

BRITISH SALT LIMITED

RESPONSE TO THE COMPETITION COMMISSION'S NOTICE ON POSSIBLE REMEDIES

NON-CONFIDENTIAL VERSION

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CLEARY GOTTlieb STEEN & HAMILTON LLP

**RESPONSE TO
THE COMPETITION COMMISSION'S
NOTICE ON POSSIBLE REMEDIES**

This Response sets out the comments of British Salt on the possible remedy options on which the Competition Commission is seeking views.

I. Divestiture

The Group invites views on whether divestiture would be effective in addressing the SLC identified as expected to result from the merger. In particular the Group invites views on:

- **The scope of the divestiture package. The CC generally prefers the divestiture of an existing business that can compete effectively in the market on a standalone basis. The Group is currently of the view that, in this case, the divestiture of the whole of the NCSW business would be necessary to address effectively the SLC. However, views are invited on whether a divestiture package short of the NCSW business as a whole would be effective in addressing the SLC.**

For the reasons discussed below, and in the Response to the Provisional Findings, British Salt does not consider that NCSW could continue, beyond the immediate term, to compete in the market on a standalone basis. It does not therefore believe that there is any potential purchaser for all or part of the NCSW business.

- **Possible purchasers. In order to be an effective remedy, divestiture would need to result in NCSW being purchased by someone who would operate it as a competitor in the market. Views are invited on possible suitable purchasers.**

British Salt does not believe that any third party purchaser would be prepared to operate NCSW as a competitor in the market, for a number of reasons identified by the Group in its Provisional Findings:

- The former shareholders did not believe that NCSW was a viable economic entity in the medium term. Had they not sold the business, they considered that “*it would almost certainly have closed in the short to medium term*” (at paragraph 5.2). Since that view was formed, the short-term viability of NCSW has been further eroded as a result of substantial recent and forecast increases in energy costs:
 - As a result of increased gas costs in the fourth quarter of 2005, NCSW’s EBITDA will be at break-even for November and December 2005.

- Based on the current IPE forward gas price for 2006, NCSW's total energy costs are forecast to increase from 2005 to 2006 by approximately a further £750,000.
- Assuming stable sales volumes and prices, these cost increases will result in a negative EBITDA for NCSW in 2006 of £[>300,000], and an operating loss of £[>600,000].
- NCSW faces significant environmental issues. In particular, the method of brine extraction operated by NCSW (wild brine pumping) is known to increase the risk of subsidence (at paragraph 5.26).
 - The results of local authority monitoring highlighted to the former shareholders that subsidence appeared to be occurring on NCSW's own land – *“and to a larger degree than they may have previously realised”* (at paragraph 5.10).
 - The former shareholders believed that the business was at risk of closure arising from legal action being taken against NCSW because of subsidence in the local area (at paragraph 5.5).
 - The former shareholders considered that the exclusion from the statutory compensation scheme of undertakings that might have been affected by subsidence on the monitored land increased the risk that NCSW would face either an injunction and/or claims for damages (at paragraph 5.10).
 - The Provisional Findings confirm that the Cheshire Brine Compensation Board is *“dealing with on-going claims in the Marston and Wincham areas in the neighbourhood of the NCSW plant at Northwich, on both residential and agricultural land, as well as having dealt with and closed similar claims over the course of at least the last five years, and that this included claims for compensation which had been paid”* (at paragraph 5.7).

These environmental risks must be considered in the context of a white salt market characterised by declining demand and rapidly increasing costs, and in which NCSW is acknowledged to be the highest-cost, least efficient and most capacity-constrained producer. British Salt's bankers have confirmed that, in light of these factors, amongst others, they would not have been prepared to finance the acquisition of NCSW had British Salt intended to maintain the NCSW plant in operation.

Given (i) the likely absence of available financing for an acquisition of NCSW as a going concern, (ii) the related environmental risk exposure, and (iii) the belief of the former shareholders – substantiated by its current and forecast financial performance – that NCSW has no sustainable future as a stand-alone business, British Salt does not believe that there is any alternative purchaser for the business.

II. Price Control

The Group is considering whether a price control would be effective in addressing the SLC and adverse effects identified as expected to result from the merger. In particular, views are invited on the following issues:

- **The scope and form of a price control. The Group invites views on:**
 - **Which prices could and should be controlled.**

While the Provisional Findings identify a single product market for both PDV and compacted salt, they confirm that, post-merger, Salt Union would remain by far the leading supplier of compacted salt in the U.K., accounting for 66% of compacted sales. By contrast, the merged group would account for just 28% of sales, inclusive of only a 4% increment. The Provisional Findings contain no evidence of any lessening of competition in compacted salt. For example:

Paragraphs 4.41/4.42: *“We took the view that a 5 per cent price increase would not be sufficient for enough customers to switch in the case of PDV salt. ... In relation to compacted salt, we did not have price information ...”*

Paragraph 4.45: *“We did not consider that solar salt and white rock salt would pass a SSNIP test in relation to PDV salt.”* No equivalent conclusion is reached in respect of compacted salt.

Paragraph 5.87: *“[I]n 2004, when NCSW’s capacity utilisation was at its highest, NCSW did bid to supply one new customer with in excess of 2,000 tonnes of PDV.”* No such bids are identified in relation to compacted salt.

Appendix G, Table 8, Note 1: *“In terms of PDV and compacted, only 5 of the 33 occasions when NCSW has competitively bid for non-NCSW customers relate to compacted salt. The rest relate to PDV salt.”* NCSW did not succeed in any of those 5 bids.

