a real variable cost (as the permit has tangible value in that it can be sold at the market price for permits). In the same way as a real variable cost, the 'opportunity cost' created would affect production decisions – and output would fall and end-prices would rise.
- 3.40 It is remarkable, therefore, that the CC did not include carbon in its variable margins analysis (and still has not done so), the outcome of which was one of the three pieces of evidence relied upon by the CC in its finding of tacit coordination. As we noted above, the CC also fails to consider the effects of carbon on the construction and performance of its well-functioning market (in the cost-based approach) – in effect suggesting it would have no impact.
- 3.41 The key issue is that, under the CC's current treatment of carbon permits – which is to include the revenues/profits from permits in EBIT but not to recognise a matching asset in the capital employed – **a ROCE in excess of WACC is actually entirely consistent with a fully competitive market if the allowance of permits was gifted to cement producers.**
- 3.42 This can be illustrated with a simple comparison between a scenario where cement producers have to buy permits from the market and the scenario where an allowance of permits is gifted to the cement producers. In both cases assume that there is perfect competition in cement:
- 3.42.1 Scenario 1: In the absence of a gift of an allowance of permits, cement producers need to purchase permits to produce cement. Marginal costs of cement production clearly rise by the amount of the trading price of the permits. With higher marginal costs, output falls below the level that would occur absent the emissions regime. In a fully competitive market, the price to end consumers would rise by the full amount of the permit's costs AND profits would continue to be normal (i.e. at a level at which ROCE = WACC).
- 3.42.2 Scenario 2: If an allowance of permits is gifted to the cement producers, rather than there being an actual cost of buying permits there is an equal (opportunity) cost of 'not selling' the permits that is incurred when cement is produced. When a rational cement manufacturer decides on its production decision, it takes into account that every unit of cement produced carries an opportunity cost of the equivalent carbon permit not sold. This is as much a

marginal cost of production as electricity costs. In both scenarios, producers' output, cement sales revenue, and physical (i.e. non-carbon) production costs will be exactly the same. The only differences between the situation in which carbon permits are gifted (Scenario 2) and that where they are not is:

- (a) In Scenario 1, there will be an extra cost per tonne of cement of paying for carbon permits, so the supply curve shifts up because of a cost actually incurred;
- (b) In Scenario 2, there is no such direct cost, but there may be a revenue stream associated with the sale of any unused permits (if any).

- 3.43 While the same production decisions will be made in both situations, the actual level of EBIT generated will be higher in the situation in which cement producers are gifted the allowance of permits (Scenario 2). The difference in EBIT between Scenario 2 and Scenario 1 will be the sum of: Revenue from sales of any unused permits + Costs not incurred in purchasing the permits used in producing cement. This is equivalent to: Number of gifted permits * Price of permits.
- 3.44 In a fully competitive market with carbon allowances, EBIT will thus be higher thanks to the gifting of permits – compared either with the position before trading was introduced or the position if allowances were not gifted (i.e. had to be bought on the market).
- 3.45 If gifted the allowances are correctly recognised as an asset of the business (and included in the capital employed), ROCE will be unaffected and ROCE would still equal WACC in the market. However, if no asset is recognised (which is consistent with the CC's current approach), the observed ROCE will be higher due to the presence of reduced costs and/or incremental revenue from the gifted permits. And, in this case, ROCE would be expected to be above WACC even in a fully competitive market. Therefore, in this case, ROCE above WACC could not be deemed inconsistent with competition.
- 3.46 Therefore, if the CC wants to use the benchmark that ROCE must equal WACC in a competitive market the CC must either:
- 3.46.1 Recognise that a gifted allowance of carbon permits is an asset in the capital employed. In simple terms, receiving a gift of allowances is of value to the cement producer – using the concept of deprival value of assets it is clear that were Hanson deprived of its allowances it would lose value. Recognising this asset would reduce the CC's calculated ROCE – and there would no longer be excess profits in cement; or,
 - 3.46.2 Deduct from revenues each year the sum of the number of gifted permits times the average price of those permits. This would again reduce the ROCE of cement producers to a point where no excess returns are made.
- 3.47 Finally, we note that going forward, if the CC persists with its current methodology, the measured ROCE will reduce as free allowances of carbon permits are phased out. The CC accepts that these revenues are “*unlikely to be reflective of forward-looking profitability*”. As such, the period over which profitability is measured will not be representative of profitability going forward.
- 3.48 In summary, if the CC persists with including carbon revenues (but not including an asset in the capital employed from the gifted allowances), then it must expect ROCE to be above WACC even under competition – invalidating its findings on detriment and in fact tacit coordination. Further, irrespective of the treatment of carbon revenues, the CC must expect that the current profitability of the industry will decline in future when cement producers have to buy permits to produce i.e. returns are transitory.

