Completed acquisition by Harsco Corporation of the Brambles Steel Services business from certain subsidiaries of Brambles Industries Limited

The OFT's Decision on reference under section 22 given on 13 March 2006. Full text published 28 March 2006.

Please note that square brackets indicate figures or text which have been omitted or replaced with a range for reasons of commercial confidentiality.

PARTIES

1. **Harsco Corporation (Harsco)** is the US parent of the Harsco group of companies. It is listed on the NYSE. It provides industrial services and products globally. Its main business activities are the provision of mill services; access services; engineered products and services; and gas technologies principally to customers operating in the steel and metals; construction; industrial plant maintenance; gas and energy; and industrial infrastructure industries. Harsco provides steel mill services through its subsidiary **MultiServ Group Limited (MultiServ),** to steel manufacturers world-wide.

2. **Brambles Industries Limited (BIL)** provides among other things industrial steel mill services to steel manufacturers world-wide.

TRANSACTION

3. On 29 December 2005, Harsco acquired the **Brambles steel services business (BSS)** from certain subsidiaries of BIL. The administrative deadline is 20 March 2006 and the statutory deadline is 9 May 2006.

JURISDICTION

4. As a result of this transaction Harsco and BSS have ceased to be distinct. Harsco (through its subsidiary MultiServ) and BSS overlap in the supply of outsourced steel mill services and the share of supply test in section 23 of the Enterprise Act

2002 (the Act) is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

Product scope

5. The parties overlap in the supply of industrial steel mill services to steel manufacturers. Industrial steel mill services are distinct from and ancillary to the core steel manufacturing carried out by steel producers (which are the parties' customers). Steel mill services encompass all services ancillary to each stage of steel manufacturing for example, scrap processing, sludge lagoon emptying; internal scrap collection, ship unloading/loading). Steel service providers place bids for certain services that are put out to tender in bundles by steel manufacturers. Steel manufacturers tender contracts for services required for each individual mill and will work on-site for the duration of the contract.

6. On the supply-side, the parties provided a list of 66 different steel mill services which they contend fall within the same product scope because suppliers can switch between each of the services with relative ease. The parties claim that most services do not require a large investment and for those services that do require greater investment, no financial commitment needs to be made until after a contract has been won, enabling new entrants to compete on a level playing field for contracts with existing service providers. The parties also pointed out that at the end of the contract, the incumbent supplier may be obliged to sell any fixed plant on the customer's premises to the subsequent winner of the contract.

7. Third parties submitted that there was a lack of supply side substitutability into (and possibly between) those services that require heavy fixed/plant and large capital investment and technical expertise as a firm without significant financial capability would be prevented from providing such services. In particular some third parties argued that the period of time over which the asset would need to be written off may exceed the length of the contract, making it more difficult for smaller service providers to obtain the required finance from banks as they would be exposed to risk upon contract expiry. Although the customer or new supplier could buy the equipment from them, the equipment would have depreciated in value making it unlikely for them to recoup all their costs. In addition the incumbent service provider would be in a weak negotiating position to recoup its costs if the equipment is bespoke to the steel mill and has no use elsewhere.

8. While there was evidence to suggest that for more labour based services (such as overhead crane maintenance) requiring less capital investment in fixed/mobile equipment, supply-side switching would not be problematic, there was insufficient

evidence to suggest ease of supply-side switching between more capital intensive services.

9. The parties submitted that the relevant product scope should be wide enough to include the provision of in-house supply of all 66 services. However customers have submitted that providing these services may detract from their core services and the costs of providing some services in-house rather than obtaining them externally are high. In addition, customers benefit from know how gained by service providers of running other customers' mills. Nonetheless 30 per cent of global steel mill services are provided in-house and there is evidence of customers bringing services in-house when they were not satisfied by offers made by external service providers, suggesting that the provision of in-house services may pose a constraint. We therefore analysed the relevant frame of reference with and without in-house supply.