Appendix G, paragraph 23: *“We have not analysed the one occasion where both NCSW and British Salt bid for a non-NCSW compacted customer.”* British Salt assumes from this that the Group did not consider this one instance to merit attention.

British Salt therefore considers that, to the extent that the provisional SLC finding is maintained, any price control should relate to PDV salt only.

- **Whether these prices could and should be controlled individually or in a basket, and, if in a basket, of what the basket should comprise.**

In order to ensure the effectiveness of any price control mechanism, British Salt believes that it would be appropriate to set a single, annual cap that would be applied to all existing customers. That cap should not apply to the extent that an existing customer chooses to switch to an alternative PDV grade, and should be inapplicable to new customers.

- **By reference to what could and should these prices be controlled (e.g., some measure of U.K. inflation, industry cost indices, prices of other types of salt, prices of salt in other countries).**

In light of the significant increases in energy costs that are forecast, British Salt considers that any price indexation mechanism would need to be cost-based. A formula that prohibited cost recovery, where commercially possible, could not be accepted.

Given, however, that energy costs are likely to rise at a faster rate than other costs, British Salt believes that an appropriate mechanism would need to be based on a “basket” of indices, with the gas component being forward-looking. This basket approach was adopted as the basis for the price control mechanism previously in place. Based on this precedent, British Salt would propose the following indices, weighted in line with British Salt’s actual cost structure:

| Cost Component | Index |
|--|---|
| Gas | Forward IPE index |
| Soda ash | Price index of soda ash (MM17 2413000000) |
| Lime | Price index of non-metallic mineral products (MM17 2652000000) |
| Packaging materials | Index of packaging products and plastic (MM17 2522000000) |
| Pallets | Index of pallets, box pallets and other load boards of wood (MM17 2040110000) |
| Personnel | Index of earnings in chemical and man-made fibre industries (EG9 AEI JVUJ) |
| Maintenance | 50% RPI (non-food items) (CHAY)/50% index of earnings in chemical and man-made fibre industries |
| Depreciation | 50% RPI (non-food items)/50% index of earnings in chemical and man-made fibre industries |
| Other materials and services, rent and business rates, other overheads | RPI (non-food items) |

- **Compliance monitoring arrangements. The Group invites views on how compliance with any price control should be effectively monitored. Specifically, views are sought on whether an independent monitor, working to a mandate approved by the CC but remunerated by British Salt, should be used to assist the OFT in monitoring a price control remedy, for example by processing compliance returns and reporting to the OFT.**

British Salt would propose that its independent auditors be used for the purpose of calculating, and ensuring compliance with, any price control, and that they be required to submit an annual report to the OFT confirming compliance in the previous financial year, and establishing the applicable price control for the following year.

In considering a price control remedy, the Group will take into account, inter alia:

- **Its effectiveness in achieving appropriate prices, in particular given that prices tend to be individual negotiated.**

British Salt believes that any price control should be applied individually to the PDV price paid by any existing customer in the preceding year.

- **Its complexity and the impact of any complexity on monitoring compliance and enforcement.**

The price control mechanism that is proposed above is based on that which was successfully applied from 1988 to 2000.

- **The duration of the remedy that would be necessary to ensure its effectiveness.**

According to the Provisional Findings Report, the commercial strategy of the NCSW shareholders pre-merger consisted “*of continuing to run the business for as long as it took to discharge their liabilities, as they perceived them, whilst also seeking to sell the business to a trade buyer*” (at paragraph 5.31). At the time that British Salt approached NCSW in 2004 with a view to a possible acquisition, the former shareholders were “*two to three years away from being in a position to wind up the company in a satisfactory manner*” (at paragraph 5.23). The expressed counterfactual situation against which the transaction must be assessed is therefore that, by 2006/2007, NCSW would have ceased to operate.

Since the purpose of any price control remedy is to replicate the competitive constraint that NCSW would have exerted, British Salt would therefore propose that any price control should apply only for two years following the date of determination of the reference, being the duration for which NCSW might, according to the Provisional Findings, have continued to operate as a viable, stand-alone competitor.

III. Toll Manufacturing

The Group would, of course, be willing to consider any other practical remedies – structural or behavioural – that the main party or any interested third parties propose in order to address the expected SLC and any resulting adverse effects.

In previous discussions, the Group inquired whether British Salt would be willing, if required, to publish the NCSW customer list by way of remedy. British Salt confirms that it would consider this to be a workable and proportionate remedy.

In addition, British Salt has given consideration to the possibility of concluding a toll manufacturing agreement with a third party distributor to which it would transfer, for consideration, the NCSW customer list. In order to constitute a viable remedy in the context of the overall transaction structure and agreed payment mechanism, British Salt considers that such an arrangement would need to include a long-term take-or-pay agreement with the distributor in order (i) from a commercial perspective, to provide some return for British Salt by guaranteeing production volume through the British Salt plant for a period of years such as to justify the transaction consideration, and (ii) from a competition standpoint, to incentivise the distributor to compete to sell that volume. Based on informal discussions with a potential counterparty, British Salt understands that such an arrangement would be unlikely to be attractive for either party, and it has not therefore been explored further.

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British Salt continues to believe that, in a declining market environment characterised by rapidly escalating production costs, the economies of scale and scope that will result from its acquisition of NCSW will deliver significant, relevant, long-term customer benefits. These will take the form of lower prices than might be expected in the counterfactual situation, improved security of supply and increased product availability.

British Salt stands ready to provide any additional information or explanation that the Group may require.