Anticipated acquisition by Midland Quarry Products Limited of the Griff Quarry currently owned by Hanson Quarry Products Europe Limited

The OFT's Decision on reference under section 33 of the Enterprise Act 2002 given on 27 September 2004

Please note square brackets indicate figures removed or replaced by a range at the request of the parties

PARTIES

1 **Midland Quarry Products Limited (MQP)** is a private company owned as a joint venture between **Tarmac Limited (Tarmac)** and **Hanson Quarry Products Europe Ltd (HQP)**. MQP produces aggregates and coated stone for supply primarily into the Midlands region. Tarmac and HQP are subsidiaries of **Anglo American plc (AA)** and Hanson plc respectively and are both active in the building materials and construction sector in the UK. **The Griff Quarry (Griff)**, an aggregates and coated stone plant in Warwickshire, is currently wholly owned by HQP. Griff's UK turnover for 2003 was [<£70 million].

TRANSACTION

2 MQP proposes to acquire Griff from HQP for a purchase price of [ ]. The transaction was notified to the OFT on 19 July 2004 and the administrative deadline expires on 27 September 2004.

JURISDICTION

3 As a result of this transaction MQP and Griff will cease to be distinct. The parties overlap in the supply of aggregates and asphalt (also termed coated stone). In relation to MQP and Griff ceasing to be distinct, the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met in respect of the production of asphalt in the 30 mile radius around Griff. In addition, as a result of this transaction, AA and Griff will cease to be distinct by virtue of section 26 of the Act, since, in the OFT's view, the 50 per cent stake held by AA in MQP will confer on AA the ability materially to influence the policy of Griff (see paragraph 15 below). In relation to AA and Griff ceasing to be distinct, the share of supply test is met in respect of the production of aggregates and asphalt in the 30 mile radius around Griff. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of two relevant merger situations.

RATIONALE

4 The parties state that the purpose of the transaction is to maximise efficiency benefits, which drove the MQP joint venture to be set up in 1996, by placing all of Tarmac's and HQP's coated stone plants and associated aggregates feed sources within the joint venture. (Griff was not part of HQP when the joint venture was established.)

RELEVANT MARKET

5 Cases under the Fair Trading Act 1973 (FTA), including Hanson / Pioneer (2000), Tarmac / Anglo-American (2000) and RMC Group / Alexander Russell (2001), have informed the OFT's consideration of market definition in this case.

Aggregates

6 Aggregates are used for construction purposes and consist of primary aggregates (sand, gravel, and crushed rock) and secondary/recycled aggregates (including china clay waste, glass waste, slag, recycled construction/demolition site waste and recycled railway ballast). Although aggregates can be sorted and graded differently, the OFT has previously considered there to be a single relevant market for aggregates given the substantial overlap between the uses to which different types of aggregates can be put. While MQP suggests that construction and demolition waste, road planings and crushed glass are substitutes for some aggregates, it has provided no evidence to support this view.

7 On a geographic basis the OFT has previously considered that a 30 mile radius from the point of production is the most appropriate basis for analysing the effect of aggregate mergers. This is because of the high cost of transport of aggregates relative to their sale values. Furthermore, Government planning policy recognises the 30 mile delivery distance.[1] The parties suggest that the delivery area for aggregates could be wider (although they note that product from Griff travels less far than is the norm in the industry). HQP believes that approximately 80 per cent of Griff's aggregate sales are delivered within a 30 mile radius, and 85 per cent within a 40 mile radius. Bidding data provided by MQP indicate that for the majority of tenders in which it has bid over the past three years, the winning bidder was located within a 30 mile radius of the customer. Third parties have mixed views as to whether or not a 30 mile radius around Griff is the appropriate geographic scope, but again, no conclusive evidence has been provided to support an alternative view.

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[1] Minerals Planning Guidance 6, published by the Office of the Deputy Prime Minister, states that '*aggregates are mainly transported from sites by road and rail. Most travel by road and rail are delivered within 30-35 miles from the quarry or pit*'; National Planning Policy Guideline 4 for land for mineral workings published by the Scottish Office states that '*since road access and related transport costs require working in relatively close proximity to the main urban markets, working more than 30 miles from the main markets will not generally be attractive to the industry and will conflict with Government objectives for reducing energy consumption*. '.

8 Given the lack of evidence provided in favour of a wider geographic scope, the effect of this merger has been considered in respect of the quarrying and supply of aggregates within a 30 mile radius of the point of production.

Asphalt

9 Asphalt is produced by heating and mixing bitumen and aggregates and is primarily used as a surfacing for roads. There are high specification asphalt products for applications such as racing tracks and coloured mixes. The specification of each type of asphalt is a function of the mix of aggregates, bitumen and additives and is made to customers' specifications. The OFT has previously considered there to be a single relevant market for the production and supply of asphalt. The parties broadly agreed with this approach and no evidence has come to light which would suggest the OFT should modify this view.

