AGGREGATES, RMX AND CEMENT MIR

HANSON RESPONSE TO THE UPDATED ISSUES STATEMENT

1. INTRODUCTION

1.1 This document sets out Hanson's response to the Updated Issues Statement (UIS).

Structure of this Response

1.2 It appears clear from the UIS that the Commission has effectively discounted in large part the possibility of an adverse effect on competition (AEC) arising in relation to aggregates and RMX, in particular given the extent of strong competition in these markets. Hanson also welcomes the fact that the Commission appears to have determined that there is no merit in relation to the margin squeeze concerns (within the RMX market) previously expressed under Theory of Harm (TOH) III.

1.3 Therefore, the focus of this response is on those theories of harm which the Commission appears to be concentrating on: unilateral and coordinated effects in relation to grey cement, unilateral effects in relation to GGBS and PFA, and vertical effects.

1.4 A number of comments on the aggregates and RMX markets are also set out at the end of this response with regard to the work carried out within the MIR. Given the positive prognosis contained in the UIS, Hanson requests that the Commission should finalise its views and conclusions as soon as possible and set out clear statements that it discounts the possibility of the concerns that were stated previously in relation to TOH I and TOH II in relation to aggregates and RMX.

1.5 This response is structured as follows:

1.5.1 **Timing of the Commission's review (pages 2 - 5);**

1.5.2 **Part I (pages 6 – 40): TOH II (Coordinated Effects in Cement)** - The Commission requested in Hanson's Hearing of 3 December 2012 whether Hanson had any views on the Commission's preliminary conclusions that it appears there exist coordinated effects in cement: Hanson respectfully disagrees with the Commission and requests that the Panel make a fresh and direct assessment of the pertinent evidence, in order to formulate a balanced and objective view. Hanson believes that such conclusions have been formulated too early in the process, since they were established prior to review of much of the key evidence and background information; this Part represents the requested summary of Hanson's views[1]**;**

1.5.3 **Part II (page 41): TOH I (Unilateral Effects in Cement)** – This Part is in summary form only as much of the evidence highlighted and explained under Part I is also relevant to Part II**;**

1.5.4 **Part III (pages 42 - 47): TOH I (Unilateral Effects in GGBS and PFA);**

1.5.5 **Part IV (pages 48 – 51): TOH III (Vertical Effects);**

1.5.6 **Part V (pages 52 – 54): TOHs I and II (Unilateral and Coordinated Effects in Aggregates);** and

1.5.7 **Part VI (pages 55 – 56): TOHs I (Unilateral Effects in RMX).**

[1] Hanson is not, at this stage, intending to put in a separate submission on coordinated effects, although it will be responding (and has already responded in certain cases) in greater depth to some of the Working Papers which have been (or are yet to be) published, where those Papers are being put forward by the Commission as supportive of a coordinated effects TOH.

TOH IV (Policy and Regulation)

1.6 The UIS considers Policy and Regulation principally in relation to barriers to entry and, to a limited extent, potential distortions of competition. However, two aspects of Policy and Regulation are directly relevant to other TOHs (these themes are dealt with in the relevant Parts of this response):

1.6.1 The Aggregates Levy (AGL) has very successfully favoured competition by enhancing the position of recycled and secondary aggregates producers, directly encouraging, subsidising and increasing competition from these sources to primary aggregates; and

1.6.2 The EU ETS scheme has a number of impacts. It should be carefully considered in the context of: (1) profitability (emissions trading windfall revenue should be stripped out as extraordinary or exceptional for the purposes of any profitability analysis, as the allowances will become a significant cost to the business in future); (2) the incentivisation of cement importers from low demand countries (e.g. Spain, Ireland and Greece) under the current trading regime and the incentivisation of non–EU imports during Phase III and after 2020, serving generally to increase the threat from cement imports; and (3) creating a material asymmetry between the GB producers with regard to major costs and incentives of producing cement, including the potential incentivisation of higher levels of supply (reducing any ability to coordinate).

1.7 Hanson would urge the Commission to consider further the impact of these regimes on competition in the cement and aggregates markets.

Further Work by Hanson

1.8 As noted below, this response inevitably represents a summary of Hanson's views in relation to some of the Commission's workstreams. Hanson has already submitted, and will submit, comments on a large number of the individual Working Papers, in which Hanson will explore some of the themes below in greater detail.

1.9 [✂]

2. THE TIMING OF THE CC REVIEW AND HANSON'S INVOLVEMENT

2.1 Hanson fully appreciates the Commission is subject to a formal statutory timetable for completing the MIR and is committed to assisting the Commission as much as possible. However, Hanson is concerned that the extensive burden placed on it through the number of work streams and very tight deadlines imposed by the Commission towards the end of 2012 and start of 2013, has adversely impacted the ability of the Commission to work to sufficiently review the responses and work streams, at a critical stage of the MIR, evidenced as follows:

2.1.1 [✂]

2.1.2 [✂][2]

2.1.3 [✂]

2.1.4 [✂][3]

2.1.5 Hanson considers the OFT's decision, to extend the scope of its Aggregates Market Study to also include Cement and RMX markets, was questionable

[2] [✂]
[3] [✂]

and has resulted in unacceptable extensive burdens on all the parties to the MIR. Hanson believes such burdens will have placed excessive pressure on the Commission's case team, possibly affecting the quality of assessment ultimately completed within the statutory time allowed for the review of all three markets and increasing the likelihood to rely on first conclusions reached during the review of the Lafarge/Tarmac merger.

2.2 Regarding the time allowed to provide comments on the UIS, this response has been requested before some of the critical Working Papers have been published and before Hanson has had sufficient time to consider those that have been published. Hanson assumes that the evidence which the Commission is relying on is explained fully in the Working Papers (as the UIS represents a summary of themes). Inevitably, this means that this Submission represents a summary of Hanson's views as currently formulated. Hanson is therefore obliged to explore many issues in greater detail in the responses to the various Working Papers as and when these are issued by the Commission and Hanson has had sufficient time to review.

Premature Publication of Preliminary Conclusions

2.3 It is clear that the Commission is considering undertaking considerable further work and analysis in relation to these areas and even at this late stage appears to be considering extending the ongoing review to other markets. Hanson welcomes the additional work being carried out now by the Commission on markets already in scope, but has concerns that the above problems will be compounded by seeking to further extend the scope of the study.

2.4 With regard to the Commission's ongoing work on existing markets within the scope of the study, Hanson considers that the need for this considerable further critical work means that the preliminary conclusions in the UIS must by definition be premature and unsafe, in that they have been established prior to completing the relevant critical work in accordance with applicable standards. A particular example relates to the Commission's statement that the cement sector shows high levels of profitability causing concern, where that profitability has been calculated according to a methodology (HCA basis) which the Commission and established practice acknowledges cannot be appropriate. The analysis of profitability on the correct measure (i.e. assessing assets on a current cost basis and adjusting for CO2 allowances) would show low (or negative) ROCE levels for Hanson (and Hanson suspects for some, if not all, of the other GB producers).

2.5 As stated above, Hanson was surprised to see a reference to potential concerns in relation to GBS supply arrangements included in the UIS. These products are out of scope of the MIR and, at least from Hanson's point of view, there was surprisingly little engagement by the Commission on the topic of the investigation leading up to publication of the UIS. It was inappropriate for the Commission to have drafted and published its preliminary conclusions without first even seeking the views of Hanson, a major producer of GGBS, on the topic. This response briefly explains the background to these arrangements and the competitive dynamic in relation to GGBS and fly ash, which the Commission is effectively only hearing in detail now for the first time.

Reliance on Tarmac/Lafarge

2.6 Hanson has a particular concern that the overlap between case teams, combined with the severe time pressures which both Hanson and the case team are operating under on the Market Investigation, means that there has been an over-reliance on the Commission's conclusions in *Tarmac/Lafarge*[4]. The shorter timetable (and the

[4] Report on the anticipated construction materials joint venture between Anglo American PLC and Lafarge S.A - published 1 May 2012.

corresponding more limited depth of review) inherent in such a review, and the fact that industry participants who are main parties to the Market Investigation, but not the merger review (such as Hanson), can not have been expected to have engaged fully in the merger review, stresses the absolute need for a "fresh look" on the Market Investigation. This was something highlighted in Hanson's Response to the Original Issues Statement.

2.7 Therefore, the work summarised in the Updated Issues Statement appears to show a number of instances where the Commission has sought to justify and confirm many of the features identified in *Tarmac/Lafarge,* in spite of the subsequent evidence received from the main parties and others. A non-exhaustive list of examples in relation to claims of cement coordination includes:

2.7.1 Supporting a preliminary finding of coordinated effects, formed on the basis of HCA profitability methodology – despite this methodology now being acknowledged to be the incorrect approach by the Commission, this evidence appears to be used to confirm the theory of harm developed in *Tarmac/Lafarge*.

2.7.2 Competition from cement importers - in *Tarmac/Lafarge*, competition from importers was not considered to be a material factor affecting external sustainability of coordination. This theme has been carried forward into the Market Investigation. Given the inherently greater scope for engagement with importers on a Market Investigation (as noted below, Hanson has concerns (based on its review of the Commission's website and various papers) as to the amount of information received from importers) and the additional information provided, Hanson would have expected the Commission to recognise expressly the much greater constraint from importers, as well as the significant market presence and share they have succeeded in establishing.

2.7.3 The continuation of the focus on 'patterns' in price increase proposal letters - noted as conduct potentially contributing to coordination in *Tarmac/Lafarge,* despite the clear evidence now obtained of a lack of any pattern in such arrangements and of the gap between proposed prices and realised prices.

2.7.4 The suggestion of the possibility of "repatriation" (on a small or large scale) acting as a mechanism to signal to, or punish, "deviators" referred to in *Tarmac/Lafarge* - the Commission has now had the opportunity to consider the circumstances surrounding the internalisation which took place in 2008, the only practical example of internalisation during the period under consideration. It should now be clear that the internalisation took place for natural business efficiency reasons and had no connection with "punishment" or the maintenance of the stability of market shares.

2.7.5 The continued reference to symmetry in costs and incentives also referred to in *Tarmac/Lafarge* – without taking any account of the material cost asymmetries and differentiation resulting from different reactions to the EU ETS, despite receiving significant information on the EU ETS.

2.7.6 The lack of analysis of the new dynamic resulting from the Tarmac/Lafarge JV and the entry of Lakshmi Mittal (via Hope Construction) into the market. This is likely at least to lead to significant instability in the market, but it is premature of the UIS to be in effect seeking to confirm the Tarmac/Lafarge findings without factoring the changing dynamic into the preliminary conclusions (although it is recognised that further work is to be done).

2.8 Hanson urges the Commission to review all the evidence and views submitted in this response (and elsewhere) in order to subject any preliminary conclusions in respect of the TOHs to rigorous and thorough fresh analysis and to ensure consistency with the evidence.

Timing of this Submission

2.9 Hanson has sought to achieve a balance with this response between providing it to the Commission as quickly as practicable and providing as full a response as possible (given the dates of publications of some of the Working Papers which appear to form the basis on which the UIS is based) in order to assist the Commission as it works towards Provisional Findings. This response is being submitted over two months before the Provisional Findings are due, and Hanson hopes that this will assist the Commission in reassessing its preliminary approach to the cement market in particular, before the publication of the Provisional Findings.

PART I: COORDINATED EFFECTS (CEMENT)

3. OVERVIEW OF THIS PART

3.1 This Part demonstrates that the Commission's perceived concerns regarding coordinated effects in cement are not consistent with the evidence now before the Commission.

3.2 The GB cement market is a competitive market, characterised by frequent competition for customers between GB cement producers and importers (as demonstrated by the empirical evidence presented below at Section 6 on the threats and losses Hanson has faced in respect of its customers), enormous instability and uncertainty and strong price competition.

3.3 This Part follows the UIS' categorisation of market characteristics, outcomes and conduct (for ease of reference). It starts by highlighting a number of the market characteristics which are relevant to the determination of whether the market is conducive to coordination:

3.3.1 A number of the market characteristics cited by the Commission in this respect (e.g. homogeneity, symmetry of costs structures and barriers to entry etc) do not exist in the manner cited by the Commission (or at all).

3.3.2 The strong and constant threat from cement importers, and the low barriers to entry for importers, mean that any coordination would, at least, not be externally sustainable. The market presence and capacity of importers has increased enormously, whilst the capacity of the incumbent majors has declined, as plants and kilns have been closed and mothballed over the years. Cement imports have built up from nominal levels (of practically zero presence) in the late 1980s to having around 13-14% of the GB market today and growing. A number of strong cement importers with secure lines of supply have arisen and there has been a trend of importers continuing to invest in GB since 2007, despite the downturn. To illustrate this, the current production level in the GB bulk grey cement market is only 7.2 million tonnes per annum. In the *Heidelberg/Hanson* decision, the European Commission stated that the capacity of all GB import terminals (in 2007) "*account for 6 million tonnes"*. Applying this level of capacity (which has continued to develop through the establishment of new import terminals such as Dudman at Montrose and Quinn at Rochester) to current production would result in imports accounting for an enormous 80% of the entire GB annual bulk cement market. Again, as will be seen from the empirical evidence on competitor threats to Hanson set out below in Section 6, importers are driving price competition and regularly constrain pricing in the market.

3.4 A focus on outcomes would reveal a market in which competition is working well:

3.4.1 Hanson presents empirical evidence of fierce competition below. This represents a mere sample. However, even the picture presented by this sample confirms Hanson's own experience of the GB cement market: that the market is intensely competitive, with Hanson facing ongoing competitive threats from both the Majors and Importers. It is critical that, to the extent that the Commission does not feel that it has sufficient evidence of strong competition, the Commission undertake further work (possibly through a case study) before reaching any provisional conclusions.

3.4.2 The Commission, as does pertinent economic literature, recognises that economic profitability analysis is the foremost indicator as to the outcome of competition: "*Outcomes of the competitive process in their different forms in a market—eg ...profitability...—can also provide evidence about its functioning. Evaluating the outcomes helps the Commission determine* *whether there is an AEC and, if so, the extent to which customers may be harmed by it, ie the degree and nature of 'customer detriment*"[5]. Indeed, the UIS cites profitability as the key indicator of potential competition problems, and appears to give significant weight to the analysis of profitability. Once the Commission updates its profitability analysis to reflect economic, rather than HCA accounting, it will be clear to the Commission that, at least with regard to Hanson's business, profits are not excessive (and generally fall below the cost of capital). In Hanson's case at least, its ROCE has been below WACC for nearly all of the period between 2007 to 2011, and indeed has been negative for [✂] out of the five years in question, as well as on average). The sustained lack of excessive profits means that customers are not being harmed by prices higher than they ought reasonably to be.

3.5 The features of <u>conduct</u> of the market participants cited by the Commission in the UIS do not support coordination, and on the contrary are, in many cases, non-existent or, in others, consistent with a highly competitive market (rather than one which is subject to hypothetical coordination).

3.6 There is no suggestion in the UIS, or the Working Papers which Hanson has seen to date, that the Commission has developed a cogent theory of coordinated effects. For example, even the economic model being relied upon in respect of coordinated effects has not been identified. This is something which the Hanson Head of Legal queried directly with the Commission back in May when he wrote to enquire which one of the various 'oligopoly models' and 'game theories' the Commission had decided to use for the purposes of the economic analysis of the market[6]. This was (and remains) required in order to consider any suggested economic theories of harm in their proper context.