Therefore, this lower industry profitability in future suggests that invasive remedies are unnecessary and disproportionate.

Is the CC justified in its revised calculation of impairments?

- 3.49 The CC adopts a completely different approach to calculating impairments in the PDR than that used in the PFs. The change in approach has a material impact on the magnitude that impairments have on the average industry ROCE – in the PFs, impairments reduced the average industry ROCE by 4 percentage points; under the revised PDR approach, the equivalent figure is only 1 percentage point.
- 3.50 The CC itself recognises the “*extreme subjectivity of the recognition and measurement of impairment(s)*”. However, rather than considering alternative approaches to determining impairments, in the revised PDR approach the CC focusses only on the scenario of the very prudent impairments recognised in company financial statements. This choice is on the extremely prudent end of the spectrum. In effect, the CC has discounted alternative approaches to impairment calculation including the approach it stood behind at the point of the PFs.
- 3.51 This is despite the fact that the PDR shows that under the CC’s original approach to impairments in the PFs, and using straight-line depreciation and a 50-year asset life, the average industry ROCE after impairments falls to under 9%. This is below even the CC’s mid-point WACC estimate. The CC shows this sensitivity in its PDR but does not acknowledge further the fact that this sensitivity casts significant doubt on the CC’s conclusions of excess profits.
- 3.52 As the CC acknowledges, there is ‘extreme subjectivity’ in the recognition of impairments. However, it has chosen to select a point on the spectrum of approaches that supports its conclusions, where it chooses to rule out an approach it stood behind at the PFs stage which would fully remove the detriment.
- 3.53 Given (i) the small margins between the ROCE and WACC estimates and (ii) the recognised measurement difficulties for impairments, the CC is not justified in the reliance it places on its revised calculation of impairments.

Is the CC justified in using the mid-point of the WACC range rather than the upper bound?

- 3.54 As explained above, the CC found a range for WACC between 8.2% and 11.5%. The CC chooses to use the midpoint at 10% as the benchmark. We note that this is inconsistent with the approach used by the CC in the Private Healthcare investigation taking place in parallel to this market investigation. In Private Healthcare, the CC has calculated detriment using the upper bound of its WACC range.
- 3.55 Given that over half of the differential between 12.4% and 10% would be removed by moving to the 11.5% level (resulting in a differential of under 1 percentage point), we consider that the CC requires far stronger justification why the choice of the midpoint is superior to the approach applied in a parallel investigation. A WACC at the top of the range cannot be ruled out as being unreasonable, given (i) the uncertainties inherent in WACC estimation and (ii) that the CC is an ex-post competition authority determining whether an outcome is compatible with a competitive market, as opposed to a sector regulator picking a best estimate ex ante from a plausible range (where a more specific WACC estimate may be appropriate).
- 3.56 Please also see paragraph 3.26.2 above for further explanation why the CC should revise upwards its WACC measure.

Is the CC justified in relying on [X] excess profits to pull up the average ROCE?

As noted, a counterintuitive result is that [X] is now the highest profitability cement producer [X]. Therefore, by looking at the profitability across all 4 Majors, the CC's theory of harm is benefitting from [X] dragging upwards the industry profitability and detriment. Indeed, in the **Confidential Appendix**, it is shown that [X] is contributing over a quarter of the detriment found by the CC. It is unfair for the CC to target remedies at the alleged coordinating group on the basis of detriment calculations that include the effect of [X]

Is the CC justified in arguing that the recession has led to an underestimate of profitability?

- 3.57 The CC makes much of the fact that it believes the recession has resulted in an underestimate of profitability. This speculation is, however, unfair.
- 3.58 First, it gives the CC room to assert profitability will be higher going forward (without even quantifying how much higher), despite the actual analysis showing profitability has been low and the further evidence that profits will decrease going forward as carbon allowances tighten. This creates significant risk of confirmation bias.
- 3.59 Second, the CC fails to recognise that if cement production were to increase:
- 3.59.1 The contribution to profits of unused carbon permits would fall in parallel. Given that 3 percentage points of the ROCE currently is accounted for by these carbon permits, cement production would need to increase significantly before the net gain in overall profits would exceed current profit levels; and,
- 3.59.2 The CC's own well-functioning market analysis shows that if market demand increases (even only by a small percentage), all domestic plants could be at full capacity with the import price becoming the market-clearing level. Therefore, there are natural limits on profits applied both by (a) on outputs the capacity constraints cement producers already face, and (b) on pricing, the competitive constraint from importers prices.
- 3.60 Third, signs of growth in the UK economy are still relatively weak and uncertain. It is highly speculative to assume that the cement market will return to its pre-crisis levels of production in the near term.
- 3.61 When one bears in mind the limits on price and output in the industry, the uncertainty of the economy, and the expected reduction in revenues from carbon permits (and carbon permits in fact becoming a direct cost to producers), Hanson does not believe the CC is in a position to claim that forward-looking profitability will be much higher than levels experienced over the past six years.