10 On a geographic basis the OFT has previously considered that a 30 mile radius from the point of production is the most appropriate basis for examining the effects of a merger between asphalt producers. This is because of the high transportation costs and the highly perishable nature of the product, which must be delivered hot. The parties to this case consider that a 30 mile radius from the point of production should be regarded as an approximation only. Bordering plants will also sell into the area and in practice product can and does travel further than 30 miles. In this particular case, they submit that there are a number of competing coated stone plants close to but outside the 30 mile radius which are nonetheless within economic delivery distance of a significant number of customers within 30 miles of Griff. Approximately 87 per cent of Griff's coated stone sales are delivered within a 30 mile radius and 98 per cent within a 40 mile radius. Bidding data provided by MQP indicates that for the majority of tenders in which it has bid over the past three years, the winning bidder was located within a 30 mile radius of the customer. However, 17 out of 60 bids were delivered outside a 30 mile radius, and asphalt has been delivered up to 60 miles away from the production point.

11 As with aggregates, third parties have mixed views as to whether or not a 30 mile radius around Griff is the appropriate geographic scope. Given the above evidence, the effect of this merger has been considered in respect of the production and supply of asphalt within a 30 mile radius of the point of production, although some consideration has also been given to the impact of plants located just beyond 30 miles.

12 The relevant frames of reference for consideration of this merger are therefore taken to be the production of aggregates and asphalt within a 30 mile radius of the Griff quarry.

HORIZONTAL ISSUES

Aggregates

13 The first merger situation at issue is the acquisition by MQP of Griff. Combined, MQP and Griff will have a share of supply of [15-24] per cent for aggregates (increment [0-5 per cent]) in the 30 mile radius around Griff (as shown in the table below).

2003 shares: 30 mile radius around Griff

	30 Mile Radius (per cent)
Griff	[0-5]
MQP	[15-25]
combined	***[15-24]***
HQP Europe (inc Griff)	[5-15]
HQP Europe (exc Griff)	[5-15]
Aggregate Industries	[15-25]
Lafarge	[20-30]
RMC	[<10]
Ennstone	[<10]
Tarmac	[<10]
Other	[<10]
HHI post-merger (increment)	1765 ([<50])

14 In the previous cases in this sector considered under the FTA the OFT was guided by a 'safe harbour' rule of thumb that post-acquisition shares of supply below 33 per cent within a target (asphalt or aggregate) production site's 30-mile delivery radius would not indicate competition concerns. There is no reason to depart from that view here. The total combined share of supply is well below that level, the increment is low, there are no third party concerns, and a number of competitors remain. The OFT therefore considers that the merger situation arising from MQP's acquisition of control over Griff will not give rise to a substantial lessening of competition in the supply of aggregates.

15 As discussed above, this transaction also gives rise to a merger situation insofar as AA, through Tarmac's shareholding in MQP, will acquire material influence over Griff. AA's material influence over both MQP and, following the merger, Griff extends to the whole of MQP's and Griff's respective shares of supply. When applying section 23 of the Act for the purpose of establishing jurisdiction account is therefore taken of the whole of MQP's and Griff's shares of supply.

16 For the purposes of considering whether the second merger situation may be expected to result in a substantial lessening of competition, [ ]. Moreover, the OFT notes that Tarmac itself has different competitive incentives vis-à-vis a related entity (50 per cent of whose profits are allocated to Tarmac) than in respect of a wholly independent entity. As share data are a means to help assess the degree of competitive constraint posed by rivals on one another, it may be appropriate to allocate 50 per cent of MQP's shares of supply to Tarmac to take account of the fact that MQP is a lesser competitive constraint than if it were wholly independent. To do so here creates a combined Tarmac/ MQP share of

supply of [10-20] per cent, with the acquisition of Griff amounting to an increment of only [0-5] per cent.

17 The OFT has also calculated diversion ratios to analyse changes in economic incentives.[2] On the data available, these do not indicate that the two merger situations substantially increase Tarmac's and/or MQP's incentives to raise aggregates prices in the area.

18 The weight of the above evidence indicates that there are no substantial competition concerns in aggregates, in particular because the combined share of Tarmac, MQP and HQP (taken together) remains unchanged, third parties are unconcerned, and significant rivals remain.

Asphalt

19 As shown in the table below, within a 30 mile radius of Griff, MQP and Griff have a combined share of asphalt supply of [35-45] per cent (increment [0-5] per cent), with HHI figures at a level which the OFT guidance states may indicate potential competition concerns.[3]

2003 shares: 30 mile radius around Griff

	30 mile radius (per cent)
Griff	[0-5]
MQP	[35-45]
Combined	***[35-45]***
HQP Europe (inc Griff)	[0-5]
HQP Europe (exc Griff)	0.0
Aggregate Industries	[25-35]
Lafarge	[10-20]
RMC	[<10]
Tarmac	[<10]
Ennstone	0.0
Other	0.0
HHI post-merger (increment)	3027 ([150-200])

20 The remaining four competitors (Aggregate Industries, Lafarge, RMC and Tarmac) have a share of [55-65] per cent of supply within this 30 mile radius. The rest is covered by MQP, and there are no independent producers of asphalt in this area. There are a number of asphalt sites located just outside the 30 mile radius, which will compete for some of the customers that Griff can serve.[4] Widening the geographic scope to a 35 mile radius does not reduce the parties' share to below 33 per cent, although widening out further to 40 miles does.