3.7 The UIS refers to a number of relatively random and unsupported factors which the Commission considers to be potentially indicative of coordinated effects, but the precise economic model has not been identified and the application of the criteria for a coordinated effects theory of harm has not been undertaken in a clear manner. This suggests that it is premature to indicate preliminary concerns over coordinated effects.

3.8 Two further key factors which militate against a finding of coordinated effects must be explored further by the Commission:

3.8.1 The industry structure is undergoing very significant change as a result of the *Tarmac/Lafarge* JV and the introduction of a new major to the industry, Hope Construction with the country's largest cement plant, some 16% of national supply[7] and led by one of the world's leading businessmen. Both these factors have the ability to change competitive dynamics very significantly. The potential impact of the *Tarmac/Lafarge* JV and the entry by Hope Construction are explored further below.

3.8.2 The depressed state of demand, combined with the unpredictable, but generally negative prognosis for recovery, means that any coordinated effects conditions are likely to be very different from those analysed by the Commission in the earliest part of the period under review. The identification of coordinated effects in such a period of prolonged demand shock and uncertainty presents significant difficulties to any potential finding.

3.9 These are explored further at the end of this Part.

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[5] Commission Draft Guidelines for Market Investigations - June 2012.

[6] E-mail from the Hanson Head of Legal of 18 May 2012 and response of the Commission Case Team on 21 May stating that no models had yet been chosen.

[7] According to an article by the Financial Times of 16 November 2012: " Mittal bets on UK with £272m cement deal"

4. MARKET CHARACTERISTICS CONDUCIVE TO COORDINATED EFFECTS

4.1 This section comments briefly on a number of the market characteristics which the Commission considers to be conducive to coordination. As will be seen below and in the next section which deals with external sustainability vis-a-vis importers, the factors cited by the Commission do not provide evidence of a market which is conducive to coordination.

Concentration

4.2 The UIS notes that the GB cement sector is characterised by a high degree of concentration, noting that there are only four GB producers. As already noted in Hanson's response to the Original Issues Statement, the number of competitors in a market can be critical in respect of a tacit collusion theory of harm. It was noted that there is strong theoretical support for the notion that coordination becomes less likely as the number of firms in an industry increases, and indeed that any number greater than three may be too many to support a theory of tacit collusion[8].

4.3 This should be set in the context of today's market including:

4.3.1 four GB cement producers (now including the new player, Hope Construction):

4.3.2 a major importer (AI/Paragon) which already has a material share of GB cement and is expanding its activities (in particular, to independent customers, as will be shown below); and

4.3.3 a small number of increasingly strong importers with significant spare capacity (two of whom, Lagan and Quinn, are considering merging their cement activities with the express stated purpose of focusing on importing to GB in greater volumes).

4.4 Hanson suggests that the number of producers and importers exceeds what would be characteristic of a market conducive to tacit collusion.

4.5 The number of players in the market means that it would be very difficult for the GB producers to maintain any form of stability or equilibrium on market shares as the UIS seems to suggest. The evidence presented in Section 6 below highlights the competitive threats to Hanson's customers and shows that Hanson faces multiple threats from GB producers and importers. In practice, it would not be sustainable for one producer to focus only on a limited proportion of GB producers, as this would be undermined by the threats from other producers and importers in the market.

Structural Links

4.6 The UIS overstates the impact of structural links (JVs and trade associations).

4.7 Hanson does not understand why the Commission is referring to its joint ventures with the other cement majors as a meaningful structural link of note:

4.7.1 Hanson only has four JVs that remain trading and which are with the other Majors.

4.7.2 Hanson has no joint ventures with Lafarge.

[8] It was noted that: "*How many firms does there have to be in a market before coordination becomes unlikely? This question was addressed in an influential behavioural economics paper by Huck (2004) "Two are few and four are many" in which he found that coordination (without communication) was rarely found where there were more than three players in the market.*"

4.7.3 The only joint venture Hanson has going forward with Cemex is to share the cost of a marine aggregates wharf in Hull (Humber Sand and Gravel Ltd). This was formed in 1993, and [✂] operates a single marine aggregate wharf in Hull. The market in this area was too small to operate individual independent marine aggregate activities efficiently.

4.7.4 The other joint venture with Cemex (Purfleet Aggregates Ltd) was also established purely for marine aggregates - Hanson [✂] served notice to terminate the JV in March 2011.

4.7.5 The only JV with a Major of any significance is Midland Quarry Products (a JV with Tarmac), formed in 1996 initially to enable minerals dividing two adjoining quarries to be worked rather than sterilized. In *Tarmac/Lafarge*, the Commission considered that Tarmac may not sit within any 'coordinating' group, which may suggest that this JV would not, in any case, be considered relevant.

4.7.6 The only other JV with a Major (AI) is Mendip Rail, a joint venture originally with Foster Yeoman dating back to 1996 and set up to provide rail freight services for aggregates.

4.8 As Hanson has no JVs in cement, it is difficult to see how these JVs can be relevant. The Commission has merely identified the existence of legacy JVs (principally with interests only in aggregates, and certainly not in cement), and concluded that it is inevitable that they must provide structural links of concern, without in any manner assessing the significance of these JVs and what (if any) visibility they provide.

4.9 Accordingly, Hanson respectfully asks the Commission now deletes all references to JVs as a structural factor of concern in its review of the relationship between Lafarge, Cemex and Hanson. The wording used currently by the Commission (for example by referring to attempts by Hanson to keep the various JVs ‘at arms length’ and inferring that there are a significant number of meaningful JVs) is highly misleading. This section of evidence therefore, as currently stated by the Commission, is inconsistent with the realities and true status of such JVs.

4.10 The other structural link cited by the Commission is the trade association, the MPA. Again, the MPA provides Hanson with no information whatsoever in relation to the businesses of its cement competitors and cannot be referred to as a ‘structural link of note’ for the purposes of the market review. Hanson derives no visibility of its competitors' businesses through its membership of the MPA. Hanson therefore suggests, with respect, that the Commission has overstated any conclusions with regard to the perceived structural links and Hanson invites the Commission to revise its published statements in this respect.

Barriers to Entry

4.11 There are barriers to entry to the greenfield production of cement. However, there are few barriers to expansion, either up to the existing capacity of clinker production facilities or, for example, if clinker is imported, beyond the existing clinker production capacity.

4.12 Importantly, there are very low barriers to entry or expansion by importers. This is discussed further below, but the evidence of expansion by importers, in particular since 2007, shows how low these barriers are. As noted above, importers already own terminals with a total capacity which was estimated to be around 6 million tonnes in 2007 (which would represent 80% of the entire GB bulk cement market and national demand). Importers could increase the level of imports within a short timeframe, which could serve to undermine any coordinated strategy. Importers further benefit from access to good distribution networks giving access across the country.

4.13 Furthermore, the establishment of new grinding operations (to process imported clinker) carries a far lower barrier to entry relative to the establishment of a new greenfield clinker and cement production plant. The UIS has estimated the cost at being up to £50 million, but the costs for a clinker grinding plant to produce grey cement and constructed on a brownfield site, could be much lower than this. This represents a credible and far more likely and economic method of entry, relative to hypothetical greenfield development of a full clinker production facility. Accordingly, the barrier to entry is not how it has been stated and assessed to date by the Commission and Hanson therefore suggests that such references, where currently referred to within the evidence before the Commission, are overstated.

4.14 This is a common method of production around the world (although not yet commonplace in GB; Cemex however does operate one grinding plant not co-located with a clinker production facility). [✂].

Symmetry

4.15 The Commission does not focus on market share symmetry as there is none. One GB producer (Lafarge/Tarmac) is significantly larger than the other GB producers and importers. There is nothing to suggest alignment of incentives based on market share.

4.16 The Commission focuses however on claimed costs symmetry. Hanson believes that this is overstated, as described below.

4.17 The UIS acknowledges that there are differences in the supply of raw materials. Indeed, the move to the use of alternative fuels in the clinker production process has led to divergences in the fuel mix and the costs of fuel between producers. [✂][9] The use of alternative fuels is constantly evolving, leading to a degree of costs asymmetry between producers. An example has been given below (at paragraph 5.18.2) where an Irish producer is rumoured to have entered into an agreement with a alternative fuels supplier, in effect altering the incentives of that producer and incentivising the maximisation of production.

4.18 As noted in Hanson's Response to the Original Issues Statement, there are considerable asymmetries even between Hanson's production plants[10]. These result from, for example, different energy-efficiency of kilns and from the access to raw materials such as the requisite limestone. [✂]. Others asymmetries include kiln capacities, storage and access to market (in particular the rail linkages are distinct providing different cost bases). Logistics differentials such as rail links and the [✂] provide for important cost asymmetries.

4.19 It is likely that such asymmetries will be duplicated and magnified when comparing different producers. For example, all of Hanson's plants use dry processing and have clinker production whereas, for example, Cemex has semi-wet, semi-dry and one plant that does not have a clinker production facility.

4.20 In addition, cost asymmetries can undermine internal stability when costs change over time. The closure of higher-cost plants and kilns, the increase in energy costs (which will exacerbate differences in efficiency between plant and between firms) and the growing impact of carbon allowances (firms may choose to run less (or more) to maximise carbon allowance sales or run more to increase capacity utilisation) all represent significant costs asymmetries that serve to make it difficult for cement producers to coordinate their strategies.

4.21 The latter item highlights the impact of EU ETS. [✂]

[9] [✂]
[10] Paragraph 11.31 of Hanson's response to the Issues Statement dated 20 April 2012.

4.22 Hanson has not been able to review the Commission's workings in full (due to redactions). However, Hanson notes that the analysis in the Working Paper on Price Parallelism in Bulk Cement suggested that there was only a weak or limited correlation between the variable costs of the Majors, which is a most surprising statement. This does not accord with the Commission's suggestion elsewhere that there is symmetry of costs and that this symmetry constitutes evidence consistent with a model of tacit collusion.

4.23 Also, with regard to the actual age of cement assets and also the internal management of the financial treatment and useful lives of such assets on an accounting (HCA) basis, there are again important differences in such ages and in the accounting cost treatment, which further provides for limitation in any assumptions that might be made regarding hypothetical costs symmetries.

4.24 Therefore, Hanson invites the Commission to expressly acknowledge these considerable asymmetries in costs between the cement producers, as well as the potential for these to develop further. The extent of scope for, and the actual level of, asymmetries undermines any hypothetical alignment of interests of the GB producers and it cannot now be said that the market has shown symmetries across the key costs that would facilitate coordination. Hanson therefore suggests that the evidence currently before the Commission omits due reference to the cost asymmetries that are now understood.

Transparency of Cement Production and Sales

4.25 A key requirement for coordination around shares of production, shares of sales and/or wins/losses of customers is for meaningful transparency in relation to these elements. The UIS refers to MPA data and customer win/loss data as providing meaningful transparency in this respect.

4.26 The MPA only provides members with data regarding the size of the market as a whole (to the extent it can be quantified by MPA members, which may exclude certain suppliers' data). Therefore, in effect, only the member's *own* share can become visible – no form of visibility whatsoever is provided with regard to the market shares of competitors.

4.27 Hanson may receive some feedback from customers it has won as to who may be their incumbent supplier and from customers it has lost as to who may have won the customer. However, the data Hanson receives merely represents a rough and ready estimation of 'win/loss' data – a proportion of the data is based upon conjecture and inference and it can in no manner be treated as accurate, precise or complete. In particular, the data cannot provide a reliable, complete or precise indication as to factors such as:

4.27.1 whether customers have switched a proportion or the whole of their demand away from Hanson (and vice versa);

4.27.2 whether lower volumes (or increased volumes) are representative merely of reduction (or increase) in production by the customer; and

4.27.3 whether the loss (or gain) of a customer is attributable to a customer switching or a new customer plant coming on stream (or a customer closing its plant).

4.27.4 In addition, the data is reliant on customer feedback which is not always precise (the customer may not give feedback or may give unreliable feedback (particularly where Hanson has lost a customer)).

4.28 The 'win/loss' data would only give an indication of wins and losses involving Hanson. There would be no indication of other movements in the market. As noted below, there are a number of companies (GB producers and importers) competing for customers on a regular basis. Monitoring movements in customers between a multitude of competitors is simply not possible when Hanson only has visibility of its own wins and losses.

4.29 The ‘win/loss’ data which Hanson receives would be the only way of estimating competitor market shares. However, for the reasons above, there would likely to be significant shortcomings in this data. Therefore, the extent of meaningful transparency in the market is fundamentally over-emphasised in the UIS and Hanson believes that any balanced or objective assessment must expressly recognise the material limitations in relying on such ‘data’.

4.30 The UIS also refers to cross sales as potentially leading to transparency in production capacity (including future intentions) and to cross sales/price increase proposal letters leading to transparency in pricing. These are dealt with below (cross-sales at paras 8.22 to 8.24 and price increase proposal letters at paras. 8.3 to 8.14), but, in brief, these do not afford the visibility suggested by the Commission:

4.30.1 As the Commission recognises, cross sales of cement are limited. These cross sales are required by efficiency factors (in particular, the need to save logistics costs and relevant environmental factors, such as the need to minimise lorry movements through towns and villages. These sales do not enhance transparency as they are unrelated to other supply arrangements in the market.

4.30.2 Price increase proposal letters do not lead to transparency in pricing as the pricing agreed with customers differs significantly from that proposed.

Impact of Vertical Integration and Intense Competition at RMX Level

4.31 The focus of the coordinated effects theory of harm is been on supply to the independent RMX sector. As has been shown below, this is highly competitive.

4.32 A significant proportion of Hanson’s cement supply is left to its own RMX channel as an important route to market, which ultimately determines who wins the supply of the relevant cement – this proportion of the market has already been acknowledged by the Commission to be extremely competitive, and therefore any analysis of competition in the cement market must begin with express acknowledgment that, at least as far as Hanson is concerned, around [✂]% of the final supply market of cement is already known to be subject to extremely strong competition, namely in the form of the RMX channel.

4.33 This is explored further below in Part IV (Vertical Effects).

5. CEMENT IMPORTS

5.1 Understanding the role of cement imports is fundamental to understanding the extent of competition in the GB cement market. It appears that the UIS is working to justify the treatment of cement importers as very much a mere competitive fringe, rather than the major competitors in GB cement markets who regularly constrain pricing, which Hanson knows them to be.

5.2 Hanson believes the Commission has overstated the barriers to entry to, and disadvantages faced by, importers, in particular as regards the perceived ‘penalty’ cost disadvantage faced by importers and the reaction of GB producers.

5.3 The Commission's analysis does not adequately recognise the importance of importers in driving customer choice, in constraining pricing and in enhancing price competition to the benefit of the independent RMX producers who have flourished as a result of their new presence in the market.

5.4 It is unclear to what extent the Commission has obtained a comprehensive picture from the leading importers as to the true costs of importing into GB and the prices at which imported cement is sold to customers. As far as Hanson can see, there is some suggestion that the Commission has not obtained comprehensive information from importers[11] and has relied, to a certain extent, on limited anecdotal evidence only. As the threat from imports is such a significant feature of the GB cement market, Hanson considers that it is essential that the Commission conducts a comprehensive analysis of the pricing and costs of importers, and identify clearly the evidence it is relying on. Hanson requests that the Commission publish how many and which importers have been fully reviewed for the purposes of the MIR, what exactly was the level of data and financial information coming from such importers and over which years, and also what the quality of such financial data was and particularly what accounting standards govern it and guarantee its integrity.