CONFIDENTIAL APPENDIX TO ANNEX I – BASED ON DATA IN DISCLOSURE ROOM



Annex II

Lack of jurisdiction in relation to GGBS

ANNEX II

LACK OF JURISDICTION IN RELATION TO GGBS

1. THE LEGAL FRAMEWORK

- 1.1 The Office of Fair Trading can make a reference to the CC *"if the OFT has reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom"*¹⁴³.
- 1.2 For the purposes of market investigation references, a **"feature of a market in the United Kingdom for goods or services shall be construed as a reference to.**
- 1.2.1 The **structure of the market concerned** or any aspect of that structure;
- 1.2.2 Any **conduct (whether or not in the market concerned)** of one or more than one person who supplies or acquires goods or services in the market concerned; or
- 1.2.3 Any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services [emphasis added]"¹⁴⁴.
- 1.3 Section 131 of the Enterprise Act 2002 (the "Act") sets the scope for the features that prevents, restricts or distorts competition - i.e., the AEC. This follows from s134(2)-(3) of the Act, according to which there is an AEC *"if any feature, or combination of features, of a relevant market prevents, restricts or distorts competition in connection with the supply (...) of any goods (...) in the United Kingdom"* where **"relevant market"** means a market in the UK for *"goods (...) of a description to be specified in the reference [emphasis added]"*.
- 1.4 As per s134(5) of the Act, *"there is a detrimental effect on customers if there is a detrimental effect on customers or future customers in the form of (a) higher prices, lower quality or less choice of goods or services in any market in the United Kingdom (whether or not the market to which the feature or features concerned relate); or (b) less innovation in relation to such goods or services"*.
- 1.5 According to s134(4) of the Act, the CC shall, if it has decided on a market investigation reference that there is an AEC, decide whether to *remedy* the AEC concerned or any *detrimental* effect on customers **"so far as it has resulted from, or may be expected to result from, the [AEC] [emphasis added]"**.
- 1.6 It thus follows that, as s131 of the Act sets the scope for the AEC, this also sets the boundaries for the CC in terms of what it can *remedy* under s134 of the Act.
- 1.7 In scenarios where a *broadening* of the reference scope is warranted, s135 of the Act enables the terms of reference to be *varied*. If the CC had *such* wide margin of discretion in interpreting the Office of Fair Trading's reference that it could investigate, identify and remedy *any* AEC in *any* market, there would arguably be no need for the requirement to seek such *variations* of the references in order for the Office of Fair Trading to widen its original references.
- 1.8 To therefore summarise the jurisdictional position under the Act as regards market investigations:

¹⁴³ The Act, s.131(1).

¹⁴⁴ The Act, s.131(2).

- 1.8.1 it is for *the Office of Fair Trading* to decide the scope of the reference to the CC;
- 1.8.2 in order for *the CC* to identify an AEC *and* remedy this AEC, the AEC in question and the remedy needs to be in relation to one of the reference products;
- 1.8.3 if the AEC in question is believed by the CC to be in relation to a product that is *not* a reference product, then - unless the AEC results from *conduct* of a company - a *variation* is required; and
- 1.8.4 unless such a variation is requested, the CC cannot impose a remedy for that product, particularly not a structural one.