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2 The diversion ratio is the fraction of the sales lost by Product A going to Product B when A raises its price by, say, 10 per cent. In this context, assuming that goods are diverted in proportion to market share, diversion ratios were calculated to assess the incentives Tarmac faces to set prices at a higher level than they would be absent its shareholding in MQP pre- and post-acquisition of Griff by MQP.

3 See *Mergers – Substantive assessment guidance* (May 2003, OFT 516), Chapter 4.

4 The nearest asphalt sites just outside of the 30 mile radius belong to Tarmac, Hanson, Lafarge and RMC.

21 MQP believes that there will be several new asphalt sites within a 30 mile radius of Griff either already operating or opening in the next couple of years. It estimates that this will add around 20 per cent to total production in the area, and expects MQP's shares to fall back proportionately. However, the OFT has not been able to verify the accuracy of these predictions, and, while noting the potential effect, does not consider them conclusive.

Non-coordinated effects

22 Various asphalt competitors within 30 miles of Griff, along with rivals just outside this radius, may be expected to constrain MQP's unilateral conduct post-merger. The OFT has considered bidding data for asphalt contracts of over 3,000 tonnes for the past three years for MQP and the past year for Griff. MQP's data indicate that Griff has not bid against MQP in any contract. However, Griff's data indicate that MQP (Cliffe Hill) has bid against it in one out of four bids made in 2003 (the outcome of this tender is not yet known). While potentially showing that there is limited head-to-head competition between the parties, care must be taken with the MQP data as they are incomplete.

23 As with aggregates, the OFT has also considered this transaction in light of AA's acquisition of material influence over Griff. Combining 50 per cent of MQP's share of supply with Tarmac's would give a share of supply of [25-35] per cent for asphalt in the 30 mile radius around Griff, with the acquisition of Griff adding an increment of only [0-5] per cent; diversion ratio calculations likewise show no substantially increased incentives to raise prices. As noted above, the OFT has previously considered that post-acquisition shares of supply below 33 per cent would not indicate competition concerns. There is no reason to depart from that view here. The total combined share of supply is below that level, the increment is low and a number of competitors remain. The OFT also notes that while it is unclear whether these competitors would be able rapidly to increase their capacity utilisation, evidence does show that they have a high degree of spare capacity. The OFT does not therefore consider that competition concerns arise in respect of the combination of Tarmac and Griff in the supply of asphalt within a 30 mile radius of Griff.

Coordinated effects

24 The combined shares of Tarmac, HQP and MQP do not change as a result of this merger, while their relative shares change by only [0-5 per cent]. As a result of the marginal change in relative shares, the merger situations at issue appear not substantially to strengthen any incentives to collude that may already exist.

Barriers to entry and expansion

25 The investment required to set up an asphalt plant is not considered substantial in relation to market size. MQP estimates that it would cost approximately £2.5 million for a stand-alone plant to enter the market on a scale necessary to gain 5 per cent of the market in the 30 mile radius. Most asphalt plants are located at aggregate quarries and the OFT is unaware of any producers within this area who are not also active in the production of aggregates. The main barrier to entry on asphalt therefore appears to be the need to secure a supply of aggregates. MQP

suggests that the substantially lower market share of MQP in aggregates as opposed to asphalt indicates that there are a number of competing aggregates plants within the 30 mile radius that do not have a coated stone unit attached. Evidence provided to the OFT suggests that a number of these aggregates plants could establish an adjoining coated stone facility at a cost of approximately £2-£2.5 million (for output of 150,000-200,000 tonnes per annum). A recent example of this is the addition of a coated stone plant at Aggregate Industries' Haughmond quarry (approx. 50 miles from Griff). Aggregate Industries also has an application to build an urban asphalt plant at Northampton, 30 miles from Griff and HQP recently opened an asphalt production plant at Pottal Pool, 29 miles from Griff.

THIRD PARTY VIEWS

26 No third party has raised competition concerns about this transaction.

ASSESSMENT

27 This anticipated acquisition will result in the creation of two merger situations. For both merger situations, and in both the aggregates and asphalt sectors, the share of supply increment is small. The OFT's previous 'safe harbour' rule of thumb of a post-merger share in the relevant area of below 33 per cent is not exceeded, and no evidence otherwise suggested substantial competition concerns in respect of AA's gain of material influence over MQP in both aggregates and asphalt or MQP's acquisition of Griff in aggregates. As to the acquisition by MQP of Griff, where a combined share of [35-45] per cent is created in the supply of asphalt in the surrounding area, the increment is just [0-5] per cent, there is no third party concern, no evidence of previous direct competition between the parties, and a number of significant remaining competitors in the area, with others just beyond.

28 Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

29 This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.