

Completed acquisition by Hargreaves Services PLC of certain assets of Scottish Coal Company Limited

ME/6153/13

The OFT's decision on reference under section 22(1) given on 30 October 2013. Full text of decision published 28 November 2013.

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**Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.**

## **PARTIES**

1. **Hargreaves Services plc (Hargreaves)** is an energy support services provider, active in sourcing, producing, processing, handling and transporting services for carbon-based and other bulk materials throughout the UK and within Europe. Hargreaves also produces coal and coke and recycles tyres for customers throughout the UK and Europe. Hargreaves, through its subsidiary Coal4Energy Limited, is also engaged in the supply and distribution of coal products to industrial and domestic consumers.
2. **Scottish Coal Company Limited (in liquidation) (SCCL)** is a subsidiary of Scottish Resources Group (SRG) a producer of coal and renewable energy products in the UK. SCCL is responsible for developing and managing SRG's surface coal mining interests. SCCL entered into liquidation on 19 April 2013. As a result of SCCL's liquidation, ownership of the Broken Cross, Chalmerston, Damside, House of Water and St Ninians coal sites was transferred to five special purpose vehicles (SPVs). These SPVs are wholly owned subsidiaries of SCCL.

## **TRANSACTION**

3. On 5 July 2013, the parties together with SCCL's Liquidators, Blair Carnegie Nimmo and Gerard Anthony Friar, and Hargreaves Surface Mining

Limited (**HSML**) signed Share Sale Agreements relating to the entire issued share capital in each of the five SPVs (**Share Sale**). In addition, the parties, SCCL's liquidators and HSML entered into site care and maintenance agreements which grant Hargreaves rights to extract coal and other minerals from the active coal sites in the SPVs and market for sale or sell the coal and other minerals extracted from the sites for its own account (**Contractual Arrangement**). In this decision, the Contractual Arrangement is referred to as the **Transaction** because Hargreaves has informed the OFT that it is uncertain that it will satisfy the conditions required to purchase the shares in the SPVs. In accordance with section 27(3) of the Enterprise Act 2002 (the Act) the OFT has not taken any account of unexercised options in this case.

4. Hargreaves notified the Office of Fair Trading (**OFT**) on 4 July of the Transaction and its proposed acquisition of certain assets in the mining sector. On 11 July 2013, Hargreaves subsequently notified the OFT that it had completed the acquisition of certain assets from SRG and the right to maintain the active coal sites in the SPVs on 5 July 2013.

## **JURISDICTION**

5. For the purposes of the OFT investigating a transaction under the provisions of the Act, the transaction must amount to a relevant merger situation. For this, two or more enterprises must cease to be distinct and either the annual UK turnover associated with the enterprise being acquired must exceed £70 million ('the turnover test'), or the enterprises which cease to be distinct supply or acquire at least 25 per cent of goods or services of any description in the UK, or a substantial part of it ('the share of supply test').<sup>1</sup>

### **Enterprises ceasing to be distinct**

6. Hargreaves submitted that it has not acquired legal ownership of the sites in the SPVs from SRG, but rather it has agreed outsourcing arrangements to mine and market any coal that is produced by the sites owned by the SPVs. Further, Hargreaves submitted that although it has an option to purchase the shares of the SPVs, the ability to exercise the option is entirely conditional on its ability to design and deliver a solution which

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<sup>1</sup> Section 23 of the Act.

deals with the ultimate restoration of each site. Hargreaves submits that it is unclear whether it would exercise the option to purchase the shares in the SPVs given the uncertainty around satisfying the relevant conditions. As such, Hargreaves doubts whether two enterprises have ceased to be distinct given it has not exercised its option to purchase the shares in the SPVs.<sup>1</sup>

7. The OFT has considered in the first instance whether SCCL's assets constitute an enterprise. Hargreaves submitted that of the five sites transferred to the SPVs only Broken Cross, House of Water and St Ninians sites are viable sites. The OFT guidance states that the transfer of physical assets alone may be sufficient to constitute an enterprise where they enable a particular business activity to be continued.<sup>2</sup> The OFT notes that the three viable sites have coal deposits and will enable Hargreaves to continue mining and selling coal extracted from these sites. As such, the OFT considers that the viable sites constitute an enterprise.
8. Secondly, the OFT has considered whether the outsourcing arrangement will constitute an enterprise. OFT guidance states that in determining what constitutes an enterprise under the Act it would have regard to the substance of the arrangement under consideration, rather than merely its legal form.<sup>3</sup> Outsourcing arrangements may result in enterprises ceasing to be distinct where they involve the permanent (or long-term) transfer of assets, rights and/or employees to the outsourcing service supplier and where those may be used to supply services other than to the original owner/employer.<sup>4</sup>
9. Hargreaves submitted that Broken Cross, House of Water and St Ninians are the only viable coal sites because Chalmerston and Damside do not have further coal. Hargreaves provided the OFT with the Share Sale Agreement relating to the entire issued share capital for Broken Cross and the site services agreements for Broken Cross and Chalmerston. Hargreaves has informed the OFT that the Share Sale Agreement for Broken Cross is in all material respects in the same form as that used for the other SPVs. Further, it has informed the OFT that the site services