2. THE APPLICATION OF THE LEGAL FRAMEWORK IN THE CURRENT CASE

- 2.1 Whilst the CC in the current case has previously identified (in the PFs) a potential AEC in cement arising from the GBS/GGBS supply arrangements, it had not identified a detriment in GGBS separately. Therefore, the simultaneous issuing of the GGBS Addendum and the PDR is the first opportunity for Hanson to engage with the CC on this issue. Indeed throughout the PDR the CC has confirmed that it is setting out its findings within the PDR as a direct result of its analysis in the Addendum. As is evident from Hanson's response to the Addendum, much of the material in the Addendum is contested, and therefore it follows that to the extent such rebuttal is well founded in substance, the reliability of the findings in the PDR will be both unclear and unsafe. Furthermore, and particularly given the extent of such debate, it is not just or equitable that the CC has formulated the PDR without first hearing Hanson's views in relation to such errors and the Addendum generally. Hanson ought to have been given ample time to respond to the Addendum, and the CC should have left itself ample time to review such Response, prior to the formulation of the PDR.
- 2.2 GGBS was *not* included in the market study conducted by the Office of Fair Trading in 2011 and, therefore, is *not* a reference market as part of the CC's MIR. Pursuant to the Act s.131(1) and s.133(1), the Office of Fair Trading limited the terms of reference to: (i) aggregates; (ii) grey cement; and (iii) ready-mix-concrete.
- 2.3 The Office of Fair Trading expressly excluded GGBS from its reference stating that "*we refer throughout this document to grey Portland cement when we talk about cement. The OFT is aware that cementitious products such as pulverised fly ash and ground granulated blast furnace slag (GGBS) are partially substitutable for cement in the production of ready-mix-concrete or concrete products. However for the purpose of this market study we have looked at grey Portland cement only [emphasis added]."*¹⁴⁵
- 2.4 In the Office of Fair Trading's *final* decision to make a reference, the Office of Fair Trading stated: "*We refer throughout this document to grey cement when we talk about cement. We have received two representations that the OFT has failed to take into consideration cementitious materials such as pulverised fly ash and ground granulated blast furnace slag (GGBS). The Anglo American/Lafarge Merger Decision concluded that, whilst cementitious material was partially substitutable for some purposes (including read-mix concrete) it did not form part of the same economic market. Furthermore, even if cementitious materials were included in our assessments of market share, the national shares of cement accounted for by the majors would still indicate very high concentration*"¹⁴⁶. Not only does this add to the clarification that the Office of Fair Trading did not include GGBS in its reference to the CC, but the final sentence suggests that it did not consider GGBS to be a significant influence on the cement market and that its inclusion would not make any difference and, hence, it was

¹⁴⁵ OFT Report on the market study and proposed decision to make a market investigation reference, August 2011 (OFT1358), para. 3.16, footnote 12.

¹⁴⁶ OFT reference decision, January 2012 (OFT1358ref), para. 3.19-3.20.

unnecessary. In addition, in the Terms of Reference, the Office of Fair Trading repeated that "*Cement means grey cement*", i.e. not GGBS¹⁴⁷.

- 2.5 The CC, however, has included GGBS, as part of the "grey cement" reference market, stating in its PFs that the "appropriate market definition" includes a single relevant product market for CEM I (pure cement), CEM II (cement blended with PFA) and CEM III (cement blended with GGBS). This, however, is in stark contrast to the CC's analysis of the market definition in the GGBS Addendum, where the CC now concludes that "*there is a distinct relevant product market for GGBS*"¹⁴⁸. When the CC explains in its GGBS Addendum that the CC has now concluded that there is also an AEC in GGBS (in addition to the GGBS-related AEC in cement), the CC merely mentions in a footnote that:

"It will be recalled that, under section 134(1) of the Enterprise Act, the CC is required to 'decide whether any feature, or combination of features, of a¹⁴⁹ relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom' (emphasis added). Such an effect on competition is defined by section 134(2) as an 'adverse effect on competition'. An AEC may therefore in principle be found in connection with any market within the UK, as long as the feature giving rise to the effect on competition can be regarded as a feature of a market in goods or services specified in the reference: see the definition of 'relevant market' in section 134(3) and the definition of 'feature of a market' in section 131(2), in particular subsection (2)(b) (...) [emphasis added]"¹⁵⁰.

- 2.6 Given the wording of s131(2)(b) of the Act (quoted above) and the important distinction between structural features and conduct-features, Hanson stressed in its response to the CC Remedies Notice that the CC must identify the *conduct* of Hanson as giving rise to an AEC in order to have jurisdiction to remedy any AEC in relation to GGBS.

- 2.7 The CC has now in its PDR and GGBS Addendum outlined the alleged AECs that the CC considers require remedying; and states (again merely in a footnote) that the only feature it has been able to claim as being a 'conduct'-feature of Hanson is the GBS exclusivity agreement with Lafarge Tarmac:

*"The definition of a 'feature' of a market in section 131(2)(b) of the Enterprise Act provides that any **conduct (whether or not in the market concerned)** of any participants in the market concerned can be considered to be a feature of that market. It follows that Lafarge Tarmac and Hanson's conduct in the GGBS supply chain can be regarded as a feature of a 'relevant market', within the meaning of section 134(3) of the Act, namely the markets in **cement** [emphasis added]"¹⁵¹.*

- 2.8 The CC also states that the "*extensive participation of Lafarge Tarmac and **Hanson** in both the **GGBS** supply chain on the one hand, and the GB cement markets on the other, whereby Lafarge Tarmac and Hanson are two of the top three GB cement producers and between them own all of the GBS and GGBS plants in GB*" and admits (again merely in a footnote) that this "*is a **structural feature** of the GB **cement markets** (and we recognise that this is also a characteristic of the GGBS market) [emphasis added]"¹⁵².*

- 2.9 However these statements are clearly not consistent with the CC's conclusion on market definition. Hanson's ownership of production plants in the GGBS market,

¹⁴⁷ Terms of Reference, 18 January 2012, para. 4.

¹⁴⁸ GGBS Addendum, para. 43.