10. From the demand-side, the OFT looked at bidding data to ascertain whether some services were always bundled which might imply they were complementary to each other. However the limited bidding data provided by the parties showed that customers offered different bundles of services in each contract for tender suggesting no complementarity between services

11. Nonetheless, when the OFT asked customers whether any of the services had similar characteristics, one customer drew a distinction between production services (requiring a high level of investment in heavy fixed and mobile equipment and technical expertise) and support and maintenance services (requiring less heavy equipment and less investment). Another customer distinguished between i) primary services (requiring high levels of investment in technical equipment); ii) mill services (requiring an intermediate amount of investment); and iii) finishing services (which are labour based services requiring little capital investment). Other parties suggested that the main 'bread and butter' services were slag handling and metal recovery (both of which require a substantial investment in specialist heavy equipment, as well as technical expertise). These customer categorisations segmented the services along broadly similar lines and supported the view that the product scope could be defined more narrowly than all 66 services particularly as regards those services requiring heavy fixed/mobile plant and significant capital investment.

12. The OFT considered whether the product scope could be widened to encompass the provision of mill services to other metal producers. In particular it was considered whether service providers for iron slag processing could quickly switch to steel slag processing. The parties submitted that the vast majority of iron is produced in blast furnaces as part of the process of steel manufacturing such that

iron slag processors would be included in the definition of steel mill service providers.

13. In relation to other metals where slag occurs the parties argued that while the methodology of carrying slag is similar, certain details are different for each metal. Third parties suggested that for larger foundries, certain mill services may be similar, particularly in terms of logistics and maintenance services. For production services, it would depend on the quantity of slag being produced as to whether the services were adaptable in other mills. Service requirements may be more similar in the bigger mills. However, neither customers nor competitors listed service providers for other metal producers as alternatives to the parties. Consequently, for the purposes of this case, we have restricted the product scope to the provision of steel mill services.

14. In the light of the above, the OFT considers that for certain services bearing specific characteristics (those requiring heavy fixed/mobile equipment and significant capital investment) the product scope is narrower than the parties suggest. In fact there was evidence of a lack of supply side substitutability even among those services, suggesting the product scope may be as narrow as each individual service. Because there was a lack of clear consensus as to which services fell into which category, the OFT looked at shares of supply on an individual service basis.

15. The OFT identified 33 services in which the parties overlapped. However in five of these there were more than six competitors, suggesting that there was sufficient competition not to raise competition concerns. The OFT therefore concentrated on 28 services (listed in Annex 1) which appeared potentially more likely to cause competition concerns, namely, services where the parties overlapped and where fewer than six competitors globally currently supply UK customers. These 28 overlaps all fall within the definition of production services (as defined by one customer) and most of the services fall within the definition of primary services (identified by another customer). Slag handling and metal recovery comprise five of the 28 services considered below. Our analysis therefore concentrates on those services identified by customers to be the more capital intensive services requiring heavy fixed/mobile equipment and technical expertise where supply-side substitutability is less prevalent.

16. Many of the services falling under customer definitions of maintenance and support services were therefore not assessed further as either the parties did not overlap in such services or more than six competitors were active in these sectors and therefore did not raise competition concerns.

Geographic scope

17. The parties argue that the geographic scope is global as international steel mill service providers bid for contracts in the UK. However the parties' UK shares of supply are very high compared to their EU/global shares of supply suggesting a narrower geographic scope. One third party did suggest that there were risks associated with using a company that did not have a reputation or experience in the UK. Nonetheless bidding data supports the view that, while, international service providers have to-date not won a contract in the UK, they have and do bid for contracts for each service in the UK. Customers with a UK presence confirmed that they could source from international competitors and in the past they have actively done so. Some international service providers that the OFT spoke to agreed that they are prepared to bid for contracts to provide services in the UK. EU and global competitors therefore appear to act as a competitive constraint on the parties. Therefore the geographic scope appears to be at least EU wide, if not global. Nonetheless it may be that competitors located nearer to customers may provide a stronger competitive constraint than those based further away.