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<sup>2</sup> OFT Jurisdictional and Procedural Guidance, OFT527, 2009, paragraph 3.10

<sup>3</sup> *Merger Assessment Guidelines, A joint publication of the Competition Commission and the Office of Fair Trading*, CC2 and OFT1254, September 2010, paragraph 3.2.3; OFT Jurisdictional and Procedural Guidance, OFT527, 2009, paragraph 3.9.

<sup>4</sup> OFT Jurisdictional and Procedural Guidance, OFT527, 2009, paragraph 3.13

agreements for Broken Cross are in the same form as that used for House of Water and St Ninians while the Chalmerston and Damside sites have similar agreements.

10. The OFT notes that while the ownership of the sites will remain with the SPVs, HSML will be responsible for extracting coal from the Broken Cross House of Water and St Ninians sites (the three viable sites) While title and risk in the coal will transfer to the SPV pursuant to the Coal Authority Lease, HSML will in turn receive title and risk as soon as it passes to the SPV. The consideration for extracting the coal is that HSML will be entitled to market and sell the coal, including determining the price of the coal and deciding to whom it is sold. HSML will also pay the SPV fixed and variable fees as well as [ ] on account for the term of the services agreement. The SPV will not perform any services at the sites or do anything to interfere with HSML's operation on the sites.<sup>ii</sup> The duration of the site services agreement is a maximum of three years from commencement of the agreement. The agreement may be terminated by completion of the acquisition of the shares.
11. The OFT considers that while Hargreaves has not acquired the legal ownership of the SPVs that own the viable sites, the Contractual Arrangement to mine and sell the coal extracted from the sites will last long enough to qualify as a relevant merger situation. The OFT notes that the Act does not define the period of time that a merger situation should last in order to qualify as a relevant merger situation.<sup>5</sup> In addition, the OFT notes that Hargreaves has pledged to invest [ ] in the viable sites.
12. The OFT believes that the combination of the above factors is sufficient to give Hargreaves at least material influence over the three viable sites. As such, the OFT considers that as a result of the Transaction, Hargreaves and the three viable sites have ceased to be distinct.
13. In light of the above, the OFT considers that it is or may be the case that two or more enterprises have ceased to be distinct enterprises.

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<sup>5</sup> See, for example, *Award of contracts to SSP Health Limited to manage and operate 22 General Medical Practices in Merseyside*, ME/5822/12, 8 August 2013.

## **The turnover test**

14. Hargreaves submitted that the turnover test is not met because it is difficult to extrapolate accurate turnover figures from the assets acquired and that the reported accounts do not represent an accurate picture of turnover given SRG was operating unviable sites.
15. Hargreaves however submitted data which indicates that on the basis of the nine months actual and three months estimated turnover figures for the 2012/2013 financial year, the turnover generated by SCCL's three viable sites was £[ ] million.<sup>6</sup>
16. Given the estimated turnover generated from the three viable sites last financial year exceeds £70 million, the OFT considers that the turnover test is met.

## **Conclusion on jurisdiction**

17. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created, satisfying the requirements of section 22(1)(a) of the Act.

## **COUNTERFACTUAL**

18. The OFT considers the effect of mergers compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. In completed merger cases, the OFT's practice is generally to adopt the pre-merger situation as the counterfactual against which to assess the impact of the merger. However, the OFT will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic.
19. The OFT notes that SCCL is in liquidation. The parties submitted that absent the Transaction, the five active sites would have exited the market. The parties noted that at the time of the Transaction, all staff<sup>7</sup> had been

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<sup>6</sup> In order to calculate the revenue figure, Hargreaves has used the most recent SRG management accounts available from December 2012.

<sup>7</sup> The OFT notes that some members of staff were retained at the sites during the court disclaimer and liquidation proceedings to ensure that the sites were kept in a safe manner.

made redundant, SCCL's mining operations had ceased all its coal contracts had been terminated and only three of the active sites remain viable. The parties submitted that Hargreaves was the only credible bidder.

20. The OFT has not found it necessary to conclude on the counterfactual in this case given no competition concerns arise when using the pre-merger situation as the relevant counterfactual.