Overview

5.5 The competitive threat from imports has been recognised consistently throughout Hanson's internal documents. For example: In Hanson's 2011 to 2015 UK strategic review, it is noted that, [✂]. The Commission has numerous other examples of the same across the documents and e-mails submitted in respect of Hanson[12].

5.6 In the 2007 *HeidelbergCement/Hanson* decision, the European Commission recognised the strong constraint exercised by cement imports (and, indeed, noted it as a key factor negating the risk of coordination by GB cementitious products producers[13]). In particular, the Commission noted:

"*any attempt to coordinate may be destabilised by the increasing constraint of imports, either by other competitors or by some customers. Currently there are 20 cement terminals in Great Britain allowing for the discharge of cement and cement additives, not only owned by the major players but also by those with a smaller presence, such as Titan and Holcim or by independent undertakings or customers. According to the parties, over the last 9 years, 11 terminals have been set up in the UK. The capacity of all these import terminals accounts for around 6 million tonnes (representing around 35% of the cementitious market) and it is only used at about 25%.*" (para. 88)

5.7 The position of importers in GB as a proportion of GB cement supply has increased consistently since the date of that decision, and, as will be seen, a number of importers have shown an enhanced commitment to GB supply through new investments since that date.

5.8 The Commission will be aware that there are now a number of large scale importers whose presence and/or recent investment/expansion in GB suggests that they are committed to participation and at least potential expansion in the GB market in the long-term. These include:

5.8.1 **Holcim/AI** – Holcim/AI is a major importer of grey cement (and GGBS) through Paragon. Whilst Hanson understands that it uses the majority of its imported cement for internal purposes, it is increasingly being seen as a competitor for independent customers. As will be seen from the empirical evidence of competition to Hanson set out below in Section 6, Paragon is increasingly becoming a major competitor to the GB producers in cement. In any case, the fact that a major customer imports cement in significant

[11] For example, the Putback Paper on Imports received on 28 November 2012 states that "*the evidence we received from importers which answered our questionnaire*.." para 12. The UIS refers to the "*cement importers for which we had data*..." (para. 92). These both suggest that data from importers has been less than comprehensive. In addition, the Commission's website suggests that, as at the date of this response, the Commission has only held a hearing with one importer (Titan Cement) other than Holcim/AI.

[12] [✂]

[13] Even though this conclusion was reached in relation to potential coordination in relation to cementitious products producers as a whole (rather than grey cement alone), there is no reason why it would not also hold true for potential coordination concerns in relation to grey cement.

quantities demonstrates the competitiveness of imports. This is recognised by AI itself: "*As AI did not produce cement in Great Britain, it needed to import it or purchase it from Great-Britain-based producers. It met approximately 50 per cent of its cement requirements through imports. AI did not believe that this disadvantaged it in any way.*"[14] Accordingly, Hanson believes that the Commission must expressly recognise and acknowledge that one of the market majors themselves relies on and bases its national UK operation on imported cement and shows that they do not suffer a cost disadvantage in using imports.

5.8.2 **Lagan and Quinn** - both are major cement producers in Ireland, and currently import into GB (and/or sell to importers, such as Dudman and Denis May). The Commission will be aware that they have recently announced a possible joint venture between them in relation to their cement and quarry products businesses. The Commission will no doubt be considering this deal as part of its "counter-factual" analysis. However, it is notable that Quinn has pointed to the growth in exports as one rationale behind the deal: "*We believe the joint venture will enhance our ability to grow both domestically and on the exports side which will underpin jobs in this business.*"[15]

5.8.3 **Cementos Portland Valderrivas (CPV)** – this is a major Spanish cement producer, which supplies independent importers (such as Dudman and Sherburn) as well as its own GB import businesses (Southern Cement and Dragon Alfa). It has two import terminals giving it access to both the West (Sharpness) and the East (Ipswich) of GB.

5.8.4 **Titan Cement –** Self supplies from its plants in Greece and imports bulk cement via its terminal in Hull. It has been active in the GB market since 1990.

5.8.5 **Dudman** – Dudman has been active as an importer into GB since 2003 and it has opened a number of new import terminals recently. Its import terminals include Shoreham (West Sussex), Howden (East Yorkshire), Lowestoft (Suffolk), Garston (Merseyside) and Montrose (Angus, Scotland). The spread of terminals is such that they can economically serve the majority of GB customers[16].

5.9 This is in addition to other international cement producers, such as CRH (which operates in GB through Premier Cement) and a number of smaller independent importers (such as Thomas Armstrong).

5.10 It is clear that there are very low barriers to expansion for importers. Importers have grown their share of the market significantly during the period of depressed demand in GB. In addition, the Commission's Barriers to Entry Working Paper identifies that six new cement import terminals have been opened since 2007[17], despite the depressed demand conditions during this period. This shows the level of commitment by importers to the GB market and the confidence that conditions will remain favourable for imports. As noted above, 2007 estimates put the capacity of cement import terminals at as much as some 6 million tonnes[18] (which would be equivalent to around

[14] AI Hearing Summary, para. 32.
15 Belfast Telegraph Article of 21 December 2012: "*Joint Venture to be cemented in deal by top firms*". See: http://www.belfasttelegraph.co.uk/business/business-news/joint-venture-to-be-cemented-in-deal-by-top-firms-16253209.html#ixzz2HtQ5S8YI
[16]Hanson is aware that, shortly before submission of this Response, an announcement was made concerning the administration of Dudman (albeit that Hanson believes that the company owning the freehold and leasehold cement import terminals are not held in the company which is in administration). Of course, it remains entirely possible that Dudman will come out of the administration in a new form (remaining a strong competitor) and/or that the administration will present a good opportunity for a competing importer to bulk up its operations to seize Dudman's share.
[17] Table 2, para 78.
[18] As reported in the *Heidelberg/Hanson* decision at paragraph 88.

80% of current GB bulk cement demand). There are further recent examples of expansion by importers into the GB market. For example, in addition to the import terminals referred to above, Hanson is aware of Quinn opening a new terminal at Rochester in later 2012, in order to enhance its supplies to the South East and London markets especially.

5.11 At the time of preparation of this response, Hanson has not had the opportunity to review the Commission's Working Paper on Cement Imports (this has not yet been published in full – Hanson has only seen limited extracts through the putback process). It will be in a better position to comment in full on that paper in due course, but makes a number of general comments on certain themes developed in the UIS in relation to cement importers.

The Perceived "Cost Disadvantage" or "Penalty" faced by Importers

5.12 The detail of the Commission's calculations are not yet clear and so Hanson cannot comment in full on the Commission's preliminary conclusions concerning the cost disadvantage.

5.13 The Commission's statement clearly does not reflect Hanson's own understanding of import costs. According to workings and assessments provided by the trading arm of the HeidelbergCement Group, the cost of purchasing cement in Spain for import into the UK would be only €[✂] per tonne FOB, and freight would be around €[✂] per tonne[19], giving a CFR price of around €[✂] per tonne[20] for UK landed imported cement per tonne (these costs would be potentially lower depending on volume). This is well below and compares favourably with Hanson's 2011 fixed and variable costs per tonne which exceed £[✂] per tonne (€[✂])[21] – Hanson does not yet have the final 2012 figures available, but Hanson already knows that its 2012 production costs will have increased by at least £[✂] per tonne, further extending the already clear advantage. These figures show the cost advantage for importers (at least as far as Hanson is concerned), and accordingly it cannot safely be said that importers suffer a 'penalty' cost disadvantage relative to GB production costs. Further detail on this will be provided in the response to the Working Paper on Cement Imports (when published).

5.14 The Commission considers that a comparison of GB producers' ex-works variable costs with importers' total costs[22] is somehow the appropriate methodology to use for these purposes. Hanson will comment on this in greater detail when it responds to the Cement Imports Working Paper (not yet published), but, as has already been set out in response to the Imports Putback Paper, Hanson considers that this methodology is fundamentally flawed. For example:

5.14.1 Put simply, this methodology would require the importer's cost to take account of recovery of fixed, as well as variable, costs of cement production, whereas the GB producers' prices would not. This would clearly not be comparing "like with like". Hanson simply does not understand how or why the Commission is able to discount the very considerable fixed costs when assessing GB production costs.

5.14.2 The Commission is suggesting that GB producers would be prepared not to recover long run marginal cost (LRMC) in order to price importers out of the market. This might in theory be a feasible strategy if there were only a single importer with no or very limited presence in the GB and limited

[19] Depending on shipment size and destination. This would be the cost from Northern Spain.
[20] The cost for discharging and handling not included, but this would be minimal.
[21] At the exchange rate of £0.85464:€1 (XE currency rate for 28 January 2012).
[22] In para. 25 of the Imports Putback Paper (sent to Hanson on 28 November 2012), the Commission states: "*It is worth noting that GB producers are likely to have higher fixed costs than importers, and therefore long-run marginal costs of production may not be as dissimilar between the Majors and the importers. However, the relevant cost concept for this analysis is the average variable cost, as these costs will determine the ability of the majors to price importers out of the market*".

commitment to the market, whereby a short-term strategy of pricing below LRMC might allow longer term recovery of LRMC upon exit of the producer. This would not be an effective or desirable strategy where there are a number of importers with a commitment to the GB market who have all established a strong foothold in the market (as noted above).

5.14.3 In any case, the argument for the appropriate metric for *importers* being variable cost is potentially stronger than for Hanson. It is Hanson's view (from competition with importers) that, particularly in the case of importers linked to major cement groups, importers' pricing approaches seems to be largely driven by simply achieving a contribution to fixed overheads (i.e. covering variable costs only, fixed costs not taken into consideration), with the fixed cost recovery having been taken care of by domestic volume in the country of manufacture. When comparing domestic cost structures with importers costs structures, it would also be entirely reasonable to use only variable costs, from the perspective of the importers.

5.15 Therefore, Hanson does not agree that there exists any cost disadvantage or 'penalty' for cement importers. Hanson would be concerned if such conclusions remain in published Commission statements. Therefore, as evidence, Hanson considers the references to the "penalty" costs suffered by importers to be inaccurate and unreliable.

5.16 Indeed, macro-economic factors can give imports certain advantages in terms of costs. These currently include low shipping rates (in particular, compared with land transport costs) and a strong £ against the €. Indeed, the effects of strengthening of the £ against the € have not yet fully been felt in cement imports terms: the general prognosis for imports is becoming even more positive – the recent strengthening of the £ against the € can only further boost imports.

5.17 Whilst these factors are potentially variable, the depressed state of the Euro area without clear growth forecasts, together with the downturn in international trade, mean that factor has a semi-permanent status providing further impetus for imports into GB even over current levels.

Other Factors Incentivising Imports

5.18 Non-GB producers may also be affected by external factors which incentivise them to maintain production at a level in excess of that required for the satisfaction of domestic demand, in effect incentivising importers to accept lower margins. Examples include:

5.18.1 The incentives provided by the EU ETS on certain producers to keep sub-optimal plants in operation, and/or increase output at certain plants (i.e. above that required for domestic demand), in order to maintain carbon allowances and thereby encourage higher levels of supply; and/or

5.18.2 Commitments to purchase raw materials - for example, Hanson understands that Lagan has entered into a deal with a Local Authority at one of its plants to use waste in the manufacturing process, potentially incentivising the maximisation of output[23].

5.19 As regards the EU ETS, the UIS notes in this respect that "*while we understand that there may be an incentive under the ETS to produce more cement in order to continue to receive a full allocation of carbon allowances, we note that this is true for all cement producers, including domestic ones. Further, the additional incentives on importers as a result of ETS partial cessation rule do not apply to all their cement plants across the*

[23] [✂]

board, but only to those plants (a) whose geographic location makes them suitable for exporting to the UK and (b) where production is near to the threshold of historic activity levels"[24].

5.20 The incentive to maintain sub-optimal plants in operation does potentially apply in the UK as elsewhere, but the effect is even more marked compared with the UK in those countries which have experienced an even greater fall in demand than GB. These include Spain, Ireland and Greece, the first two of which are ideally suited for exports to the GB, and the latter of which is also a regular "exporter" to GB.

5.21 Rather than being over-stated, as the UIS claims, this is something which has a real impact on incentives to import into GB. There are a number of references, in Hanson internal documentation provided to the Commission, to importers to GB being incentivised by the carbon trading regime. [✄][25]

5.22 The exact incentives provided by the EU ETS for importers will be explored in the response to the relevant Working Paper(s)[26], as will the likely position following 2020 when carbon allowances are likely to become a cost for EU producers, potentially removing the additional incentive for EU producers to maximise production, but greatly incentivising imports from outside the EU (in particular, Africa - one of the areas of focus for new clinker production capacity).

Perceived Incentive to "take" the same GB cement producers' prices

5.23 The UIS notes that "*the higher costs faced by cement importers creates incentives for them to price their cement just below the price of GB-produced* cement"[27]. As noted above, the UIS does not consider that a cost advantage exists for importers, although as stated above, Hanson's believes that a full analysis would show the contrary.

5.24 By way of empirical evidence, it is not clear to what extent importer offered prices have been analysed in full by the Commission. If not, Hanson considers that further work on this would be essential. Hanson's experience is not of importers merely pricing "just below" the price of its GB-produced cement, but of importers significantly undercutting it and successfully constraining pricing throughout the year.

5.25 The documents available to the Commission include numerous examples of pricing being offered by importers to customers significantly below those charged/proposed by Hanson. A sample of instances is set out below:

5.25.1 In an internal e-mail in March 2011 (submitted to the Commission in respect of the latest request for cement e-mails[28]), the Commercial Director notes in relation to Dudman: "*They are in the prices [Sic] of giving prices to our customers in the* [✄] *and as discussed yesterday he tried to take a customer from us at a price* [✄]"[29].

5.25.2 The loss of a customer to Dragon in Birmingham in March 2011 is reported internally at a price reputed to be £[✄] per tonne below Hanson's price.

5.25.3 In an internal e-mail in March 2011 (also submitted to the Commission[30]), it is noted that: "*One point is that they* [importers] *are still at 2010 rates as none have had any significant increases...to win business you need to be* [✄] *in the South.* [✄] *are currently quoting very low £*[✄] *to win* [✄]

[24] Updated Issues Statement, para.123.
[25] [✄]
[26] The Cement Imports Working Paper and/or the Working Paper concerning Policy and Regulation: Regulations covering Carbon Emissions in the Cement and Aggregates Markets.
[27] Updated Issues Statement, para.86.
[28] [✄]
[29] [✄]
[30] [✄]

business." (This is significantly below Hanson's ASP for 2011 once its first January 2011 price increases were proposed)

5.25.4 Around November 2011, Hanson had to work to retain a customer ([✂]) which was reportedly offered £[✂] per tonne by an importer for CEM 1 (compared with Hanson's price of £[✂]) (and £[✂] per tonne for GGBS (against Hanson's price of £[✂]) – see further below) – these prices were reported to be fixed until the end of 2012 (the comparative pricing from Hanson does not take account of its proposed January 2012 price increase).

5.25.5 There were other examples of Paragon being reported to have offered GGBS during that time to customers of Hanson at around £[✂] to £[✂] lower (and fixed until the end of 2012) than Hanson's 2011 prices. GGBS is dealt with separately below, but, as the UIS notes that the import "cost penalty" applies to both cement and GGBS, such examples may also be relevant to cement.

5.26 The list above merely represents a sample of the situations in which importers have offered prices to Hanson customers significantly below its existing prices (and relies on customer feedback, which, as noted above, is unlikely to be fully reliable). However, this is representative of a general trend which Hanson perceives to exist in the market.