HORIZONTAL ISSUES

Nature of Competition

18. Competition for the provision of industrial steel mill services takes place in the form of competitive tendering. Price therefore plays a very important role in the bidding process. In addition to competition on price, customers stated that competition also occurs on certain non-price factors such as technical expertise (in particular safety performance); financial standing; past experience and customer references in relation to the specific service. They also stated that experience of working with that service provider can often influence a customer's choice of provider. However, price remains a very important factor in the bidding process, as evidenced by certain customers' insistence on open book accounting obliging service providers to provide transparent costings thereby enabling customers to negotiate more effectively on price.

Competition between the Parties

19. [ ] Third party responses support the view that the parties are the largest providers of capital intensive steel mill services in the UK. There are a limited number of competitors in the UK who have the financial capability to provide services requiring large capital expenditure.

20. The parties also appear to be one of a few UK competitors to be able to provide a wide range of services to customers. Customers confirmed they greatly valued the

synergies that could be derived from using firms like the parties to provide a wide range of services. Third parties also stated that having a wide range of services enabled firms to obtain increased purchasing power for equipment.

21. Third parties raised concerns that the merger would not only eliminate competition between the parties, but also that the merged entity would be considerably bigger than its nearest rival enabling it to win most of the contracts requiring significant capital investment and to raise prices in the UK. Third parties also argued that the merged entity might be able to gain a stranglehold on the more capital intensive services and possibly leverage its position in these services to gain contracts in the less capital intensive services.

22. On the other hand, the parties' shares of supply at an EU and global level are significantly lower than in the UK. They range from [less than 5] per cent and do not exceed [15-25] per cent with increments [of less than 5] per cent suggesting they have limited market power on an EU or global level.

23. In addition, bidding data demonstrated that contracts can and do change hands. Bidding data also showed that international competitors do bid for contracts in the UK. Customers confirmed that they have asked international competitors to bid for contracts in the past, and although to date no international firm has won a contract in the UK, customers submitted that they consider them a serious option and would consider offering contracts to them. International competitors confirmed that they would be willing to provide capital intensive services to UK customers. The threat of entry from these international competitors into the UK does, and may in the future, be expected to act as a competitive constraint to the parties.

24. The parties argued that customers had the ability to take these services in-house. The parties' internal documents supported the view that the parties consider in-house production a significant constraint post-merger. Some customers confirmed that they regularly benchmark the cost of outsourcing industrial steel mill services with taking them in-house. While a number of customers have said that there are significant costs involved in taking the more capital intensive services (such as slag handling and metal recovery) in-house. However these costs do not comprise a large proportion of customers' total spend suggesting that if customers wished to take such services in-house they could do so. Indeed customers have provided evidence of doing so.

25. In-house production would therefore appear to act as a strong constraint for the less capital intensive services and a sufficient (all be it weaker) constraint for the more capital intensive services.

BARRIERS TO ENTRY AND EXPANSION

26. The parties contend that barriers to entry are low: while certain services require substantial investment, no financial commitment needs to be made until after the contract has been won, enabling new entrants to compete on a level playing field for contracts with existing service providers.

27. Third parties suggested that incumbency advantages exist in the more capital intensive services, such that a company already holding the contract benefits from already being in situ. In particular contracts typically last between five to twelve years by the end of which the incumbent supplier has built fixed plant on the customer's mill that it has expertise in operating, has established a relationship with the customer, and is therefore better able to adapt its services to the customer's needs.

28. Relationships are particularly important in this industry as contracts are sometimes not put out for re-tender but are simply renewed. Whilst MultiServ's internal documents suggested that it has a [ ] per cent contract renewal rate, [ ] per cent of these are won in a competitive tender. In addition, bidding data provided by the parties did on occasion show contracts held by the parties being lost to competitors, suggesting that the competitive tender process still acts as a competitive constraint.

29. In addition customers and competitors alike confirmed that it is not necessary to have a physical presence in a country to win a contract for the provision of services.