## **FRAME OF REFERENCE**

21. The parties overlap in the mining and supply of coal. The parties submitted that coal is the same for all users irrespective of qualities and applications. They however note that there are four main customer groups, namely power stations, large industrial, small industrial and domestic customers. The parties also noted that products such as wood, coke, gas and biomass could be used as an alternative to coal.

### **Product scope**

22. The OFT has considered whether the production of coal should be distinguished further by types and customer groups.

### **Segmentation by product types**

23. The parties submitted that the relevant market for the assessment of the Transaction is the supply of coal. However, third party comments suggested that there are four different types of coal namely, thermal (steam) coal, coking coal, anthracite and domestic coal.
24. Thermal coal has a lower calorific value than other types of coal and is used mainly for producing steam while coking coal which is used for the production of coke, mainly in the iron and steel industries is of higher calorific value than thermal coal. Anthracite is a high-calorific fuel suitable for industrial purposes and as a domestic fuel.<sup>8</sup> Domestic coal is described as pieces of some types of thermal coal that are bigger than 50mm.

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<sup>8</sup> Key Note (2010) Energy Industry, Chapter 8 "The Coal Industry", page 92.

25. Third parties have informed the OFT that they would not switch between the various types of coal, even when faced with a price increase, because each type of coal has a different application, and as such not suitable for other applications. Third party suppliers also informed the OFT that they could not switch production easily between the different types of coal, mainly because production is subject to their rights to mine from specific sites. They noted that they could only produce coal from the mines they currently operate and there is very little scope to open new mines quickly in response to increase in price of a particular type of coal.
26. The OFT does not consider it necessary to come to a firm conclusion on whether to distinguish between the production of thermal coal, coking coal, anthracite and domestic coal given that, on the evidence available to it, no competition concerns arise on any plausible frame of reference.
27. The OFT has also considered the extent to which alternative products such as wood, coke, gas and biomass impose a competitive constraints on the different types of coal. Third parties informed the OFT that for some types of coal, there is limited ability for users to switch to these alternative products. In addition, switching is unlikely occur in response to a five to ten per cent price increase. Based on available evidence, the OFT does not consider that wood, coke, gas and biomass should be included in the product scope and has not considered it further in this decision.

#### Segmentation by customer groups

28. The parties submitted that there are four main end customer types for coal, namely power stations, large industrial, small industrial and domestic customers. Third party comments suggested that each customer group may use a different type of coal for their end applications. For example, while power stations largely use thermal coal, domestic customers use domestic coal.
29. For the purposes of this case, the OFT does not consider it necessary to come to a firm conclusion as to the precise product scope given that, on the evidence presented to it, no competition concerns arise on any possible frame of reference.
30. The OFT has not received sufficient evidence in this case to conclude on the exact overlaps between the parties on the basis of type of coal

produced or customer segmentation, however the OFT has considered these distinctions in the competitive assessment where relevant.

### **Geographic scope**

31. The parties submitted that the geographic market for the supply of coal is global, noting that there are high levels of imports of coal to the UK, production sites are spread worldwide and no technical differences between indigenous and imported coal. The parties also provided evidence on the international price of coal as a tradable commodity and how this influences coal produced in the UK. Third parties, noted that imported coal competes strongly with UK produced coal and that there are no properties of UK produced coal that make it more appealing than non-UK produced coal. However, a few third party comments suggested that the market might not be global. In particular, one third party informed the OFT that it has a preference for indigenous coal given the logistical costs involved with coal imports and the constraints faced at the UK ports. This third party suggested that while port capacity increased the price of imported coal, domestic coal had been priced at the same level in the same period. This comment was not supported by other third party comments.
32. It is not necessary for the OFT to come to a conclusion on the exact geographic scope in this case given there are no competition concerns arising on any plausible frame of reference. For the purposes of the assessment of this case, the OFT has focused its competitive assessment on production of coal in the UK, while taking full account of the possible constraints from coal imports into the UK.

### **HORIZONTAL ISSUES**

33. The OFT has assessed whether there is a realistic prospect that the Transaction will result in unilateral effects in the production of thermal coal, coking coal, anthracite and domestic coal in the UK. The parties provided no information regarding their production or the size of the UK market for the different types of coal. The OFT has therefore considered whether, on the basis of the evidence available, there is realistic prospect of a substantial lessening of competition for any of the individual types of coal.