5.27 This general trend is further supported by the empirical evidence presented in Hanson's response to the Market Questionnaire concerning its Top 10 customers (and repeated below). Not only does this show that, over a short period of time, Hanson has faced threats from importers for around [✂]% of its top customers, causing it to lower its prices, abandon proposed price increases and/or offer better terms, but also that the prices offered by importers often undercut Hanson by a significant margin. Therefore, Hanson would invite the Commission to revisit the preliminary view that importers only “take” the GB producers prices without ever constraining them. Hanson respectfully suggests that such statements are not consistent with the evidence now before the Commission, which clearly demonstrates how importers are acting as meaningful price constraints.

5.28 As noted above, Hanson considers that there is no incentive on importers created by any cost ‘penalty’ or disadvantage to price just below the price of GB producers. Hanson further considers that the empirical evidence also demonstrates the clear and effective price constraint that importers provide.

5.29 The preliminary findings of the UIS also contradict the previous finding by the European Commission. In 2007, the Commission stated in relation to the geographic dimension of grey cement (and cement additives) markets: "*This extent* [extent of cross-border trade] *has been supported by the market investigation that has confirmed that European continental cement, fly ash* [PFA] *and GGBS exporters exert a price pressure as regards the UK"*[31]*.* It must be assumed that such a conclusion would be even more strongly supported by the evidence given the development of imports (and import terminals) since that date. Importers have continued to flourish and grow their presence and develop their huge capacity in the market, in contrast to the majors whose capacity has declined with the closure and mothballing of plants and kilns. Hanson is concerned that the considerations to date from the Commission have not yet taken into account the relevant evidence with regard to the successes of importers and their establishment of a strong market share.

Geographic Scope of Imports

5.30 The geographic scope of effective competition from imports is not restricted in the manner suggested in the UIS. The UIS suggests that "*the majority of imported cement*

[31] *HeidelbergCement/Hanson* decision (para. 31) – see further below in relation to GGBS.

is sold within a limited distance of the terminal through which it is imported, meaning that there are some areas of the GB in which it is possible that imported cement may not compete as effectively with GB-produced cement as in other areas".

5.31 Even if there were a natural supply radius of 50 miles around import terminals, this would not leave many parts of GB outside the respective radii of various import terminals. No point in Great Britain is further than 78 miles from the coast. The import terminals currently in operation are well placed to serve the major centres of demand: for example, Avonmouth to serve the Midlands, South West and South Coast, the East Coast terminals to serve the South East and the East Coast generally (as well as the Midlands), the North West terminals to serve the North West, and Dudman's Montrose depot to serve the Central Belt of Scotland. The development of new terminals by importers shows the low barriers to, and the willingness of, importers to expand the scope of their operations, given their continuing successes through recent years.

5.32 The spread of import terminals means that imports are better placed to serve certain centres of demand than the more narrowly spread cement production facilities in GB (the majority of which are by necessity centred around limestone reserves in the Midlands, Yorkshire and the North West). Given the prevalence of import terminals around the GB coast, many customers will be significantly closer to an importer than they will be to Hanson's own production facilities. Indeed, any costs arising due to shipping costs must be counterbalanced against the additional road/rail transport costs faced by Hanson. Given that shipping rates are generally very low, there is likely to be very limited cost disadvantage (if any). A further point which should be appreciated by the Commission is that GB cement plants are generally located at large limestone quarries, which are in rural locations away from conurbations, with relatively poor local road infrastructure often with restrictions on working hours, weight limits or with added traffic routing requirements. By contrast, import terminals have the added advantage of being located in areas with better road infrastructure, often with General Development Order and Enterprise Zone status, and free of the operational and logistical restrictions suffered by the GB clinker producers.

5.33 As noted in other submissions, Hanson's experience is of imports moving large distances by road. For example, it recently lost a contract to an importer for a customer at Newark, Nottinghamshire which was supplied from a port in South Wales. Another example of the competitiveness of imports is that cited above in paragraph 5.25.2 relating to a customer lost to Dragon in Birmingham, where the importer was able to undercut Hanson's price significantly despite being a reasonable distance (of approximately 80 miles) from its terminal in Sharpness. A further example involves Dragon now looking to pick up new customers in the North Wales market ([✂]), which is a significant distance from its terminal based at Sharpness in Gloucestershire.

GB cement producers' perceived actions to undermine viability of imports

5.34 The UIS notes that GB cement producers "*consider, and in some cases take, specific action to undermine the viability of imported cement, such as applying pressure to cut off cement supplies to independent importers, purchasing of import terminals and targeting lower-price cement selectively at customers of cement importers*". The evidence Hanson has seen to date (for example, through the Working Paper/Putback process) does not provide any evidence in support of this hypothesis. Hanson would welcome a clear statement of the specific evidence the Commission is relying on to support such a theory. Hanson would suggest that, with respect, it is not open to the Commission to make such assertions without substantiation by way it is of adequate and specific evidence.

5.35 Three preliminary points can be made relating to perceived concerns on the "undermining" of imports:

5.35.1 Mere aspirational considerations would not have an impact on imports unless actioned. Numerous (and contradictory) competitive strategies are likely to be debated or raised casually and given differing degrees of internal consideration by companies in any business sector, which are then quickly rejected or discarded as irrelevant and, as a result, have no impact on the market.

5.35.2 The Commission is obliged to distinguish between a normal reaction to competition (such as trying to win customers back who have been lost to competitors) from specific strategic measures to undermine imports as a whole.

5.35.3 No evidence has been presented to date indicating that the major cement producers have undertaken attempts to undermine imports generally: such alleged strategies have not existed and could never succeed or otherwise be effective.

5.36 Indeed, the empirical evidence is inconsistent with any successful undermining of imports. The market shares of importers have increased in recent times from around 9% in 2007[32] to over 13% currently. The expansion by existing importers (as the Commission notes, there have been (at least) six instances of new import terminals opening since 2007 by at least three separate importers[33]) is particularly notable. This type of investment and expansion would not take place if independent importers perceived a real threat of incumbents punishing them as has been suggested by the Commission. Importers have flourished and grown in presence, capacity and market share, in contrast with the cement majors, who have reduced capacity and lost market share.

5.37 Some general comments on the Commission's specific concerns in the context of these preliminary points are noted below:

5.37.1 "*Applying pressure to cut off cement supplies to independent importers*". Hanson is aware of one example cited by the Commission where Hanson sought to persuade a sister company ([✂]) that it was not in the interests of the HeidelbergCement group for that sister company to supply a competitor to Hanson, on highly favourable terms (agreed under a historic supply deal) that undercut Hanson's own supplies. It is natural that Hanson would seek to dissuade a sister company from supplying to a competitor on terms which allowed a competitor to undermine Hanson's own business: this is not an attempt to undermine the importer, but reflective of a natural desire not to compete directly with a sister company. No business can reasonably be expected to invest time and resource into working to compete against itself and destroy its own value – a company who expresses concerns that such may be occurring can in no manner be said to be 'engaging in inappropriate strategies to undermine importers'. Despite the correspondence in question, the relevant importer [✂] continued to purchase cement from [✂]. The availability of cement is not an issue for importers, who are generally linked to major cement producing groups (this represents the majority of major importers). For those who do not have their own in-house supply lines, competitively priced cement is readily available for exports in those markets geographically suited to supplying GB (in particular, from Ireland and Spain). There exists a liquid market for the trading of cement. [✂]

5.37.2 "*Purchasing of Import Terminals*". In the period under review by the Commission (2007 to 2012), whilst it has historically considered the possibility of purchasing import terminals, Hanson has not purchased any import terminals[34] and is not aware of any GB cement producer purchasing

[32] http://www.mineralproducts.org/sustainability/cement-production-data.html
[33] Working Paper on Barriers to Entry, para. 78.
[34] Not accounting for the terminals purchased for GGBS purposes at Glasgow, Belfast, Teignmouth.

an import terminal. The purchase of an import terminal would not be an effective strategy to reduce the constraint from imports: there are a large number of import terminals currently in operation and the UK coast is "porous" as far as imports are concerned. There are numerous terminals around the UK with enormous capacity (as noted above, recognised by the European Commission with potentially 80% of the entire bulk cement national market) – it would be impossible to restrict such wharves: import terminals are cheap and simple to establish.

5.37.3 "*Targeting lower-priced cement selectively at customers of cement importers.*" The Commission has not presented any evidence of this, and so Hanson can not respond to anything specific. Hanson does identify competitor customers which it considers to be potential targets (i.e. customers which it would be economic for it to supply and which might be likely to switch): Hanson does not distinguish between GB producers and importers in this respect. Nor does Hanson distinguish between GB producer and importer customers. In addition, where it loses a customer to a competitor (GB producer or importer), it will generally work to win the customer back[35] with price discounts or other improved terms that might be attractive to the customer; this is not a selective process. Each of these is consistent with normal competition and a desire not to lose business, rather than any attempt or strategy specifically to undermine imports.

6. EMPIRICAL EVIDENCE OF COMPETITION IN CEMENT

6.1 Hanson's own experience of the GB cement market is one of strong competition with customers rejecting proposed cost-led price increases, switching between suppliers and using the threat to switch to secure better prices or terms. Hanson faces strong competition from both the other Majors and from Importers.

6.2 The Commission appears to have focussed on switching between suppliers by independent customers. Whilst there is evidence of material switching by customers, permanent switching is merely a manifestation of one feature of competition in the cement market. Threats of (and short term) switching by customers also represent a very significant demonstration of competition and the exercise of bargaining power by customers. Customers use the threat of switching to resist proposed price increases, secure lower prices and/or secure better deals generally (e.g. better credit terms, guarantees of no future price increases for a specified period). This is driven by the availability of competing offers to customers.

Analysis of "Top Ten" Customers

6.3 In order to demonstrate this, Hanson undertook (for the purposes of its response to the Market Questionnaire[36]) sample analysis of its biggest grey cement customers in each of the RMX and Concrete Products key customer segments to determine the recent competitive threats to Hanson's supplies to those customers. This is attached at **Annex 3**[37]. What is clear from the data is that during the time of the review (2011):

6.3.1 Some [✂]% to [✂]% of these customer relationships (in both RMX and Concrete Products segments) appear to have experienced strong adverse competitive impact and consequences after direct approaches by importers

[35] Unless there is some reason why Hanson is very unlikely to win the customer back or has reasons not to wish to continue supplying the customer, e.g. change of specification by the customer which means that Hanson can not supply, pricing requested by the customer significantly below Hanson's margin expectations or customer raising credit concerns (or H&S concerns relating to deliveries).

[36] Annex 41C to Market Questionnaire response submitted on 24 July 2012.

[37] This presents two summary tables setting out Hanson's biggest customers in these segments for 2011, ranked by volumes sold. The summary tables present some of the principal instances of recent competitor threats to these customers. These have been prepared on the basis of interviews with Hanson Cement's sales staff which covered recent (2011/12) competitor threats Hanson had faced in respect of each of the Top 10 customers in each category and Hanson's response to the threats.

(leading to permanent or temporary losses of very significant amounts of business and/or material price reductions by as much as [✄]%);

6.3.2 Some [✄]% of customers have been impacted by direct competitive approaches by [✄];

6.3.3 Some [✄]% to [✄]% by direct competitive approaches by [✄]; and

6.3.4 Some [✄]% by [✄].

6.4 Hanson contends that:

6.4.1 This trend would be the same across any selection of its bulk cement customers in RMX and Concrete Products segments.

6.4.2 The figures show competition working freely on an everyday basis on the ground.

6.4.3 The regular approaches and challenges from importers are so significant that they provide clear evidence that contradicts the Commission's conclusions that importers do not (in the Commission's opinion) act as price constraints to counter any hypothetical tacit collusion. The Commission's statements to date in this respect now appear to be inconsistent with the evidence before it.

6.4.4 A market suffering from tacit collusion as suggested by the Commission would not show the levels of direct competition from other majors as this study evidences.

6.4.5 The direct competitive approaches from the other majors are completely independent of any perceived 'targeted retaliation' schemes that the Commission has suggested have been designed to maintain a convenient colluding group that may be quietly enjoying equilibrium and customer relationships that are free of risk of challenge from other majors.

6.4.6 Hanson remains concerned that such direct important evidence has not been presented in its original form to [✄] and [✄] of the Panel[38], despite express requests from both Hanson and the Panel members to date.

Sample Analysis of Cement E-mails

6.5 Further, a sample analysis has been conducted of the e-mails submitted to the Commission in response to its most recent request for e-mails relevant to the cement market. This analysis has been conducted in respect of the e-mails submitted in respect of the cement Commercial Director and the Bulk Cement Sales Director for the first six months of 2012[39]. The analysis has been undertaken with a view to identifying competitive threats to Hanson's existing bulk cement customers[40].

6.6 The analysis sought to categorise the e-mail evidence in numerical terms:

Table 1: Cement Competitive Threat Analysis (Jan-June 2012) – Bulk Grey Cement only to Non-Majors: Based on Review of Limited E-mail Correspondence

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[38] [✄]
[39] [✄] However, as [✄]
[40] [✄]

	Threat, or attempt to win, from Major	Threat, or attempt to win, from Importer
Evidence of threat from competitor - Hanson reaction/outcome not clear	[✂]	[✂]
Evidence of threat from competitor - Hanson has had to offer better price or terms (or forego price increase (in whole or part)) to retain customer	[✂]	[✂]

Note: For these purposes, Paragon (linked to Holcim/AI) is categorised as an importer where it competes for customers other than AI.

6.7 In short, this shows (based on the sample of e-mails reviewed and subject to the caveats expressed above concerning the reliability of customer feedback of this nature) that:

6.7.1 Out of less than [✂] Hanson bulk cement customers (excluding internal sales and other Majors and Job Sites[41]), over a quarter ([✂]) were recorded in the sample e-mails in question as having been subject to an actual competitive threat from a customer.

6.7.2 The threats came from both the GB producers and from importers (including Titan, Southern Cement, Paragon and Dudman).

6.7.3 In [✂] of these cases, Hanson is identified as lowering its price, foregoing a price increase or offering better terms (e.g. credit terms) in order to retain its customer in the face of the threat.

6.7.4 This does not mean that, in other instances, Hanson did not offer better terms, just that those terms have not been recorded in the sample e-mails reviewed (given the methodology employed, the subsequent developments would not necessarily have been evident from the e-mail review). In many (if not all) of those cases, Hanson would have offered a better price (or better terms).

6.7.5 In either case, it is not necessarily clear whether Hanson managed to retain the customer.

6.7.6 The e-mails retrieved and referenced here only represent a subset of all discussions between the Commercial Director and Bulk Cement Sales Director about competitive threats. Discussions take place on a regular basis (not just over e-mail but also by phone and face-to-face team meetings) on such matters.

6.8 The numbers are notable given the small sample of e-mails reviewed (involving only a selection of those e-mails involving two employees provided to the Commission[42]), this is likely significantly to under-estimate the instances of Hanson facing a direct competitive threat to one of its customers and/or having to better the customer offer in response to a competitive threat.

6.9 Hanson would be pleased to discuss the methodology behind either of the exercises noted above with the Case Team and/or undertake further analysis of this nature.

[41] Job sites involve a one-off or intermittent sales, characterised more by "bidding" than "switching". Therefore, these sites would not be relevant to an analysis of switching.

[42] [✂]

However, even based on this snapshot, the results show a strong level of competition, including:

6.9.1 Threats from numerous sources for Hanson customers.

6.9.2 Customers being able to secure better deals by either using these threats to secure better terms from Hanson or switching in order to secure a better deal.