¹⁴⁹ The CC wrongly quotes s134(1) in this regard as that provision refers to "**each relevant market** [emphasis added]", not "**a relevant market** [emphasis added]", as the CC suggests.

¹⁵⁰ GGBS Addendum, para. 3, footnote 2.

¹⁵¹ PDR, footnotes 29-30 to para. 2.11; and GGBS Addendum, footnote 40-41 to para. 94(b)-(c).

¹⁵² PDR, footnote 28 to para. 2.11; and GGBS Addendum, footnote 39 to para. 94(a).

which the CC defines as being *separate* from the reference product market of cement, *cannot* be characterised as a *structural* feature of that separate *cement* market. This would be similar to claiming for example that steel production plants are structural features of the GGBS market. If anything, Hanson's GGBS plants are *structural* features of the *GGBS* market, but not the cement market (as defined by the CC); and, pursuant to s131(2) of the Act, the CC does *not* have jurisdiction to investigate and remedy AECs in the GGBS market, at least not insofar as they relate to a structural feature, such as the GGBS plants, as the Office of Fair Trading specifically excluded GGBS from its reference to the CC.

2.10 To conclude, the CC lacks jurisdiction to remedy any structural-related AEC in relation to GGBS under the current MIR, as:

2.10.1 the Office of Fair Trading *did* refer cement, aggregates and RMX to the CC and, in doing so, *did* make a distinction between *GGBS* and cement, meaning that GGBS was *not* referred originally by the Office of Fair Trading to the CC;

2.10.2 *the* CC has concluded that GGBS does *not* form part of the relevant market for cement (or any of the other reference products);

2.10.3 *no variation* has been requested to include *GGBS* as a reference product; and

2.10.4 the CC has concluded itself that Hanson's GGBS plants are:

(a) not structural features of the GGBS market; and

(b) not a conduct-feature in any market.

Annex III

Comments on documents in the GGBS Data Room

Annex III

Comments on documents in the GGBS Data Room



Annex IV
GGBS Pricing

ANNEX IV

GGBS PRICING

The alleged detriment of "too high prices" has not been demonstrated

1. It appears from the PDR and the GGBS Addendum that the CC considers allegedly **high prices** to effectively constitute the AEC. However, it is clear from evidence presented by the CC that third parties even consider the prices as *reasonable* and/or certainly *not* as being "too high":
 - 1.1 the British Aggregates Association told the CC that its members used GGBS or PFA in almost all the RMX they produced, because it was cheaper than just using CEM I;¹⁵³
 - 1.2 Breedon Aggregates told the CC that it bought GGBS from Hanson and believed that:
 - 1.2.1 *"it got a competitive price for GGBS from Hanson" and that an "indicator of this was that the price of GGBS had come down recently"; and*
 - 1.2.2 *the "difference between the price of GGBS and cement was reasonable in Breedon Aggregates' view"*¹⁵⁴.
2. Therefore, it is not clear to Hanson how the CC can regard the GGBS prices as being on such a level that they give rise to a "customer detriment" if the customers do not even regard them as being "too high". Hanson is not aware of specific customer complaints that GGBS prices are too high but rather the reverse (see above). Indeed, if the CC had received specific complaints about prices being "too high", these should have been shared with Hanson directly to give Hanson a fair opportunity to respond (e.g. to qualify the circumstances of the specific complaint).
3. More importantly, "too high" prices and "too high" profitability as "detriments", even if shown, do not affect competition in the relevant markets and, hence, cannot be described or characterised as AECs in their own right. As mentioned above, a "high" price does not necessarily give rise to any foreclosure and the CC has not presented any evidence to that effect (see above). As the CC states itself in its Market Investigation Guidelines, "the CC will consider prices and profitability in the context of its overall assessment of the market"; and the CC goes on to explain that: *"[w]hile useful, findings that price-cost margins are wide or profitability is high in a market do not on their own provide conclusive evidence that the market could be more competitive"; and adds that "[s]uch findings are not in themselves causes of competitive harm—they are not features of the market for the purpose of the AEC test [emphasis added]"*¹⁵⁵. This is also in line with the CC's statement that, whilst market investigations' "overarching framework allows the investigation to tackle [AECs] from any source", e.g. "causes of possible AECs, such as structural aspects of the market (...) the focus of an investigation is always on competition [emphasis added]." ¹⁵⁶
4. Consequently, a "high" price does not constitute a feature of the market that would render the market as being "not well-functioning", as a "too high price" does not affect competition and, hence, would not be expected to give rise to an AEC. Indeed, it is difficult to demonstrate under competition law in general that a "too high price" gives rise to competition concerns. By their nature, cases concerning excessive pricing carry a high standard of proof and require proof of dominance in the market in question; and evidence that the dominant firm has abused that position. A lower standard of proof for what is considered to constitute "too high" a price should not be applied under the market investigation regime, as this would raise concerns as regards e.g. predictability.

