

Completed acquisition by Hanson Building Products Ltd of Marshalls Clay Products Ltd

The OFT's decision on reference under section 22(1) given on 2 March 2005. Full text of decision published 1 April 2005.

Please note that square brackets indicate exact figures replaced by a range, at the parties' request.

PARTIES

1. **Hanson Building Products Ltd** (HBP) is a subsidiary of Hanson PLC and is a supplier of walling blocks, clay bricks, concrete flooring, pre-cast concrete and packed aggregates. Its total turnover in 2003 was £321 million. **Marshalls Clay Products Ltd** (Clay) is a manufacturer of clay bricks and pavers. Its total turnover in 2003 was £32 million.

TRANSACTION

2. HBP acquired 100 per cent of the issued share capital of Clay for £65 million on 4 January 2005. The administrative target date is 8 March 2005 and the statutory deadline is 4 May 2005.

JURISDICTION

3. As a result of this transaction, HBP and Clay have ceased to be distinct. Clay's UK turnover does not satisfy the test in section 23(1)(b) of the Enterprise Act 2002 (the Act). However, the parties' combined share of the supply of clay bricks in the UK exceeds 25 per cent. The share of supply test in section 23 of the Act is consequently met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created. The ECMR does not apply.

RELEVANT FRAME OF REFERENCE

Product market

4. The parties overlap in the manufacture and supply of clay bricks. Clay bricks are used principally as a walling material in buildings.
5. HBP proposes that there are two alternative means of segmenting different types of clay brick: either (a) by manufacturing technique or (b) according to end use.

Segmentation by 'manufacturing technique'

6. If clay bricks were categorised according to the methods by which they are manufactured, the following segments would be applicable:

- i. 'Extruded bricks'

These are bricks shaped by forcing processed clay through wire-cutters. Such bricks can be used for new build and for repair, maintenance or improvement (RMI). This highly automated production process makes extruded bricks cheaper than many other types.

- ii. 'Soft mud bricks'

Also known as 'hand-made bricks' – these are made by 'throwing' a soft, pliable mix of clay and water into brick-shaped moulds. Compared with the extrusion method, this is a relatively labour-intensive and more costly process. However, the bricks produced are of a higher aesthetic quality and are used where the appearance of the exterior walls is considered as important as their durability. Clay does not manufacture or supply soft mud bricks.

- iii. 'Fletton bricks'

Also known as 'London bricks' – these are manufactured from shale-rich 'lower Oxford' clay using a method of brickmaking called the Fletton Process. The high carbon content of the clay allows for the bricks to be fired in kilns very economically. However, fletton bricks are considered inferior to other varieties since they are not as well suited to more severe conditions of exposure. Their use is now almost exclusively in RMI in

buildings already constructed from fletton bricks. Clay does not manufacture or supply fletton bricks.

Segmentation by 'end-use'

7. If clay bricks were categorised according to their end-use in new build or in RMI, the following segments would apply:

i. 'Facing bricks'

Such bricks may be of any of the 'extruded', 'soft mud' or 'fletton' varieties. They are selected mainly for visible exterior walling.

ii. 'Engineering bricks'

Engineering bricks are of the extruded variety and are used for their performance characteristics rather than their appearance. They are best suited for groundworks, retaining walls and other situations where strength and resistance to frost attack and water are the most important factor.

8. HBP considers that both extruded facing bricks and engineering bricks should be included in the same frame of reference. It refers to a decision¹ made in 2002 by the European Commission in which the question of the scope of the product market for clay bricks was left open (due to the absence of any concerns for competition) but which states nonetheless that:

'The Commission's market investigation has substantially confirmed the parties' views. On the basis of the replies received, it could be concluded with regard to the relevant product market that there exist [sic] a single market for bricks in general. From a supply-side view, (i) production methods are basically the same, with the clay type, clay mix or the applied finish producing the difference between facing and engineering bricks; (ii) both kinds of bricks can be generally produced at the same plants, provided the suitable process technology and clay are available; (iii) in this context, it is feasible for some manufacturers to switch production according to requirements of demand and to price evolutions of the respective types of bricks.'

9. In the present case, some third party respondents expressed doubts as to whether facing and engineering bricks were interchangeable from a demand side

¹ Case No COMP/M.2737 - Royal Bank Private Equity/Cinven/Chelwood Group.

perspective. However, the responses and the evidence overall indicate that it is appropriate to consider facing and engineering bricks together.