6.9.3 Competitive threats from numerous importers as well as the Majors, showing that importers have a real role in driving competition in the market.

6.10 Empirical evidence of this nature is critical to the Commission's analysis. If the Commission does not accept that this evidence is sufficient to demonstrate strong competition, Hanson would encourage the Commission to focus its resources on undertaking some form of analysis of the exercise of bargaining power by customers through the threat of switching and/or actual switching in order to drive better deals. Hanson considers that such an analysis would demonstrate the extent of competition in the market, undermining any perceived concerns over ineffective competition and any coordination between GB cement producers.

7. CEMENT PROFITABILITY

7.1 Economic profitability is a critical issue in this investigation. Hanson does not believe there is any evidence of sustained excess profitability in any of the markets under investigation when profitability is measured on the appropriate basis that is in accordance with the Commission’s own published guidelines.

7.2 In particular, the cement market does not exhibit persistent excess profits over any sustained period. As such Hanson has concerns about how the Commission appears to be using perceived excess profitability to form conclusions at this stage and to suggest adverse effects on competition and possible tacit collusion. The clear lack of excess profitability over a sustained period casts fundamental doubt on the Commission’s contention in the UIS that the cement market is ‘not working effectively’[43], as well as any claims of tacit coordination between the cement producers[44]. In any case, Hanson considers that any such conclusions on the cement market cannot safely be reached or published before completion of the further relevant MEA analysis of whether profit levels in the market are excessive. Hanson suggests that, with respect, concerns voiced by the Commission in this respect and conclusions published now appear to be inconsistent with the evidence.

7.3 Hanson agrees with the Commission in its longstanding published view that economic (or continuing) costs are the relevant cost basis for economic assessments and also this investigation, and not costs measured on a historical cost accounting (HCA) basis[45]. Hanson therefore cannot understand why the Commission has formulated and published adverse views and concerns on perceived profitability in the cement market in its UIS, having only carried out profitability analysis on the HCA basis. The conclusions and concerns published cannot therefore be said to have been considered with the benefit of complete analysis, and Hanson is disappointed in case the Commission may naturally now find itself in the position where it is working purely to justify previous statements and concerns that were formulated and published prior to full or proper analysis.

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[43] “*...market concentration, barriers to entry, profitability* ***(calculated on a preliminary basis)*** *and trends in margins over time indicate that competition in the cement market may not be working effectively*” (emphasis added), Competition Commission, Updated Statement of Issues, 26 Nov 2012, para 52.
[44] Updated Statement of Issues, para 99.
[45] “*We are interested in economic (or continuing costs)...Hence the value of resources consumed and assets utilized should reflect their current value to the business, not their historical cost.*” The Note, para 69.

7.4 As set out in Hanson's responses to the Financial Questionnaire and the Original Issues Statement[46], there are two fundamental problems with using an HCA basis, which are: (i) asset values measured on an HCA basis cannot reflect the economic value of capital, particularly in the presence of inflation; and (ii) it implies a downward-sloping cost recovery or required revenue profile which is unlikely to be commercially achievable or desirable. HCA analysis is completely inappropriate as the basis for the Commission's work on profitability.

The Commission's Proposed Methodology

7.5 There are three key methodological aspects which need to be incorporated into the Commission's approach:

- **Use of Modern Equivalent Asset (MEA) values**. Hanson agrees with the Commission that valuing assets on a replacement cost basis is a superior economic measure, compared to the HCA basis which is inappropriate. Hanson has previously set out its suggested approach using inflated gross book values (GBVs) to estimate replacement costs as well as providing the Commission with bottom-up MEA assessments. Hanson recommends the inflated GBV approach, which is simple and complies with the financial capital maintenance (FCM) principle. But if a detailed MEA approach is used - which seems to be the Commission's preferred approach - then holding gains and losses must be reflected in the assessment of ROCE. [✂]

- **Hanson's assets are highly depreciated**. Hanson suggests the Commission adjusts for the age profile of assets in its profitability assessment (possibly by taking the capital value at the midpoint of assets' lives). Omitting this consideration from the profitability analysis will distort results.

- **Emissions trading revenue is extraordinary or at least exceptional and must be disregarded entirely for Cement**. Hanson considers that any earnings from the sale of unused carbon allowances should be completely stripped out as exceptional or extraordinary items. Hanson thus welcomes the Commission's proposal to now conduct sensitivity analysis including and then excluding carbon allowances, to understand the true economic profit of the business. Hanson considers results excluding carbon allowances to be the only results that are valid in the context of forward looking economic profitability. [✂]. The proceeds from the sale of allowances were wholly unanticipated by Hanson and by industry, as they were similarly unanticipated by governments and environmentalists alike.

Summary of Results for Hanson

7.6 These three factors have a significant impact on the results of the Commission's return on capital employed (ROCE) analysis for Cement[47]. Whereas the 5 year ROCE on a HCA basis is [✂]% (based upon the Commission's interpretation of the information provided by Hanson), this falls to as low [✂]% when assessing economic profitability using a MEA approach to value assets and [✂]% when valuing assets at the mid-point of their useful economic lives. Deducting the revenue from the sale of unused carbon allowances brings the 5 year average ROCE down to [✂]%. These figures compare to a 5 year average pre-tax nominal cost of capital of [✂]%.

7.7 A summary table is set out below showing the impact of the three methodological aspects which Hanson considers should be incorporated into an assessment of its economic profitability:

[46] Hanson, Response to Financial Questionnaire (para 23.3 to 23.4), 23 July 2012 and Response to the Issues Statement (section 12.41 to 12.70), 20 April 2012.
[47] The same methodological issues are relevant for Aggregates and RMX, with the exception of the sale of carbon allowances.

Table 2: Summary Table of Cement ROCE (2007-2011)

ROCE calculation	2007	2008	2009	2010	2011	Average
HCA basis – as per Commission HCA analysis –	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]
(1) MEA basis of assessing capital employed incorporating CCA depreciation, holding gains due to inflation and holding losses due to plant mothballing	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]
(2) MEA basis using mid-points asset lives. Also incorporating CCA depreciation, holding gains due to inflation and holding losses due to plant mothballing	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]
(3a) Combination of (1) and deducting revenue from the sale CO_2 allowance	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]	[✂] [✂]
(3b) Combination of (2) and deducting revenue from the sale CO_2 allowance	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Nominal pre-tax WACC	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

7.8 On the basis of these three corrections (which are all combined in item 3b in the summary table), Hanson does not believe there is evidence for excess profitability. This casts significant doubts on the Commission's contention that the cement market is not working effectively and that it has shown excess profitability through a sustained period. The Commission's statements and provisional conclusions in this crucial respect of the MIR do not now appear to be consistent with the evidence before it.

7.9 Hanson has also provided further detail and a number of comments on less significant items to take account of in its response to the Commission's Working Paper setting out the Planned Approach to Assessing Profitability.

An EBIT-based Approach

7.10 If an EBIT-based approach were to be adopted, this would show in stark profile the economic situation of Hanson Cement over the last five years of the review period:

7.10.1 Hanson Cement's returns after adjusting EBIT for the MEA methodology and associated CCA depreciation and holding adjustments, as suggested by the Commission, has [✂] – this is before making any adjustments to review profitability without the windfall carbon revenue.

7.10.2 When making the adjustments for carbon (in order to remove the windfall sales from the allowances from EBIT analysis), [✂] of the five years show negative returns (as much as £([✂]) for [✂] and totalling some £([✂]) of losses across the [✂]); this is compared to only [✂] of the years on this basis (MEA and excluding carbon) showing positive returns (which total only £[✂] of returns relative to the above mentioned losses of (£[✂]) across the five year period 2007 through 2011).;

7.11 Further detail is provided in Hanson's response to the Commission's Profitability Approach Working Paper. However, even these basic statistics directly contradict any theory of excess profitability or an industry which is subject to competition problems.

8. CONDUCT OF THE GB CEMENT PRODUCERS

8.1 The UIS refers to a number of factors as "Conduct" which are considered to be potentially supportive of coordinated effects. These include the use of "price announcement letters" (supported by its analysis of price parallelism), cross-sales between GB cement producers and internalisation.

8.2 Hanson demonstrates below (and in the responses to the relevant Working Papers[48]) that either (1) the Commission has incorrectly conflated normal business practices which would be found in many markets where no competition problems arise (this is partly recognised by the Commission in the UIS[49] with indicators of coordinated effects or (2) the Commission has misunderstood the context of the circumstances in question.

Price Increase Proposal Letters[50]

8.3 Hanson welcomes the Commission's preliminary conclusion that price increase letters are unlikely to be a focal point for coordination as prices are individually negotiated, announced price increases do not translate systematically into actual price increases and actual prices and any actual increases are not transparent.

8.4 However, the Commission considers that it is possible that the letters could be used as a "signal" between the GB cement producers as to the timing and amount of changes in cement prices that they are each seeking. Hanson considers that such an assumption cannot reasonably be arrived at on the basis of the context of these letters.

8.5 First, it is important to understand the purposes of sending price increase proposal letters. Customers require advance notice of any proposed price increases so that they can be prepared for their own budget considerations. The sending of these letters to customers is a practice required by those customers. From the point of view of Hanson, the letters constitute opening proposals to customers. The impetus for Hanson to send a price increase proposal to customers is an increase in its costs. Cement production costs have risen very sharply during the period under review (in particular, energy, coal and distribution costs).

8.6 The requirement for advance notice by customers means that a degree of similarity in the timing of the issue of these letters is to be expected. It is common practice in many industries for any price increases to be agreed from the start of the calendar and/or financial year (as in cement). It is to be expected that each producer would try to give advance notice of any proposed price increase to its customers with the result that timing might overlap on occasions.

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[48] In particular, the Working Papers on Internal Cement Documents, Cement Internalisation, Cement Price Announcement Letters and Price Parallelism. At the date of submission of this Response, Hanson has only submitted comments on the first of these Working Papers, but the other sets of comments are expected to follow shortly.

[49] Para. 98 in relation to Working Paper on Cement Internal Documents; "*some of the behaviour described could be considered normal business practice in many industries*".

[50] The Commission refers to these letters as "announcements". This is inaccurate in relation to price increase proposals. Hanson Cement sends out standard price increase letters privately and directly to its customers, for grey cement supplies. They are private letters and are not public 'announcements'. Letters such as these are essential for customers, so customers are notified of any proposed changes to the prices they are paying for what they buy.

8.7 This would also be likely to have been the case with any mid-year price increases proposed by Hanson (i.e. prices taking effect from a date other than the start of the year). These would have been initiated (at least within Hanson) by extraordinary and rapid cost increases which it needed to recover before the next year. In such circumstances, there would have been an imperative to send a price increase proposal to customers, given the advance notice required by customers and the negotiation process which generally follows the sending of such letters. Hanson can only speculate, but it is likely that other producers would have been subject to similar cost pressures and need to notify proposed price increases to customers as soon as possible.

8.8 Second, the UIS already recognises the most important point in this respect, which is that these letters represent the [✂] for negotiation with customers. The final price will vary to range very significantly [✂]

8.9 This has been illustrated in the Commission's own work on the realisation of proposed price increases[51]. The Commission appears also to have discovered the same trend in relation to other UK cement producers. For example, one of the preliminary conclusions of the Working Paper on Price Announcements was that the major cement producers were not able to realise the full "announced" price increase[52]. [✂][53]

8.10 The letters therefore provide a [✂] for subsequent rigorous negotiations, where the customer then negotiates with the supplier [✂]

8.11 Therefore, the value of the letters as an indicator to competitors as to a producers' pricing strategy is very limited. If a competitor obtained access to a letter issued by Hanson, it would not be able to work out from the letter (1) what starting price the customer was paying (as this would already have been bilaterally negotiated and would not be indicated in the letter), or (2) the actual level of increase achieved with that customer. Therefore, such letters provide no reliable market intelligence either on the prices charged by competitors or the price increases they have actually agreed with customers.

8.12 Given the limited utility of these letters as an indicator of either actual price increases accepted by customers and/or actual prices paid after these have been applied, it is not credible to characterise these letters as a form of 'signalling' to competitors. As noted above, the price increase actually accepted by the customer can be a small proportion of that proposed (or even negative) with the result that, even if these letters were used as some form of signal to competitors, they would not create meaningful pricing transparency. Hanson therefore contends that the Commission is yet to factor in the clear limitations and incompleteness of any information in these letters, before balancing the degree of evidential weight they may hold for the purposes of the Investigation.

8.13 The UIS, the Commission appears to indicate certain "<u>patterns</u>" in the sending out of these letters:

8.13.1 The UIS notes that "*the four GB producers generally announced similar price increases in fairly close succession*". Practically all of the letters referred to by the Commission are beginning of year (new year) price increases for the calendar year ahead. As noted above, these are required to be sent in advance by customers for business planning purposes for the calendar year

[51] The Putback Paper on Price Announcements for Bulk Cement sent to Hanson on 18 October identified a significant divergence between Hanson's proposed price increase and the price increase realised. In at least one instance, Hanson's average prices to independents appear to have fallen following a price increase proposal to customers (for example, the table in A3 of the Putback Paper appears to indicate that Hanson's prices fell by £[✂] in the first two months of 2010 despite Hanson proposing a price increase of £[✂] to take effect from 1 January 2010). Whilst Hanson has noted that it cannot verify the figures and the methodology, it would agree with the general trend presented that it generally recovers only a proportion of the price increases it proposed to customers.
[52] Paragraph 46 of Working Papers on Price Announcements in Bulk Cement.
[53] [✂]

ahead and so a certain degree of similarity in timing is to be expected (and is consistent with normal year practice in other industries). As regards any mid-year price increase proposal, these are extremely rare and would be driven by extraordinary and immediate input cost increases: this kind of cost increase would have been common across producers, leading to producers independently reaching a decision to announce price increases within a similar timeframe. In any case, as will be explored further in Hanson's response to the Working Paper on Bulk Cement Price Increase Announcements, there is significant divergence in timing and amounts of the price increase proposals. Even when issued for the calendar year ahead, they have been issued weeks and even months apart.

8.13.2 The UIS claims that "*one particular producer was often the first to announce a price increase, with the other GB producers generally following with the same, or higher, announced increases*". Hanson believes, with respect, that the Commission has misinterpreted the evidence and worked to establish patterns where none exist:

(a) For example, during the last four to five years of the review period, it appears that Cemex issued such letters first *five* times, Hanson once, Tarmac once and Lafarge only *twice*. Hanson simply does not understand how the Commission can possibly suggest this constitutes evidence that Lafarge '*always go first with the letters first or at least most of the time*', as suggested by the Commission. With respect, Hanson invites the Commission to now acknowledge this error and rescind statements made to date in respect of this evidence.

(b) Similarly, the Commission has stated that typically the other majors will all follow the first increase letter with increases that are higher. Likewise, Hanson does not understand this statement: this has not occurred in a single instance of the last eight or nine increases through the same four to five years of the review period. Again, and with respect, Hanson invites the Commission to rescind statements made to date in this respect as such conclusions are not open to any assessment of such evidence. Hanson does not understand why the Commission is seeking to rely on such patterns, when they do not exist.

8.13.3 The UIS notes a further pattern of interest in that "*in most cases, the four GB producers were able to increase the average price paid by their customers following a price increase announcement...*" It is not unexpected that some degree of average price increases might rise following a price increase. The price increase proposal letters should be set in the context of rapidly increasing costs for the GB cement producers. The fact that prices might increase in the context of costs increases cannot be said to be evidence indicative of competition problems. Of more relevance by way of evidential conclusion, as the Commission's analysis notes, the GB cement producers were generally *not* able to realise the full price increase [✂]. This constitutes clear evidence of the incompleteness of any 'information' that might be visible from such letters and Hanson requests that the Commission now expressly recognise such limitations, before seeking to assess what evidential weight such letters might offer in considering the extent of true visibility provided.