¹⁵³ Appendix 7.6 of the PFs, para. 9.

¹⁵⁴ Appendix 7.6 of the PFs, para. 10.

¹⁵⁵ See para. 126, CC3.

¹⁵⁶ See para. 19, CC3.

5. As explained in the *United Brands* judgment, "excessive pricing" is defined as a price that "*has no reasonable relation to the economic value of the product supplied*"¹⁵⁷. In other words, even a *dominant* company is entitled to charge prices that take account of the *economic value* of the goods provided to third parties; and, as explained above, Hanson is not dominant in the relevant market for cementitious products in Great Britain (see above) but case law on excessive pricing is highly relevant in the context of this matter.
6. As the Court of Appeal has made clear, the "*economic value*" looks to the *demand-side* rather than the supply-side, i.e. the *value* to the *customer*, not the cost to the seller¹⁵⁸; and the price cannot be abusively unfair if it has a reasonable relation to the economic value of the product supplied¹⁵⁹. To quote the EC in its *Scandlines* decision on this point:

*"The demand-side is relevant mainly because customers are notably willing to pay more for something specific attached to the product/service that they consider valuable. This specific feature does not necessarily imply higher production costs for the provider. However it is valuable for the customer and also for the provider, and thereby increases the economic value of the product/service"*¹⁶⁰.
7. In order to ascertain whether the pricing would constitute an abuse of a dominant position, it is necessary to:
 - 7.1 Consider whether "*the **difference** between the **costs** actually incurred and the **price** actually charged is **excessive***"; and
 - 7.2 **If** the answer to that first question is in the affirmative, confirm whether "*a price has been imposed which is either...*"
 - 7.2.1 *...unfair in itself*"; or
 - 7.2.2 "*when **compared** to competing products* [emphasis added]"¹⁶¹.
8. In other words, even if the price/cost difference appears "*excessive*" within the meaning of the *first* question in *United Brands*, it is necessary to *then* proceed to the question of whether the prices charged are *unfair* before it can be concluded that a dominant position has been abused¹⁶². As the Court of Appeal made clear in the *Attheraces* judgment, the "*law on abuse of dominant position (...) is **not a law against suppliers making 'excessive profits'*** [emphasis added]"¹⁶³. In the PDR, the CC appears to wrongly have concluded that there is a separate law in the UK, under the market investigation regime, which bans 'excessive profits' – but this is not so.
9. When assessing whether a price is excessive or not, the *starting* point is to analyse the *costs incurred* by the dominant company that charges the price in question. As regards the most appropriate methods of measuring cost in excessive pricing cases, there is no single approach laid down by case-law as to *how* that is to be done, but is rather a matter of fact, accounting technique and economic assessment to be conducted on a case-by-case basis. The concept of costs in this context is thus not unambiguous: there are various possible costs, methods and models for cost

¹⁵⁷ Case C-27/76 *United Brands* [1978] ECR 207, para. 250.

¹⁵⁸ Court of Appeal, *Attheraces Ltd & Anor v The British Horseracing Board Ltd* [2007] EWCA Civ 38, [2007] UKCLR 309, para. 186.

¹⁵⁹ Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 227-228 and 241.

¹⁶⁰ Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 227.

¹⁶¹ Case C-27/76 *United Brands* [1978] ECR 207, para. 252; cf. Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para 147; Commission decision, Case COMP/C-2/37.761 *Euromax/IMAX*, 25 March 2004, page 10.

¹⁶² Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 142, 149-150, 158 and 216.

¹⁶³ Court of Appeal, *Attheraces Ltd & Anor v The British Horseracing Board Ltd* [2007] EWCA Civ 38, [2007] UKCLR 309, para. 119.

calculation¹⁶⁴. It has also been established in case law that, when setting a price *a priori*, a company is not limited to including only the incurred direct costs (production costs) but the costs can also include depreciation and WACC¹⁶⁵; and indirect costs.¹⁶⁶ In *Scandlines*, for example, although Port of Helsingborg's cost of capital was not a cost accounted for as such in its audited financial reports, the EC acknowledged that it could be taken into account when setting the price for a product¹⁶⁷.