## Share of supply

34. The parties submitted that the total market for coal in the UK, including imports, is approximately 50 million tonnes. The parties noted that post-transaction, Hargreaves' combined share of supply of coal in the UK is less than [five-15] per cent.<sup>9</sup> The parties have not provided data based on types of coal.
35. The OFT notes that the total production of coal in the UK in 2011 was 17.9 million tonnes. The OFT has considered, on a cautious basis, that Hargreaves would control production of approximately four million tonnes.<sup>10</sup> Accordingly, the parties combined share of supply would be approximately [15-25] per cent with an increment of [0-10] per cent, based on UK production. The OFT notes that UK Coal, Miller Argent, Celtic Energy and HJ Banks also produce coal in the UK.
36. The OFT did not receive any evidence to suggest that the parties have a notably stronger market position in the production of any particular type of coal.

## Closeness of competition

37. Hargreaves considers that, in addition to producers outside the UK, it competes with other producers of coal in the UK such as UK Coal, Kier Construction, HJ Banks, Celtic Energy, Miller Argent and Bryn Bach. Third party comments confirmed that there are many suppliers of coal in the UK.
38. The majority of third parties contacted during the OFT's investigation did not consider the parties as close competitors. Although, one third party customer informed the OFT that the parties are close competitors and switching to other suppliers is increasingly difficult, although it subsequently listed three other credible suppliers within the UK as well as importation of coal as an option.
39. The OFT has received no evidence from its market investigation to suggest that the parties are close competitors for the production of any particular type of coal. Third parties informed the OFT that they would switch to

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<sup>9</sup> Based on Coal Authority Statistics and Coalpro data.

<sup>10</sup> The OFT has aggregated the coal production from sites that Hargreaves has minority interests in together with the sites it has contractual arrangements to mine coal.

other suppliers, including those outside the UK in the event of price increase.

40. Therefore, in light of the parties combined market share, the large number of competitors post-merger, the high level of importation of the different types of coal and the fact that almost all third parties raised no competition concerns about the Transaction, the OFT does not consider that the Transaction gives rise to a realistic prospect of a substantial lessening of competition for the supply of thermal coal, coking coal, anthracite and domestic coal in the UK.

### **Barriers to entry and expansion**

41. The parties submitted that the barrier to importation of coal into the UK is low given around 65 per cent of coal in the UK is imported and therefore the market is constrained by internationally traded prices. The parties also noted that the ability to substitute other equivalent products such as coke, wood, briquettes, coal slurry, petcoke and waste materials is easy.
42. Third parties informed the OFT that the barriers to entry to UK coal production are high, mainly because of planning regulations. Third parties did suggest that there were mineral deposits available in the UK for extraction, if a rise in the price of coal makes it economical. Few third parties suggested that there were significant barriers to importing different types of coal, although one third party mentioned that they had seen some examples of constrained port capacity increasing the price of imported coal.
43. Given the competition assessment above, the OFT has not found it necessary to reach a firm conclusion regarding barriers to entry and expansion.

### **THIRD PARTY VIEWS**

44. In this case, the OFT contacted coal producers, power stations, coal merchants, coal distributors and large industrial companies. No competitor raised competition concerns about the Transaction. While a significant number of customers had no concerns about the Transaction, a few customers noted that the Transaction will reduce the number of coal

producers in the UK. Some customers considered the Transaction would ensure that SCCL's sites will remain operational and reduce logistic costs of importing coal. Third party views have been incorporated where relevant in the decision.

## ASSESSMENT

45. The OFT believes that it is or may be the case that two or more enterprises have ceased to be distinct as a result of the Contractual Arrangement. Further, the OFT believes that it is or may be the case that the viable sites generated turnover in excess of £70 million in the last financial year. Accordingly the OFT believes that it is or may be the case that a relevant merger situation has been created.
46. The parties overlap in the production and supply of coal in the UK. Given its view that no competition concerns arise on any possible frame of reference, the OFT has not considered it necessary to conclude on the appropriate frame of reference in this case. The OFT has however focussed its assessment of the Transaction on the production of thermal coal, coking coal, anthracite and domestic coal in the UK, but have also taken full account of the possible constraint from imports.
47. The OFT found that in relation to supply of different types of coal in the UK, the level of coal importation is high, the parties combined market share is low, a large number of competitors will continue to impose competitive constraints on the parties and almost all third parties raised no competition concerns about the Transaction.
48. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## DECISION

49. This merger will therefore **not be referred** to the Competition Commission under section 22(1).

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<sup>i</sup> Hargreaves clarified that it had entered into a conditional share sale agreement on 5 July 2013 to purchase the shares of the SPVs. Hargreaves further submitted that satisfying the conditions depended on its ability to design and deliver a solution to deal with the ultimate restoration of

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each site, that is acceptable to the relevant local authorities and meets with planning approval. As referred to above at paragraph 3, in accordance with section 27(3) of the Act the OFT has not taken any account of unexercised options or conditional rights in this case.

<sup>ii</sup> Hargreaves clarified that HSML is not the operator of the sites within the SPV.