8.14 As noted above, there is now very considerable doubt as to whether the "patterns" claimed in the UIS are supported by the facts of the evidence and the Commission's own analysis. Hanson therefore is of the view that the evidence now before the Commission obliges it to reassess any statements with regard to how such letters might provide 'evidence consistent with a finding of tacit collusion'..

Price Parallelism

8.15 The UIS deals with the Commission's cement "parallelism" work under the Conduct section of its analysis of coordinated effects. It is unclear how this work is meant to fit into its theories of harm generally. As with the work on price increase proposal letters, Hanson considers that, if it seeks to rely on this analysis, the perceived link with the coordinated effects theory of harm should be made clear.

8.16 The UIS states that the Commission has found a close correlation between GB cement producers' prices and between those producers' prices and cement importers' prices. It also states that it has found common movements in GB cement producers' prices which it could not fully explain by changes in their variable costs. The Commission's workings are set out in the Working Paper on Price Parallelism in Bulk Cement. Hanson has submitted a formal response to that and requests that the paper be reviewed in full, but Hanson sets out some summary comments here.

8.17 Hanson has concerns about the analysis presented in the Working Paper and the evidential conclusions that can be drawn from that analysis. Hanson has significant concerns over the theoretical grounding of the test the Working Paper applies.

8.18 The Working Paper explains that one would expect high correlation in prices between companies tacitly colluding, but also between companies in intense competition. There is therefore doubt as to how conclusive any such price correlations between the Majors may or may not be – since they are inconclusive as to whether tacit coordination is happening or not. Therefore, the Working Paper advances the test: "*if we find that the Majors' price series are highly correlated, and that the Majors' price series are not correlated with their variable costs, this may be inconsistent with intense competition, and could instead be evidence of dampened competition, which may be due to coordination*". As a result, what appears to matter is not whether prices move in parallel - the topic of the Working Paper - but whether prices move in parallel with variable costs.

8.19 Yet, the Working Paper fails to explain:

8.19.1 Any theoretical link between variable costs/price correlation and intensity of competition. No academic literature is cited. Hanson believes that the Commission's approach is fundamentally flawed. Contrary to what the Commission suggests, there appears no support in economic theory for the notion that a firm's prices and average variable costs are more closely correlated when competition is intense. Indeed, under conditions of perfect competition, firms are price takers, and so there is no relationship between prices and their average variable costs. In contrast, under monopoly pricing in an environment of stable demand, prices are perfectly correlated with marginal cost – every time the monopolist's marginal cost changes, it will move its price in the same direction.[54] The observed correlation between prices and variable costs as measured by the simple correlation coefficients estimated by the Commission therefore tells us nothing about the intensity of competition in a market.

8.19.2 Even if some link could be established, how "weakly correlated" do prices have to be with variable costs to conclude *objectively* that competition is dampened? The Working Paper provides no benchmark for the level below which the correlation coefficient must fall to conclude "dampened competition". For example, it is not clear that the Commission's estimated correlation coefficients would be different to the results that occur in a situation of four firms competing intensively (with no tacit coordination) on a Cournot basis where variable costs amount to 30% to 40% of costs. Therefore, what the Commission concludes as dampened competition,

[54] Average variable costs are generally viewed as a proxy for marginal costs.

another observer would see as effective competition taking place, but with that competition taking place on a different basis to the stylised model of perfect price competition.

8.19.3 How firms recover fixed costs. The analysis assumes incorrectly that fixed costs do not influence prices. Hanson does not understand why the Commission has restricted its analysis only to variable costs impact in this respect. In the real world and throughout business sectors, price increases are also required because of fixed cost increases. With demand for cement falling dramatically, fixed costs are spread over a lower base, average total costs increase, and so price-variable cost margins widen (apparently leading to a lack of correlation). [✂]

8.20 Second, Hanson has concerns about the empirical analysis. The estimated correlation coefficients are based on very low sample sizes (the Commission has at most 20 data points in the time-series), with even fewer degrees of freedom due to detrending and lagging the time-series. The small numbers of degrees of freedom lead to very large standard errors (not reported, but can be implied) on the estimated coefficients, which cast significant doubt over the robustness of results. There are also concerns on how the Commission has specified the relationship it models. The Commission recognises that both current and lagged average variable costs are likely to affect pricing decisions. However, the Commission only looks at their individual effects rather than their cumulative effects. As a consequence, the reported correlation coefficients are likely to understate the correlation between prices and costs. Further, many factors affect prices in a competitive market other than costs, including the demand for cement, the prices of substitute products for bulk cement, and the prices of complementary products, such as CO2 permits. By omitting these important variables from its analysis, the Commission is likely to bias the estimated correlation coefficient.

8.21 Hanson considers that the significant theoretical and empirical weaknesses mean that **no** definitive conclusions about the presence of dampened competition (or tacit collusion) can safely be reached from this Working Paper. As a result, Hanson has significant concerns with the "price parallelism" analysis, which it considers should be removed in its current form ongoing considerations and evidence that form part of the MIR.

Cross-Sales

8.22 The Commission notes that cross-sales of cement between the majors could potentially facilitate coordination through a number of potential means. A number of these are addressed below.

8.23 It should first be noted that the Commission is correct when it notes that "*cross-sales between the Majors have declined in recent years...it appears that the current pattern of cross-sales may at least in part be consistent with the Majors seeking to make logistical savings*". This represents a correct interpretation (certainly as far as Hanson is concerned). [✂]. It purchases this for logistical reasons, it being uneconomic for Hanson to supply to these plants due to transport considerations. As explained below, purchases beyond this were inherited since prior to its acquisition by Heidelberg Cement, Hanson had no cement operation so naturally could not supply itself. In the months after becoming vertically integrated, Hanson unilaterally moved to self-supply as a natural efficiency measure, so Hanson's purchasing for example from Lafarge (after Hanson and Castle Cement Limited found themselves in the same corporate group) was both short-lived and temporary pending its termination.

8.24 [✂]

Internalisation

8.25 The full rebuttal and analysis of the Commission's statements to date with regard to historic efficiency internalisations is provided in the Hanson Response to the Internalisation Paper (still in progress at the time of submission of this Response).

8.26 The limited scope of such cross-sales, and the clear cost efficiencies and environmental advantages they create, also mean that the use of internalisation as a "punishment mechanism", as suggested by the Commission, is not credible.

8.26.1 Indeed, the UIS appears to rely heavily on a one-off series of events in 2008 (involving the internalisation by Hanson from Lafarge) as evidence of internalisation contributing to coordination by being driven by a 'retaliatory punishment mechanism'.

8.26.2 This has been misinterpreted by the Commission to date. This internalisation was a natural consequence of, and followed soon after, the acquisition by HeidelbergCement of Hanson Plc which integrated the cement and RMX businesses. It does not reflect coordination at the time in question or provide any indication of conditions conducive to coordination now, over a five year period or in future.

8.26.3 The simplest analysis is that internalisation represented the natural and unilateral move by Hanson to serve its own interests and maximise its own profitability and market share at the expense of other majors, after it found itself vertically integrated for the first time.

8.26.4 Furthermore, the simple analysis of the actions at the time is that Hanson (and by wider implication, the market) expressly and repeatedly rejected all notions of facilitating any common understanding or equilibrium based on convenient market shares; instead, on joining the cement market, Hanson worked to maximise its own efficiency and business by internalising its cement procurement.

8.27 [✂]

8.28 The Commission appears to have focused on the internalisation of 2008 and the concept of competition, within a model of collusion, being restricted only to the retaliatory "punishment" actions that occur as a response to a member of the colluding group having 'broken the common understanding' by winning another's business. The Commission has pointed to the 2008 internalisation to suggest that any monitoring of market share and volumes during that time must somehow prove the notion of the majors working together to maintain each other's market shares.

8.29 Not only does Hanson disagree with the Commission's analysis of the 2008 internalisation (as stated above and as described in detail in the Hanson Response to the Internalisation Paper). Hanson suggests that a balanced assessment of the data, communications and evidence before the Commission through the years of the review period demonstrates that the competition between the majors, the regular wins of each others' customers and the regular price reductions to counter such approaches and preserve longstanding key relationships, cannot safely be categorised as being restricted to 'punishment actions' in the context of responses to a major breaking a hypothetical common understanding in a colluding group.

8.30 The significant volume of emails and internal communications before the Commission and submitted through the MIR, show repeatedly how the cement business was working to second guess what the actions, reactions and pricing of competitors might be, and how competitors might be undercut in order to win business for Hanson. The Commission has, with respect, not been able to show in any manner, how such dealings and competitive actions across the review period can safely be categorised as mere 'punishment' actions within a retaliatory framework. This is because they represent natural competition, although through a declining, changing and uncertain market.

8.31 It appears to Hanson that the Commission is seeking to rely on the extraordinary events of the 2008 internalisation to suggest that the market generally competes only by way of retaliatory actions within a punishment mechanism designed to ensure the maintenance of each others' market share. With respect, Hanson believes that:

8.31.1 The Commission is affording undue and disproportionate weight to the extraordinary events of 2008;

8.31.2 The Commission's analysis of the internalisation is not the most simple and obvious assessment, for the reasons stated above and elsewhere within the MIR;

8.31.3 The Commission has not substantiated or sought to substantiate either:

(a) A period of sustained tacit collusion through the review period after 2008 and until today;

(b) The existence of tacit collusion *before* the 2008 internalisation, which would certainly be required if the 2008 internalisation is to be viewed as a retaliatory business response further to a pre-existing and common understanding based on precise and critical market shares.

8.31.4 There can be no suggestion that, either now or in 2007 (before the HeidelbergCement/Hanson acquisition) that Hanson's purchases were not justified either by necessity or efficiency grounds. Based on this precedent, there is no reason to suspect that Hanson's purchases from Lafarge would increase, even if demand increased (in any case, demand seems highly unlikely to recover to 2007 levels - see further below). Hanson does not understand why the Commission appears to be speculating in its suggestions that it is concerned that Hanson will move away from self-supply and will again become dependent upon Lafarge and that this will happen as and when the market resumes. Not only is this stated concern contrary to Hanson's understanding, it is entirely incorrect since it would reverse the efficiencies that Hanson effected when it internalised in order to maximise its own profit at the expense of its competitors in 2008-2009.

8.32 [✂][55]

8.33 The fact that Hanson's purchases from Lafarge, and sales to Tarmac, are justified on efficiency grounds suggests that, at least as far as Hanson is concerned, cross-sales are not being entered into as a potential mechanism for side-payments between members of a coordinating group.

8.34 Hanson appreciates that this only represents one party's circumstances (Hanson), but it is consistent with the general picture represented by the relatively low level of cross-sales and the efficiency justifications found by the Commission for cross-supply deals generally. In particular, the apparent reliance by the Commission on the 2008/09 internalisation by Hanson from Lafarge as evidence of cross-supply deals contributing to coordinated effects, and the apparent misinterpretation of the circumstances surrounding that internalisation, suggests that the Commission's concerns as regards cross-supply deals are not supported by evidence, at least as far as the use of internalisation or the use of cross-supply deals as side payments are concerned.

[55] [✂]

Cross-Sales enhancing transparency

8.35 In addition, to the extent that the Commission's concerns are predicated on an increase in demand (potentially up to 2007 levels), the factors below concerning the poor prognosis for the industry may mean that such concerns are merely academic.

8.36 The Commission raises a further potential concern with cross-sales. It states that these could be used to facilitate transparency in pricing, and that the internal documents of the Majors showed close monitoring of competitor price increase proposal letters.

8.37 A number of points should be noted in this respect:

8.37.1 Any pricing discussions in this context would be between one major cement producer to another's downstream business in the context of a legitimate supply arrangement between them. The justifications for the cross-supply deals, at least as far as Hanson is concerned, have been noted above.

8.37.2 Any pricing discussions would be unique to that supply arrangement. The Commission has repeatedly recognised that the pricing paid in cross-sales between the major producers may not be the same as what some other customers achieve and may differ from other market prices.

8.37.3 Similar principles would apply to any price increase proposal letters sent in the context of such supply arrangements. As noted above, these letters are sent in the context of legitimate supply arrangements. Whilst the downstream business may receive the same letter as other customers, it will not have any indication of the extent to which other customers will be able to negotiate a lower (or no) price increase. As noted above, there can often be a significant divergence between the price increase proposed and the price increase accepted by individual customers.

8.37.4 Therefore, the supply arrangement would give no indication of the price paid by other customers or the level of price increase accepted by other customers. Any pricing information received in the context of such supply deals would only have limited utility as market intelligence.

8.38 Therefore, there ought not to be any concern that, on the evidence, such supply deals serve to enhance transparency in a meaningful or reliable manner with regard to cement prices, or price increases, agreed with customers.

Lack of Common Mindset consistent with Collusion

8.39 Hanson submits further that, were tacit collusion to exist as suggested by the Commission, there would have to be evidence of a clear common mindset whereby the maintenance of a precise market share was the priority focus of the senior management through the review period. Hanson contends both that:

8.39.1 No such mindset existed – the controlling management of Hanson’s cement business changed radically after Hanson’s acquisition by Heidelberg Cement, as Castle Cement Limited became incorporated into the Hanson reporting structure.

8.39.2 The concept of an absolute priority to maintain a precise and critical market share is noticeably missing from the emails, internal communications and corporate documentation of Hanson when taken as a whole across the years of the review period. Although, as in any company in any business sector, there may appear occasional references to the desire not to lose volume or business, and, during critical business times, there may be a stronger natural desire to estimate or know one's market share as a metric of performance, it cannot be said that the body of evidence before the Commission suggests an absolute priority to maintain a precise market share at all costs. Hanson contends that the fact that such a continuous critical objective is noticeably absent from the body of evidence when reviewed across the general period of investigation would suggest that such a priority or mindset did not exist in the manner suggested by the Commission and that the body of evidence is consistent with this.

9. THE IMPACT OF LAFARGE/TARMAC AND THE ENTRY OF LAKSHMI MITTAL INTO THE UK MARKET

9.1 Any coordinated effects theory of harm will have to take account of the changing market dynamics resulting from the completion of the Lafarge/Tarmac JV and the entry of Lakshmi Mittal and Hope Construction into the cement, RMX and aggregates markets. These developments introduce tremendous uncertainty into the markets and will most likely lead to a fundamental shift in market dynamics (in particular, as regards cement and RMX) and on a very significant large scale. It is not possible to know what strategy or conduct Hope Construction Materials and Lakshmi Mittal may bring to the UK cement market, other than to note that Hope will in all likelihood work to establish a very significant market share to match their capacity and that Hope will bring the world leading skills, experience and resources of the Mittal group to the national cement market, which will be expected to change and develop as a result.

9.2 The new Lafarge/Tarmac entity has a different cement and RMX profile to that of either of the legacy companies. Hope Construction is a new entrant into GB cement and RMX markets with material positions in both markets, but a different profile and potentially different incentives to either of the legacy operators.

9.3 In particular, it is estimated that Hope Construction will have around a [✄]% share of GB grey cement supply and [✄]% of RMX. Hope Construction can also be expected to introduce very significant uncertainty. For example:

9.3.1 Unlike Tarmac, Hope Construction is expected to be "long" in cement. Tarmac's cement plant was largely concentrated on internal supply, whereas Hope Construction will have excess capacity to supply independent customers - the net effect will be to introduce a new major player into the supply of cement to the independent RMX sector[56].