10. Moreover, the mere fact that the price charged would exceed the costs actually incurred is not sufficient to conclude that the difference is "excessive" in the meaning of the first question posed in the *United Brands* judgement. As made clear by the EC, account *must* be taken not only of the costs actually incurred by the company in supplying the relevant product, but *also additional costs and other factors* which are not reflected in the audited profits and losses of the company in question that charges the price¹⁶⁸. Examples of such factors considered by the EC include high sunk costs, in which case the economic value of the product/service could be considered to be much higher than the costs accounted for by the dominant company providing it¹⁶⁹. Consequently, the 'economic value' of a product is not limited to direct costs - as the EC stated in its *Scandlines* decision, "*the economic value of the product/service cannot simply be determined by adding to the costs incurred in the provision of this product/service a profit margin which would be a pre-determined percentage of the production costs*"¹⁷⁰.
11. Even a company in a dominant position is entitled to make a reasonable *profit* and *also take account of non-cost-related factors* when setting a price for the product in question¹⁷¹. Features that make the product particularly attractive to the purchaser, *are to be taken into account when determining the economic value of products/services*.¹⁷²
12. It is clear from case-law that economic value is not to be determined simply on a 'cost+' basis.¹⁷³ As mentioned, calculating the costs is just a *first* step in assessing whether a fee is "excessive" and in breach of EU/UK competition law; and it has been recognised in case law that there are "*considerable and at times very great difficulties in working out production costs which may sometimes include a discretionary apportionment of indirect costs and general expenditure and which may vary significantly according to the size of the undertaking, its object, the complex nature of its set up [and] its territorial area of operations*"¹⁷⁴. Costs "*actually incurred*" in this context should thus not be restricted to Hanson's investments in its GGBS facilities actually producing the GGBS purchased by the customers.
13. Only in the *absence* of any relevant non-cost-related factors, could it be the case that the costs of supplying a product or service (plus a reasonable return), i.e. 'Cost+', could represent the "economic value" of the product/service¹⁷⁵. The fact however that

¹⁶⁴ Case 1046/2/4/04 *Albion Water v. Water Services Regulation Authority* [2008] CAT 31, para. 88-89; cf. Case C-27/76 *United Brands* [1978] ECR 207, para. 253; and Court of Appeal, *Attheraces Ltd & Anor v The British Horseracing Board Ltd* [2007] EWCA Civ 38, [2007] UKCLR 309, para. 213.

¹⁶⁵ Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para 107-109.

¹⁶⁶ Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 224.

¹⁶⁷ Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 224.

¹⁶⁸ Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 209.

¹⁶⁹ Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 209-210.

¹⁷⁰ Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 221.

¹⁷¹ Court of Appeal, *Attheraces Ltd & Anor v The British Horseracing Board Ltd* [2007] EWCA Civ 38, [2007] UKCLR 309, para. 186-187 and 207; and Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 226-228 and 232-233.

¹⁷² Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 226-228 and 232-233 and see also para. 97, 102, 150, 152, 209-210, 214-218, 221 and 224; Court of Appeal, *Attheraces Ltd & Anor v The British Horseracing Board Ltd* [2007] EWCA Civ 38, [2007] UKCLR 309, para. 168, 186-187, 195, 207-209 and 218; and Case 1046/2/4/04 *Albion Water v. Water Services Regulation Authority* [2008] CAT 31, para. 222-224.

¹⁷³ Court of Appeal, *Attheraces Ltd & Anor v The British Horseracing Board Ltd* [2007] EWCA Civ 38, [2007] UKCLR 309, para. 173, 207, 209 and 218; Commission decision, Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 226-228 and 232-233.

¹⁷⁴ Case C-27/76 *United Brands* [1978] ECR 207, para. 254; and Case COMP/A.36.568/D3 *Scandlines v Port of Helsingborg*, 2004, para. 117.

¹⁷⁵ Case 1046/2/4/04 *Albion Water v. Water Services Regulation Authority* [2008] CAT 31, para. 225.

no non-cost related factors were identified in *Albion Water* does not mean that such factors are not present in relation to Hanson, which is not holding a network/infrastructure similar to the one that *Albion Water* held. Unlike *Albion Water*, Hanson sets a price of a product that it supplies on an open and competitive market for cementitious products. In that context, it is important to bear in mind that GGBS is not a 'must-have input' for downstream applications, as cement and PFA can be substitutes for GGBS in RMX production; and PFA can be a substitute for GGBS in cement production. This was also a conclusion reached by the EC in its assessment of the *HeidelbergCement/Hanson* merger¹⁷⁶.