10. HBP's alternative proposal for product market definition (i.e. that clay bricks could be sub-divided according to the method by which they are manufactured) takes account of the limitations for supply-side substitutability, due to the substantially different manufacturing processes. However, on the demand side, HBP believes that customers switch between extruded and soft-mud bricks, and can – albeit to a lesser extent – substitute extruded bricks for fletton bricks. Third party respondents, however, had mixed views on the degree of substitutability between different types of brick. Some considered that, due to differences in aesthetics and weathering characteristics, the scope for demand side substitutability was limited.
11. Overall, on the basis of both HBP's submission and of the information collected from third party respondents, the evidence suggests that the following frames of reference should be examined:
 - (a) the supply of extruded bricks; and
 - (b) the supply of soft-mud and extruded bricks (i.e. all bricks excluding fletton).

Geographic scope

12. HBP submits that the relevant geographic scope is Great Britain (GB) for a number of reasons:
 - (a) the conditions of demand are similar throughout GB;
 - (b) bricks are transported across the whole of GB; and
 - (c) most customers (98 per cent of HBP's customers and 78 per cent of Clay's customers) operate and procure brick supplies on a national basis.
13. Most third party respondents estimated transport costs within GB to be around 10 per cent of the value of the delivered product, although two responses proposed that they could be as high as 20 per cent to 30 per cent.
14. HBP argues that imports of bricks, given that they currently represent 5 per cent of total GB purchases, acts as one of the constraints imposed on GB brick suppliers. Third party respondents expressed mixed views on this proposal – largely due to the significantly higher transport costs involved in shipping bricks

from continental Europe. Overall, it would seem that there are limitations to the constraint imposed on GB brick suppliers by imports.

- 15. In the Comp.M/2737 case referred to in paragraph 8, the European Commission notes that third parties had agreed that the relevant geographic scope was Great Britain. However, given that the merger in question did not raise any serious doubts, no conclusions were drawn regarding the precise geographic market definition.
- 16. The region where both HBP and Clay have production facilities is defined as having a boundary of Lancaster/York to the north and Warrington/Sheffield to the south. Within those boundaries, HBP submits that around ten customers currently purchase only from local/regional suppliers. HBP submits that there are numerous alternative suppliers with manufacturing facilities in the area who could prevent the merged entity from raising prices to these customers. Within a 50 mile radius of either an HBP or a Clay production facility in this area, there are the following brick manufacturers:

Competitor	Location(s) of plant
Wienerberger	Cheadle, Denton
CRH/Ibstock	Nostell, Ravenhead, Roughdales, Parkhouse, Chesterton, Dorket Head
Carlton Main	Barnsley
Phoenix	Chesterfield
York Handmade	York
Normanton Brick	Wakefield
Cheshire Brick	Chester

- 17. HBP believes that these ten 'regional' customers already purchase materials from the manufacturers in the above list. Moreover, there are no restrictions on the ability of these customers to purchase from facilities outside this area. A number of brick plants in the Midlands of England are well placed as alternative sources of supply. Customers' ability to switch to suppliers outside the area constrains the merged entity's pricing. The geographical spread of Clay's own supplies shows the scope for the sale of bricks to customers in areas some considerable distance from the manufacturing plant. 25 per cent of Clay's total brick supplies were to

customer located in the South West and South East of England, in spite of the fact that its brick plants are all based in Lancashire and Yorkshire.

18. Overall, the evidence suggests that it is appropriate to assess the impact of the merger on competition within GB rather than within individual regions.
19. HBP submits that the merger will not give rise to any competition concerns in Northern Ireland. Although HBP and its competitors do make a proportion of their sales to customers in Northern Ireland, the majority are made through distributors in the Republic of Ireland. Prior to the merger, the total volume of sales made by Clay into Ireland as a whole were very small. No third party raised concerns regarding the impact of this transaction on customers in Northern Ireland and no further consideration with regard to this specific region of the UK need be given in this paper.

HORIZONTAL ISSUES

Shares of supply

Table 1: Shares of GB production volume (%) in 2004

	All bricks	All bricks excluding fletton	Extruded bricks
HBP	27	19	23
Clay	6	7	10
Combined	33	26	33
Ibstock	32	36	36
Wienerberger	17	19	16
Baggeridge	9	10	10
Others	9*	10	5

Source: the parties. Third parties that provided estimates confirmed these figures.

*Includes imports as well as other firms such as: Blockley/Michelmersh, Carlton Main Brick, Freshfield lane, EH Smith, Hammill Brick, Phoenix Brick, Furness and Carrodale.