9.3.2 The fact that Hope Construction is ultimately owned by an investor (Lakshmi Mittal and Mittal Investments) who has world leading experience in steel manufacture, but no experience in cement manufacture, brings considerable uncertainty as to its strategic behaviour. For example, the ultimate owner of Hope Construction has a reputation for bringing world leading process improvements and efficiency investing in logistics. This could bring a differentiated approach to GB cement production and supply. Arcelor Mittal leads the world's steel industries in research and development as well as in very significant CO_2 reduction techniques and Hanson believes Mittal Investments may look to similar leadership and change going forward in cement.

9.3.3 [✄]

9.3.4 [✄]

[56] This was recognised by the Competition Commission in the *Anglo/Lafarge* Decision. "*The Hope cement plant to be divested is significantly larger than Tarmac's Tunstead plant. If the purchaser of the divestiture package runs Hope at its capacity, then concentration may be expected to decrease on some commonly-used indicators—for example, the three firm concentration ratio.*" Para 8.106 .

9.4 It is clear that the changing industry structure and the introduction of a new competitor (in the form of one of the world's most dynamic, successful and leading businessmen) from outside the industry into the market will create tremendous uncertainty as to that competitor's strategic behaviour. This was reflected in the Commission's final report on the anticipated construction materials JV between Anglo American and Lafarge, which noted that *"it is also conceivable that such uncertainty might increase following divestiture...compared with the situation before the proposed JV"*[57].

9.5 It is established that coordinated effects are more difficult to establish in a market which is subject to radical change and uncertainty in terms of industry share and/or where a new competitor is introduced whose strategic behaviour is likely to be subject to significant strategic uncertainty. Hanson submits that the Commission has not yet given due evidential consideration to this very significant market change. Hanson suggests that the evidence provided by the advent of Lakshmi Mittal to the GB market ought to be assessed by the Commission as a key factor suggesting that any model of suggested or sustainable coordination going forward is extremely unlikely.

9.6 The Commission notes in the UIS (para. 9) that further work is to be done on the impact of the Lafarge/Tarmac JV and the Hope Construction divestment. Hanson suggests that this development should encourage the Commission to revisit its analysis on coordinated effects and recognise that establishing coordinated effects has now been made even more difficult by the advent of Lakshmi Mittal into the UK marketplace[58].

9.7 One particular challenge in terms of coordinated effects would be to determine where Hope Construction sits in terms of the "coordinating" producers. The Commission, in *Anglo/Lafarge*, when considering whether there existed a degree of pre-existing coordination (prior to the Tarmac/Lafarge JV) did not reach a conclusion, but noted: "*we found that it was likely that (a) Tarmac did not, at present, have the same incentives to coordinate as the other UK cement producers, and (b) if there were a degree of pre-existing coordination, Tarmac was likely to be part of a competitive fringe.*" (para. 6.199).

9.8 If the Commission persists with a coordinated effects theory of harm, it would have to determine whether:

9.8.1 Hope Construction "sits" outside the coordinating group, in which case external sustainability could be difficult to establish with such a strong competitor outside the group; or

9.8.2 Hope Construction is part of the coordinating group, in which case it will have to reconcile the fact that a new entrant with uncertainty as to its strategic behaviour will have the same incentives as the existing GB cement producers.

9.9 Hanson has shown that, for the reasons set out above, there should be no concerns over coordinated effects. The impact of the Hope Construction divestment means that such effects are even less likely and that Hope will be working to secure the significant market share that justifies its high investment in GB cement capacity.

[57] A report on the anticipated construction materials JV between Anglo American PLC and Lafarge S.A, 1 May 2012, para.8.113.

[58] There is precedent for a change in market circumstances during the course of a Commission Market Investigation to lead to the Commission adopted a forward-looking view and conclude that changing market dynamics indicate that no AEC arises. For example, in the *Movies on Pay TV* Market Investigation (final report issued on 2 August 2012), the Commission took into account the emergence of Netflix and LOVEFiLM during the course of the Investigation as alternatives to Sky Movies. This led the Commission to revise its provisional views. Even though the Commission recognised the lack of empirical evidence as to the likely impact of the new services, it concluded that there was likely to be increased competition to Sky Movies going forward (despite the very strong position of Sky Movies and the very small position established by the competing services at the time of the Final Report in this Investigation) and used this factor to dismiss an AEC.

10. THE ECONOMIC SITUATION

10.1 Hanson has provided information to the Commission already in relation to the performance of and prognosis for the market, [✂][59]. The detail is not repeated here, but, in short:

10.1.1 Hanson's own cement business has suffered an extreme decline in sales in recent years. In 2006, Hanson's cement business sold approximately [✂] tonnes of grey cement but this declined to [✂] tonnes in 2008, before falling further to approximately [✂]tonnes in 2009. Despite some limited recovery towards [✂] tonnes in 2011, the subsequent recession and downturn through 2012 (the 'double dip') has resulted in cement volumes falling in 2012 (and next year) to levels significantly below the lowest levels of 2009.

10.1.2 Whilst Hanson's share does fluctuate, the picture is generally reflective of the severe drop in market demand as a whole.

10.1.3 There is no indication that demand will ever return to the levels experienced in 2007 or even increase over the medium term, given the macro-economic outlook for the construction sectors downstream of Hanson's business and the lack of any significant plans for government led infrastructure projects or public sector investment. The short to mid-term prognosis is at least for a continuation of current dire conditions. For example, the MPA projects further declines for 2013, some moderate recovery for 2014 but not even returning across the majority of products to the hugely depressed 2010 levels by 2015.

10.2 The effects of this are critical for Hanson's business and the effects are being felt by all players in the industry. The fluctuations in demand in the last few years, together with the uncertain prognosis, create a very difficult market in which to operate.

10.3 Hanson asks that the Commission work the current economic conditions fully into its analysis and consider the impact on any theories of harm.

10.4 In particular, demand shocks, and a fluctuating and uncertain demand profile, make coordination very much difficult to establish. For example, in the context of established economic theory on coordination:

10.4.1 It appears that much of the Commission's focus is on 2008/09, when the industry experienced its greatest demand shock. Coordination during a period of intense demand shock is inherently difficult to establish and unlikely.

10.4.2 In a period of excess capacity and depressed demand, there can be greater competition for larger projects (i.e. "an opportunity too good to miss") destabilising any equilibrium.

10.4.3 Coordination is both highly unlikely and more difficult to maintain in periods of uncertain and fluctuating demand as being experienced at present.

10.5 Hanson considers that the Commission has not yet worked to assess the impact of these critical evidential factors in its considerations regarding a possible model of collusion. Hanson invites the Commission to expressly assess these fundamental market characteristics and, with respect, suggests that these fundamental market characteristics are inconsistent with a market that is likely to be susceptible to suffer from coordinated effects.

[59] [✂]

PART II: UNILATERAL MONOPOLISTIC EFFECTS (CEMENT)

11. TOH I (UNILATERAL OR MONOPOLISTIC EFFECTS) – CEMENT

11.1 The reasoning set out above in relation to coordinated effects in cement applies equally in respect of unilateral effects and so is not repeated in depth here.

11.2 In short, Hanson considers that the cement market is competitive and there should be no concerns over unilateral or monopolistic effects.

11.3 In particular:

11.3.1 Importers represent a real and constant threat to GB producers, acting to constrain prices to customers:

(a) Importers do not suffer from 'penalty' costs as suggested to date by the Commission;

(b) There are low barriers to entry and expansion by importers as demonstrated by the commitments made by importers to the GB market in the last five years;

(c) Importers have established a significant market share of some 13% to 14% from zero in the 1980s and have established enormous capacity; and

(d) There is empirical evidence of strong competition for customers between GB cement producers and importers.

11.3.2 The lack of persistent excess profitability demonstrated in the cement market and, indeed, the low levels of profitability experienced, demonstrate strong competition.

11.4 Hanson's view is that for the specific reasons set out above in this Response, the evidence raised to date in the MIR is yet to be fully assessed by the Commission and that on a balanced, complete and accurate review, the evidence before the Commission is *not* consistent with a finding of unilateral of monopolistic effects in cement.

PART III: UNILATERAL EFFECTS (GGBS AND FLY ASH)

12. OVERVIEW

12.1 [✂]

12.1.1 The role of GGBS and PFA as cement additives;

12.1.2 [✂] the GBS supply agreements which Hanson has with Tarmac and the rationale for the exclusivity; and

12.1.3 Alternative sources of GGBS.

12.2 [✂][60]

12.3 [✂]

13. THE ROLE OF GGBS AND PFA AS CEMENT ADDITIVES

13.1 Both GGBS and PFA are used as cement additives in the RMX or the concrete block production process:

13.1.1 [✂][61] [62]

13.1.2 [✂][63]

13.1.3 [✂]

13.2 [✂]

13.3 [✂]

13.4 [✂]

13.4.1 [✂][64]

13.4.2 [✂][65]

13.4.3 [✂][66]

13.4.4 [✂][67]

13.4.5 [✂]

13.5 [✂]

14. BACKGROUND TO, AND RATIONALE, FOR THE TARMAC GBS SUPPLY AGREEMENTS

14.1 [✂][68]

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60 [✂]
61 [✂]
62 [✂]
63 [✂]
64 [✂]
65 [✂]
66 [✂]
67 [✂]
68 [✂]

14.2 [✂]

14.3 [✂]

14.4 [✂]

14.5 [✂]

14.6 [✂]

14.7 [✂]

14.8 [✂]

14.8.1 [✂]

14.8.2 [✂]

14.8.3 [✂]

14.9 [✂]

14.10 [✂]

14.11 [✂]

15. ALTERNATIVE SOURCES OF GGBS

15.1 The arrangements do not give Hanson exclusivity over supplies of GGBS in GB. There are already [✂] quantities of imports into the UK, [✂].

15.2 [✂][69]

15.3 [✂]

15.4 [✂]

16. CONCLUSION ON PFA AND GGBS

16.1 [✂]

16.2 [✂][70]

[69] [✂]
[70] [✂]

PART IV: TOH III (VERTICAL EFFECTS)

17. VERTICAL INTEGRATION

17.1 Hanson welcomes the Commission's provisional decision not to pursue unilateral or coordinated foreclosure (or margin squeeze) concerns in relation to either cement or aggregates into RMX. As noted in Hanson's response to the Original Issues Statement, this was not a credible theory of harm, in particular in the light of the relative growth of the independent RMX sector.

17.2 The UIS expresses potential concerns over vertical integration as a barrier to entry to RMX, and as a barrier to entry or expansion in cement, as well as potentially facilitating upstream coordination in aggregates and cement. The UIS does not expand on the evidence to support these concerns, and they appear merely to be theoretical at this point. However, Hanson sets out some general comments below.

The Current Level of Vertical Integration has been approved

17.3 First, it is worth noting that the current vertically integrated industry structure has been expressly and repeatedly approved by the Competition Authorities. This was highlighted in Hanson's response to the Original Issues Statement, but is worth repeating as the UIS does not explain how the Commission could have concerns in relation to an industry structure whose structure has been repeatedly scrutinised and approved by the Competition Authorities.

17.4 A clear example of this relates to the European Commission's 2007 clearance of the acquisition of Hanson by HeidelbergCement[71]. This involved, in particular, a significant degree of vertical integration between a major GB cement producer (Castle Cement) and major GB RMX producer (Hanson), in the UK.

17.5 This acquisition did not involve a minor change to the counter-factual: it involved a major shift in the structure of the industry in terms of vertical integration between cement and RMX. This was cleared by the European Commission in Phase I. Indeed, the European Commission considered possible input and customer foreclosure strategies, but expressly rejected them. This clearance decision will be considered further below.

17.6 In addition to this clearance, other mergers leading to vertical integration in the UK (aggregates and/or cement into RMX), effectively in a number of cumulative stages, have been dealt with in a significant number of cases. Examples include:

17.6.1 Aggregate Industries' acquisition of Atlantic Aggregates Limited and Stone Haul Limited (secondary aggregates into RMX)[72];

17.6.2 Aggregate Industries' acquisition of Foster Yeoman (aggregates into RMX)[73];

17.6.3 Lafarge's acquisition of Blue Circle Industries (a major cement player combining with a vertically integrated aggregates and RMX player)[74];

17.6.4 Minorco's (Anglo American) acquisition of Tarmac (aggregates into RMX)[75];

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[71] See e.g. Case COMP/M.4719 *HeidelbergCement/Hanson*, paragraph 90 et seq.
[72] OFT decision, *Aggregate Industries Limited / Atlantic Aggregates Limited / Stone Haul Limited*, 2 March 2009, paragraph 121-123.
[73] Case COMP/M.4298 *Aggregate Industries/Foster Yeoman*, paragraph 18-20; and subsequent clearance by the OFT following referral by the European Commission; OFT decision, *Aggregate Industries/Foster Yeoman*, 22 December 2006, paragraph 96-98.
[74] Case COMP/M.2317 *Lafarge/Blue Circle (II)*, paragraph 15 et seq.

17.6.5 Hanson's acquisition of Pioneer (aggregates into RMX)[76]; and

17.6.6 RMC's acquisition of Rugby Cement[77].

17.7 In addition, the RMC/Rugby decision involved significant horizontal overlaps in cement.

17.8 The fact that these cases have effectively given the current industry structure a "clean bill of health" by approving (subject only to local market divestment requirements in aggregates and RMX markets in certain cases) means that the Commission would need to show substantial changes to industry structure or underlying competitive conditions in order to find an AEC. A number of the cases are historic, but the *HeidelbergCement/Hanson* decision, in particular, is more recent (2007) and involved a major change in the structure of the industry (in effect, creating the structure which has largely existed through to the end of 2012), also entailing a competitive assessment of conditions when demand was at its peak.

17.9 While industry conditions in all three reference markets (as well as the GGBS and PFA sectors) have developed significantly since the date of that decision, all the developments are ones which only point in one direction - a greater intensity of competition than in 2006/07. These include:

17.9.1 The fundamental shift in industry conditions through a massive drop in demand and a forward prognosis suggesting no recovery to anything like 2007 levels - highlighted above.

17.9.2 Growth of imports of cement. In its decision, the European Commission recognised that the cement imports represented a real constraint to UK cementitious products producers: "*any attempt to coordinate* [in relation to cementitious materials] *may be destabilised by the increasing constraint of imports, either by other competitors or by some customers. Currently there are 20 cement terminals in Great Britain allowing for the discharge of cement and cement additives, not only owned by the major players but also by those with smaller presence, such as Titan or Holcim or by independent undertakings or customers. According to the parties, over the last 9 years 11 new terminals have been set up in the UK. The capacity of all these import terminals accounts for around 6 million tonnes (representing around 35% of the cementitious market) and it is only used at about 25%.*"[78] The market share of imports has increased substantially since the date of that decision, from around 9% in 2007[79] to over 13% currently. Importers are continuing to invest in import facilities. These suggest that imports are even more of a constraint now than then.

17.9.3 Relative growth of the secondary and recycled aggregates sectors, constraining primary aggregates producers. As noted in previous submissions, the secondary and recycled aggregates sector now represents around 29% of the supply of aggregates in GB, up from around 25% in 2006/07[80].