14. For the Office of Fair Trading to demonstrate an excessively high price in breach of the Chapter II prohibition under the Competition Act 1998, it would need to adhere to the case law referred to above. Amongst other possible sanctions for such a breach of the Competition Act 1998 would be a fine, but the Office of Fair Trading would have *no* power to order divestments, as there is no ban on dominance, only on the abuse. Divestment remedies imposed by the CC under the Enterprise Act 2002 could therefore be potentially *more* severe for the undertaking concerned. Therefore, in order for the CC to demonstrate, firstly, an AEC; and, secondly, that this AEC leads to such a high price that it warrants remedying under the Enterprise Act 2002, the CC should not apply a standard of proof and strength of evidence at a lower level than that outlined in the above case law. In order to follow the principle of proportionality, the CC would therefore need to adhere to the principles set out in case law in the area of excessive pricing under Chapter II/Article 102 when seeking to demonstrate that a price is "too high" (see also above, Section 7).
15. However, the CC has not followed the principles outlined in this case law. The CC has:
 - 15.1 Not explained in the PDR or the GGBS Addendum what the 'economic value' of Hanson's GGBS is;
 - 15.2 Not assessed Hanson's costs correctly (see Hanson's response to the GGBS Addendum);
 - 15.3 Not assessed properly relevant non-cost-related factors in determining the appropriate economic value of the GGBS;
 - 15.4 Not explained properly the difference between Hanson's costs and the price charged for GGBS is excessive; and
 - 15.5 Not explained whether, if the price was concluded as excessive (following the correct text as set out in the above-cited case law), the GGBS price was unfair, either in itself; or when compared to competing products.

¹⁷⁶ M.4719 *HeidelbergCement/Hanson*, paragraph 107.

Annex V

Workability of proposed GGBS divestments

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Workability of proposed GGBS divestments

As set out in detail in the main body of this Response and the response to the GGBS Addendum, Hanson does not accept that the case for divestment is proven, or that the basic required consultation process has been followed, since the formative stage of decision making has already passed and Hanson is being forced to engage on the detail of the remedies devised by the CC, although the consultation exercise is only now underway by way of the data room review and the release of the GGBS Addendum.

On a strict without prejudice basis regarding Hanson's response to the PDR and GGBS Addendum, and without prejudice to any current, impending or future appeal, Hanson sets out below, as an absolute minimum, the commercial agreements, security and arrangements that the CC must consider, allow and ensure in any divestment or other remedies process, to ensure that Hanson is to remain in any manner a viable competitor with a sustainable business in the GGBS market, and so able to compete with [a] new entrant[s].

Hanson reserves the right to make such additional requests for consideration both before and after Final Decision, including based on further discussions with the CC in 2014, in the event of remedies then proceeding in accordance with the CC's published decision.

1. **CONTEXT – COSTS AND IMPAIRMENTS**

1.1 The remedies simultaneously require the divestment of two of Hanson's three active GGBS grinders and the immediate termination of all of the exclusivity agreements. Hanson anticipates this will have very significant costs for its business. Therefore, Hanson requests and expects the CC to work with Hanson to ensure these costs are minimised to no more than the strict minimum necessary to achieve the CC's objective.

1.2 [✂]

2. **TIMING AND SEQUENCE**

2.1 Consideration whether the proposed remedies in the cement substitutes market ought to be delayed until remedies in cement market have taken place and can be assessed, so CC can have due regard to any reducing cement price that impacts and constrains the substitutes market. A period of [✂] from completion of the cement divestments would be necessary for such purposes.

[✂]

3. **GRANULATOR**

[✂]

4. **SINGLE SITE DIVESTMENT ONLY**

[✂]

5. **TWO SITE DIVESTMENT AS SCHEDULED**

[✂]

6. **SUPPLY AGREEMENTS**

[✂]

7. **PROPERTY RIGHTS**

[✂]

8. **TEESSIDE**

[✂]

9. **PURFLEET**

[✂]

10. **[✂]**

[✂]

11. **SCUNTHORPE JOINT VENTURE – CALUMITE LTD**

[✂]

12. **PORT TALBOT**

[✂]

13. **GLASGOW DEPOT**

[✂]

14. **VEHICLE FLEET**

14.1 [✂]

Annex VI

Response to CC questions regarding issues to be taken into account on divestment

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Response to CC questions regarding issues to be taken into account on divestment

Again on a strict without prejudice basis, the following issues are some of the issues that may need to be considered and effected on any divestment at the granulator / grinder level:

1. Full disclosure by Lafarge Tarmac/steel companies of the capital needed to be invested in each granulation facility at each possible divestment asset location to ensure a suitable minimum life for future production.
2. Full disclosure from Tata and SSI of matters affecting the certainty of steel production at each plant e.g.:
 - a. macro-economic steel markets;
 - b. competition in respect of the specific products made at each location;
 - c. steel plant investment requirements;
 - d. environmental issues;
 - e. effect of escalating energy costs on viability; and
 - f. workforce and trade union issues.
3. A price regime regulating the owners of the granulators to enable their satisfactory (but not excessive) profit on the supply of GBS to a GGBS producer.
4. Possible price regime for GGBS - any proposed linkage of GGBS price to CEM1 price, considering that the price of CEM1 may endure volatility consequent on current poor but improving market, and also in the context of the CC's proposed cement remedies.

ANNEX VII
Cost of Remedies

ANNEX VII

Cost of Remedies

Hanson's response to follow-up questions on cost of remedies

[✂]