20. Table 1 shows that, post merger, the parties' share of the supply of all bricks in GB is 33 per cent: an increment of 6 per cent. If fletton bricks are excluded, the parties' combined share falls to 26 per cent, and the increment becomes 7 per cent.
21. The majority of customer respondents considered that Clay was a smaller player and the evidence suggests that HBP and Clay had not been each other's closest

competitors. Post merger, there remain at least three other large suppliers of bricks and a number of smaller local producers.

22. Of the total number of respondents, three customers and one competitor considered that there would be a reduction in competition post merger.
23. The competitor in question considered that HBP's and Clay's respective product ranges and geographic locations were compatible and that their negotiating position would be consequently improved. As a result, the competitor believed that there would be a reduction in competition in the UK, particularly due to the aggregation of their capacity in the production of engineering bricks in the North of England. This proposition is at odds with those set out in paragraphs 8 and 9 (regarding the likelihood of engineering bricks and facing bricks both forming part of the same product reference) and those in paragraph 16 (concerning the accessibility of alternative sources of supply).
24. One of the customers submitted that, although there would not be a substantial lessening of competition at the national level, the loss of competition might be more significant in regions where the parties' combined shares of supply are high. However, when asked whether it would be possible (a) to identify such regions or (b) to switch to another supplier in another region, the customer did not respond.
25. Despite the fact that a number of other suppliers remain post merger, another customer considered that the merger would significantly reduce its negotiating strength given that, prior to the merger, it had purchased bricks only from HBP or Clay.
26. The third of the customers who expressed concerns considered that HBP was already in a strong position to increase prices prior to its acquisition of Clay. The customer considered that the effect of this merger and also the recent (September 2004) acquisition by Wienerberger AG of thebrickbusiness² would be to reduce competition despite the fact that the customer identified three alternative brick suppliers to whom it could switch.

Barriers to entry

27. The parties propose that entry barriers are likely to be significant. They include access to clay reserves and the requirement for substantial capital investment. Construction of manufacturing facilities would amount to ca £20 million for plant with a production capacity of 50 million bricks a year – around 2 per cent of the

² thebrickbusiness is the name of a brick-making business created from the merger of two UK manufacturers: Ambion Brick and Chelwood Brick.

total GB supply. Prospects for new entry therefore appear remote. Third party respondents shared this view.

Buyer power

28. HBP submits that the bricks sector is one which is characterised by significant buyer power. There has been increasing consolidation in the customer base in recent years. Prior to the merger, [30-45] per cent of HBP's sales and [40-55] per cent of Clay's sales were to their respective top five customers.
29. The merged entity supplies three broad categories of customer: builders' merchants, DIY retailers, and house builders.
30. Approximately 58 per cent of the builders' merchant sector is in the hands of four players: Travis Perkins, Jewson Graham, Wolsely, and Grafton. The remaining approximately 40 per cent of builders' merchants outside 'the big four' concentrate their procurement of supplies almost solely through three buying associations: The National Buying Group, The Combined Buying Association, and Cemco. HBP estimates that three DIY retailers (B&Q/Kingfisher, Wickes/Focus³ and Homebase) account for [75-90] per cent of sales made within that sector. Finally, although the house building sector is less concentrated, the top ten players account for [35-50] per cent of purchases. HBP argues that house builders exercise buyer power through the use of intermediaries such as builders' merchants and brick 'factors' (distributors).
31. The majority of customer respondents considered that they did have buyer power and that this would not be significantly reduced by the merger.

Co-ordinated effects

32. HBP argues that the merger will not increase the ability of or incentive for brick suppliers to co-ordinate their commercial behaviour. It points to certain features of the brick sector that impede the ability of manufactures to align their behaviour, including: lack of price transparency, lack of homogeneity⁴ of the main suppliers, lack of stability in demand due to fluctuations in the economic cycle, absence of barriers to customer switching and buyer power. No third parties raised concerns regarding co-ordination.

³ This statement was based on information prior to the acquisition by Travis Perkins of the Wickes business.

⁴ Little or no uniformity between market shares, size, cost-structures and product ranges.

VERTICAL ISSUES

33. The transaction does not appear to raise any vertical competition concerns.

THIRD PARTY VIEWS

34. The OFT contacted competitors and customers. Third party views have been discussed in paragraphs 9 to 26.

ASSESSMENT

35. The merger brings together the second and fifth largest suppliers of clay bricks in Great Britain. The majority of customer respondents were unconcerned, although a couple indicated that they might be more worried in the event of any further consolidation. However, the evidence suggests that the merging parties were not each other's closest competitors and that the post merger constraint will still be posed by several alternative large competitors and a number of smaller regional suppliers. Barriers to new entry appear to be significant. However, buyer power is a significant feature within the bricks sector and this will not be materially diminished as a result of this merger.

36. 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.

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