17.9.4 Relative growth of independent RMX producers at the expense of the Majors.

[75] Case COMP/M.1779 *AngloAmerican/Tarmac*; and subsequent clearance by the Secretary of State (subject to undertakings) following referral by the European Commission.
[76] Case COMP/M.1827 *Hanson/Pioneer*.
[77] Case COMP/M.1759 *RMC/Rugby*.
[78] Case COMP/M.4719 *HeidelbergCement/Hanson*, paragraph 88
[79] http://www.mineralproducts.org/sustainability/cement-production-data.html
[80] Based on 2009 and 2012 MPA sustainability reports, http://www.mineralproducts.org/sustainability/reports.html

17.9.5 Looking forward, the potentially radical shift in industry structure and dynamics through the introduction of a major new player (Hope Construction) – highlighted above.

17.10 The Commission should not be able to conclude an AEC related to industry structure where that industry structure has been explored and, in effect, approved previously by Competition Regulators unless industry developments indicate that competition problems have surfaced since the date of the previous analysis. The industry indicators point to the opposite conclusion.

Vertical Integration as a Barrier to Entry

17.11 The fact that it is not a barrier to RMX is clearly demonstrated by a healthy and growing independent RMX sector, which has flourished and succeeded in growing market share and capacity, whilst the market share and capacity of the majors have declined. (Hanson believes that this is well understood by the Commission with regard to the independent RMX sector and invites the Commission to set out why similar recognition and analysis have not to date been given with regard to the similar successes experienced by cement importers in the GB market).

17.12 Hanson does not accept that any new entrant to the RMX markets would be deterred by the fact that it did not own its own clinker production operation.

17.13 Hanson is "long" in cement, dependent on independent [✂][81]. It would not be economic for it not to supply the non-vertically integrated sector on the most economic terms as it would risk losing significant demand were it to do so.

17.14 It does not represent a barrier to entry or expansion in cement. There is a large independent customer base which has grown. The ongoing investments by importers shows the confidence which they have in the liquidity of demand from the independent RMX sector.

Vertical Integration facilitating Collusion

17.15 Under the Commission's theory, it is not vertical integration which facilitates coordination, but the fact that companies are not vertically integrated to the extent that they can self-supply fully.

17.16 Hanson does purchase from/supply to competitors. These arrangements are dictated by logistics/technical considerations, but it would prefer to self-supply [✂]

17.17 All contacts with competitors in the context of supply arrangements are limited to that necessary for the purposes of any supply arrangement.

17.18 Such arrangements do not create pricing transparency and Hanson reiterates that any pricing information received relates to that cross-supply deal and does not impact on other deals. As noted above, price announcement letters represent just the starting point for negotiation.

17.19 The theory that it would be possible to punish a cement supplier for "stepping out of line" in cement by penalising it in the RMX market is not workable. RMX is highly competitive and would not be conducive to a punishment strategy. The quasi-bidding nature of much of RMX work, with no transparency as to bidding suppliers, would mean that it would not be practicable to target a particular RMX supplier.

Cement/RMX integration driving Cement competition in effect

[81] [✂]

17.20 Hanson welcomes the conclusion that the Commission appears to have reached with regard to the RMX market, in that it is known to be extremely competitive, with very low barriers to entry and access to both GB and imported cement. It is of course one of the most competitive markets that exists in any business sector:

17.20.1 As Hanson has raised previously with the Commission, more than [✄]% of Hanson's cement is sold internally. The eventual outcome in the market is therefore left to whatever happens at the level of concrete sales, which effectively provides the single most important route to market for Hanson's cement.

17.20.2 The Commission has not responded to date on this critical and structural aspect of the market. Hanson invites the Commission to acknowledge that:

(a) As such a significant proportion of cement supply is determined by the extremely competitive RMX sector (where both majors and independents win and lose contracts from one another on a daily basis), in effect, that proportion of the cement supply (c. [✄]%) is subject to the extremely competitive conditions of the RMX market.

(b) Accordingly, when the Commission is assessing whether it has any concerns with regard to the market conditions for cement supplies, it is in effect only assessing the remaining [✄]% of the market. In other words, the proportion of GB cement supplies being provided through the integrated RMX channel is now confirmed by the Commission as subject to extremely competitive market conditions.

PART V: AGGREGATES

18. COMMENTS ON AGGREGATES

18.1 The aggregates market is a competitive one and Hanson welcomes the positive preliminary conclusions contained in the UIS[82]. As the Commission now finalises its views, Hanson hopes any concerns in relation to TOH I and TOH II for aggregates (and also RMX) are discounted and these lines of inquiry of dropped as soon as possible.

18.2 Within the UIS the Commission states that it intends to complete further analysis of the market for specialist aggregates[83]. Hanson would be happy to assist the Commission with this work stream as the MIR progresses.

Theory of Harm I: Unilateral Effects

18.3 The UIS provides a positive outlook on the current structure of the aggregates market and the significant level of competition which all aggregates producers encounter across various local markets. For example, with regards to TOH I, the UIS sets out that based on the Commission's preliminary work "*it appears that most aggregates customers have some degree of choice of suppliers*"[84]. As Hanson has previously highlighted to the Commission[85], there are more than 230 producers currently supplying aggregates[86], which illustrates the strong level of competition and number of alternative suppliers available for aggregates customers.

18.4 Hanson has welcomed the local aggregates case study undertaken for the South Wales market and also the Price Concentration Analysis (PCA) by the Commission. The results published so far of both of these exercises support the position that the aggregates market is a competitive one.

18.5 For example, as part of the local aggregates case study, the Commission has highlighted how highly competitive the South Wales aggregates market is. There are competitive constraints on all producers provided by both majors and independents[87]. Hanson considers the South Wales market is a typical example of the competitive nature of local aggregates markets across the country.

18.6 The Commission's PCA analysis supports this view further[88]. In particular, the finding that nearly 100% of customers have more than 5 plants within 20 miles (urban) or 28 miles (rural) of a job site, and that over 90% have more than 5 competing supplier fascias within 20 or 28 miles is indicative of the strong level of competition in local markets[89]. This illustrates that local aggregates markets are intensely competitive, and customers are able to choose from a range of suppliers for particular jobs. It is also clear that there is a surplus of supply capacity across the aggregates market in general, which, coupled with the extent of competing suppliers, provides for a fiercely competitive market.

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[82] For example at para. 39 of the Updated Issues Statement, "*Indications from our analysis to date are that any concerns about the ability of companies to exercise unilateral market power in relation to construction aggregates may be confined to a limited number of local markets*".
[83] Updated Issues Statement, para.40.
[84] Updated Issues Statement, para.26.
[85] Paragraph 1.7.1 of Hanson's response to the Issues Statement dated 20 April 2012.
[86] BDS Marketing Research: "*Estimated market shares of pits, quarries and marine wharves in Great Britain (2010)*", October 2011, page 163 et seq.
[87] For example, within the Aggregates Case Study working paper received by Hanson on 28 November 2012, the Commission notes at paragraph 37 how Hanson is in close competition with Tarmac and Cemex. Whilst at paragraph 46 the Commission cites a Hanson document noting the influence and constraint provided by independents by providing the example of Sammy Rees.
[88] Hanson did express some concerns regarding the methodology applied for the PCA analysis. These comments were submitted to the Commission on 13 December 2012.
[89] Slide 11 of Aggregates PCA and EEA: Draft Results (Hanson) dated 19 November 2012.

18.7 A further factor indicating how competitive the aggregates markets are is the low or nominal levels of profitability the Commission has reported in the UIS[90]. For example, the UIS notes the returns on capital employed within aggregates have been "*low to modest across these businesses over the last five years*"[91]. Such low levels of profitability further indicate a competitive market where the prices agreed and implemented with customers are at competitive levels.

Secondary and Recycled Aggregates

18.8 The UIS understates the extent to which primary aggregates are subject to significant constraints from secondary and recycled aggregates. In particular, the Commission has not acknowledged the significant inherent advantages that both secondary and recycled aggregates have over primary aggregates. Hanson has previously explained to the Commission the financial, production and technological advantages of both secondary and recycled aggregates[92]. These include:

- The deliberate state sponsored cost advantage given to all recycled/secondary materials due to their express exemption from the Aggregates Levy. Along with incentivising the greater use and production of secondary and recycled aggregates, as noted above, this is an example of the policy and regulations in place enhancing competition, since the state directly sponsors such direct competitors with a levy exemption worth some £2 per tonne; since these materials can be substituted in full for all primary low grade aggregates, Hanson has lost significant volumes of business as a direct result of the levy exemption;
- The support provided by the National Planning Policy Framework (NPPF) for recycled/secondary material;
- Various regulatory/public initiatives promoting the use of recycled/secondary material, such as the Waste Resources Action Plan (WRAP), the Code for Sustainable Homes (CSH), the Building Research Establishment Environment Assessment Methodology (BREEAM) and the Government Strategy for Sustainable Construction; and
- Public sector initiatives and impetus more generally towards the use of sustainable materials.

18.9 A further inherent advantage, which the Commission has not appreciated fully, is that the barriers to entry for recycled aggregates are considerably lower when compared to primary aggregates. There are no barriers to entry for recycled aggregates, and recycled aggregates represent a potentially flexible resource which can constrain the activities of primary producers[93]. As the MPA has noted "*an additional up to 5 million tonnes of hard material could potentially still be extracted from the waste stream*"[94]. The reason for such a surplus is that recycled aggregates are derived from construction and demolition waste. Therefore, in areas where construction and demolition activities are most prevalent (typically urban areas), recycled aggregates can be easily sourced. Continuing redevelopment inevitably leads to significant demolition waste being created, and, therefore, the ready availability of materials for recycling. Recyclers also have the added cost advantage of not being required to pay Landfill Tax through producing a recycled product.

18.10 By not highlighting these advantages, the UIS underplays the role of use of secondary and recycled aggregates, especially in their use for concrete blocks and RMX production. Secondary and recycled aggregates sectors represent around 28% of

[90] Updated Issues Statement, paras.35-36.
[91] Updated Issues Statement, para.35.
[92] Paragraphs 7.7 – 7.10 of Hanson's response to the Issues Statement dated 20 April 2012.
[93] This has consistently been recognised in Hanson internal documents such as the 2011-2015 Strategic Plan
[94] MPA Hearing Summary – Paragraph 12.

supply in GB of aggregates which represents a significant alternative to the use of primary aggregates[95].

Theory of Harm II: Coordinated effects

18.11 As regards coordinated effects, the Commission appears to be reaching the conclusion that no coordinated effects exist within the aggregates market. Hanson would welcome an early resolution on this point if this is indeed the case. The factors noted above, which indicate how competitive local aggregates markets are, undermine any coordinated effects theory of harm. In addition the following factors further counter this particular theory:

- At both national and local levels the markets are not sufficiently concentrated. The presence of five majors may already be too many for coordinated effects theory of harm, but, in any case there are also a number of other large regional players (for example, Brett Aggregates and Breedon Aggregates) and numerous local players to consider.

- As the Commission recognises, the nature and number of local markets make coordination difficult[96], in particular where there is potential differentiation between aggregates produced at different locations and between supply conditions between locations.

- As explained above, the viable threat from secondary and recycled aggregates would further undermine any coordination within the primary aggregates markets. The low barriers to entry present, particularly in the recycled markets, ensure customers have flexibility in the sources of supply which can be chosen.

- As the Commission recognises the nature and make up of the aggregates markets results in many factors which limit any transparency in these markets[97]. For example, the local nature of markets result in a geographical differentiation in the aggregates produced across the country. Added to this is that customers tend to negotiate supply relationships on a bilateral basis and often on a project by project basis. Finally, transparency is also limited given the large number of customers and local aggregates providers in place.

- The UIS examines the way aggregates price increase letters are sent out and how these may relate to TOH II. When the historical price increases are examined[98], the empirical evidence appears to indicate that, even if there is a degree of transparency, this does not mean that producers who are not the first to announce follow the first to announce in the level of the price increase and indeed sometimes use the opportunity to undercut the first to announce. Again, this is consistent with a competitive market. Producers may use market intelligence gained (e.g. from customers) as one factor in their own pricing strategy which is also not consistent with any arguments of price parallelism.

[95] As reported at paragraphs 7.16 of Hanson's response to the Issues Statement dated 20 April 2012.
[96] Updated Issues Statement, para.80.
[97] Updated Issues Statement, para.73.
[98] As reported at paragraph 24 of the Aggregates Price Increase Announcement Letters Working Paper.

PART VI: RMX

19. COMMENTS ON RMX

19.1 Hanson welcomes and supports the Commission's preliminary conclusions on the RMX markets being competitive in nature "*given the indications that the extent of concentration in local markets for RMX may be limited*"[99].

19.2 Hanson considers this to be accurate as RMX markets are highly competitive, with multiple suppliers (from the Majors, independent fixed RMX producers and volumetric truck operators) frequently competing on price and quality and offering customers wide-ranging choice.

19.3 As Hanson explained in the response to the Issues Statement[100], it faces competition from at least four other RMX competitors in nearly all markets and the Commission/OFT guidance in the area of merger control states that "*the OFT has not usually been concerned about mergers that reduce the number of firms in the market from five to four (or above)*". This suggests that competition can generally be assumed to be sufficient where there are at least four other players competing in the market, in which case there is no need for regulatory intervention[101].

19.4 Hanson also welcomes the Commission's initial view that volumetric trucks are a competitive constraint within the RMX market[102]. Volumetrics also have the inherent advantage of having the capability of being able to batch RMX on-site and therefore are not restricted as fixed plants are in requiring delivery of the product within two hours as noted by the Commission[103]. Volumetrics also have the advantage of being to able supply and compete for larger jobs and projects[104].

19.5 Barriers to entry and expansion are low in the RMX market, as the level of financial resourcing needed is lower. Land suitable for RMX production is generally available as general industrial land and the planning process is relatively straightforward to obtain.[105] This is also corroborated by the fact that independent suppliers recently have increased their relative share of supply in the market[106]. The general growth of the independent RMX sector during the period of depressed demand also runs counter to any theory that the lack of availability of cement and/or aggregates at competitive prices represents a real concern for the independent RMX sector (and, consequently, a barrier to entry).

19.6 The Commission sets out in the UIS that it is planning to consider the competitive conditions in the supply of RMX to customers requiring very large quantities[107]. Within RMX there is evidence that many suppliers (both majors and independents) possess the capability to be able to supply customers requiring such quantities. Supplies to such customers can be made by RMX producers from outside particular local markets by setting up and operating site plants (i.e. meaning that a supplier from outside the area may compete in the area). Hanson has previously cited to the Commission

[99] Updated Issues Statement, para.66.
[100] At paragraph 8.10.4.
[101] Merger Assessment Guidelines, CC2/OFT1254, paragraph 5.3.5. See also OFT Reference Decision, paragraph 4.11, where the OFT recognises that two players are sufficient for competition.
[102] Updated Issues Statement, para.20.
[103] Updated Issues Statement, para.21.
[104] Hanson noted in its response to the Issues Statement of being aware of volumetric trucks supplying larger projects in the West Midlands (one example being for a large project involving the M42). In addition, volumetric truck suppliers generally now supply both domestic and commercial customers, to a variety of project types and sizes. Volumetric truck producers also have the advantage of now being able to fill the trucks the night before a morning delivery. This is advantageous for them as this reduces what would be the batching time at a static plant.
[105] OFT Reference Decision, paragraph 4.46.
[106] OFT Reference Decision, paragraph 4.48.
[107] Updated Issues Statement, para.66.

examples where independents such as Brett Aggregates and Euromix Concrete have been able to supply such projects and quantities[108].

[108] [✂]