30. While there is no evidence of new entry within the last five years, there has been expansion by existing players and international firms have bid for contracts in the UK.

31. On balance, evidence suggested that capital investment is high in those services requiring heavy fixed/mobile plant, making entry more challenging for smaller service providers, whereas existing international competitors of a certain level of financial standing and expertise could and would bid for contracts in the UK without difficulty.

COUNTERVAILING BUYER POWER

32. The steel industry is characterised by a number of large sophisticated manufacturers. In the UK, Corus accounts for [ ] per cent of steel production. Post merger Corus will represent [ ] per cent of the parties' revenues suggesting that it holds substantial buyer power. There might be concerns that despite the apparent

strength of bargaining position of the customers, this bargaining power would be ineffective if they did not have a choice of service provider. However, customers confirmed that even in the more capital intensive services, they could outsource to international service providers, lending weight to the view that customers could exert sufficient bargaining power on the merged entity if it wished. The parties supported this view. Smaller customers did not represent a large proportion of the parties' turnover. It appears that these customers also source from smaller providers. Evidence suggests that small customers have been willing to take services in-house or invite offers from other competitors if the bid from the parties was not satisfactory. It therefore appears that some customers hold significant countervailing buyer power.

VERTICAL ISSUES

33. There appear to be instances of vertical integration between certain service providers and steel manufacturers. However the parties submitted that there were no vertical issues arising in this merger and there appear to be only minimal vertical links between Corus and Brambles.[1] No third parties raised any concerns in this regard.

THIRD PARTY VIEWS

34. Several competitors raised concerns about the removal of competition between the parties resulting from the merger and the lack of remaining UK based competitors in the more capital intensive services (such as in slag handling and metal recovery) where there are few UK based competitors. One customer was concerned about the economies of scope that the merged entity would be able to achieve enabling it to win substantial business from its competitors and become such a key supplier that it would be able to raise prices to customers.

35. However on balance, the majority of customers were not concerned with the merger, stating that they could source elsewhere were the merged entity to raise prices. Competitors were also generally not concerned.

ASSESSMENT

36. The parties overlap primarily in the supply of production services to steel manufacturers.

37. [ ] [T]he evidence in this case confirms that competition for UK contracts between steel service providers occurs at least on an EU or global basis where the parties' shares of supply are much lower.

[1] Corus owns a 3 per cent shareholding in Brambles.

38. While significant investment may be required for certain heavy fixed/mobile plant services which may deter the smaller firms from entering, there appear to a number of larger international firms with sufficient financial capability to provide services to uk customers. In addition, the threat of taking these services in-house is a realistic and significant constraint on the parties.

39. Therefore, there is sufficient competition from competitors overseas or the threat of taking the services in-house to offset any a loss of competition between the parties. Generally customers were not concerned.

40. Given the above, the OFT does not consider that the merger has resulted or may be expected to result in a substantial lessening of competition (in terms of either price or non-price competition) in the supply of industrial steel mill services.

DECISION

41. 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.

Annex 1

25 overlap services where there are currently fewer than six competitors supplying UK customers.

1 Ship loading / unloading
2 Raw materials management
3 Blast furnace services
4 Air-cooled slag removal
5 Air-cooled slag crushing & screening
6 Iron ponding
7 Sludge lagoon emptying
8 Scrap processing
9 Scrap management
10 Meltshop services
11 Steel slag transport
12 Pit dig & slag removal
13 Internal scrap collection
14 Scrap breaking
15 Lancing
16 Gas cutting
17 Metal recovery plant
18 Coolant production
19 Screening & crushing slag for sale
20 Ladle carrying
21 Ladle services
22 Millscale processing
23 Briquetting
24 Semi-finished product handling
25 Inspection, scarfing & grinding
26 Marking & Tracking
27 Slitting & cutting
28 Finished product management

Services where there are currently more than six competitors supplying UK customers.

29 Workshop Services
30 Labour Rentals
31 Equipment Rentals
32 Plant Cleaning
33 Environmental Services