

## Non-cost issues facing NCSW

1. In this Appendix, we describe and analyse the non-cost issues affecting the future commercial viability of NCSW, as identified by the former shareholders of NCSW and British Salt. We considered that these issues fell into three categories.
2. The first set of issues related to how NCSW obtained brine from which to manufacture vacuum salt, in particular:
  - the risk of subsidence caused by NCSW's method of extraction of brine from the ground; and
  - NCSW's inability to secure commercially-viable alternative sources of brine and therefore, its inability to grow its market share.
3. The second set of issues related to the risk of future decreases in revenues for NCSW, in particular:
  - NCSW's susceptibility to price deflation;
  - the risk of increasing supplier base rationalization by major customers; and
  - increased competitive pressure on NCSW from British Salt in the absence of the merger as a result of British Salt's loss of sales of UV salt due to the closure of the Albion Inorganic Chemicals chlor-alkali plant, to take effect in November 2005.
4. The third set of issues related to the scarcity of management resource at NCSW, in particular:
  - the risk of adverse regulatory changes and the consequential additional burden on NCSW's limited management resources; and
  - NCSW's inability to identify suitable successor management.

### Obtaining brine:evidence

5. The former shareholders of NCSW told us that they believed that the business was at risk of closure in the event that legal action was taken against NCSW in relation to subsidence in the local area allegedly caused by NCSW's 'wild brine pumping'.
6. Wild brine pumping involves the pumping of naturally-occurring brine to the surface, whereas controlled brine pumping involves pumping water down to dry salt deposits, which are subsequently dissolved to form brine which is then pumped out. NCSW obtains all its brine from wild brine pumping, whereas British Salt obtains all its brine from controlled brine pumping. We were told that wild brine pumping had occurred in the Cheshire area for many years and also that, over that time, there had been

subsidence related (amongst other things) to wild brine extraction.<sup>1</sup> However, incidences of subsidence related to wild brine pumping had reduced as the number of wild brining operations had reduced. There is no similar risk of subsidence with controlled brine extraction because the shape of the cavities left underground can be carefully designed to prevent any subsidence. We were told that both the geology of the land around NCSW's Northwich site, and the inability to achieve a return on the costs of the development of a controlled brine pumping operation, precluded NCSW from switching to controlled brine pumping at the Northwich site.

7. The Cheshire Brine Compensation Board was established by statute in the 19<sup>th</sup> century<sup>2</sup> due to the large number of wild brine pumping operations in the county at that time. All Cheshire brine pumpers pay a levy into a central fund managed by the Cheshire Brine Compensation Board which then handles all claims in relation to subsidence in the area (except claims from excluded bodies as discussed in next paragraph) and pays out compensation from this fund.<sup>3</sup> We were told that the Cheshire Brine Compensation Board was dealing with on-going claims in areas in proximity to the wild brine pumping activities of NCSW, namely the Northwich, Marston and Wincham areas, on both residential and agricultural land, as well as having dealt with and closed similar such claims over the course of at least the last five years, and had awarded compensation.
8. We were told that certain statutory bodies are excluded from being able to claim for compensation from the Cheshire Brine Compensation Board<sup>4</sup> and would therefore have to seek redress through the Courts. We understand that NCSW is now the only commercial organization in the UK (and Western Europe) which uses wild brine pumping and that the former shareholders has been concerned that any subsidence in the local area would be directly attributed to its continuation of this method of brine extraction. In particular, the former shareholders had concluded that, [redacted]. The former shareholders did not believe that NCSW had the financial means to meet the costs of a legal challenge. The granting of an injunction could force permanent cessation of NCSW's wild brine pumping activities. Further, the award of damages against NCSW could threaten NCSW's commercial viability and could erode the assets available to the former NCSW shareholders to meet their liabilities (and hence their ability to achieve their core objectives as discussed at paragraph 5.14).
9. Stafford is another area where wild brine pumping was historically carried out, but it is not covered by the Cheshire Brine Compensation Board. Both the former shareholders of NCSW and British Salt referred us to the Lotus Shoe Company case.<sup>5</sup> In that case, the Lotus Shoe Company was able to obtain a High Court injunction in 1970 restraining further wild brine pumping by British Soda Company Ltd, a wild brine extractor in Stafford owned by Staveley Industries. The Lotus Shoe Company was able to prove, on the balance of probabilities, that the subsidence on the shoe company's adjacent property was directly attributable to British Soda's wild brine pumping activities. British Salt told us that this plant never reopened. British Salt noted that all commercial wild brine extraction (except that at NCSW) had ceased shortly after this case.

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<sup>1</sup>Cheshire County Council told us that there were natural (ie not pumped) movements of underground brine or water that could cause subsidence, although it felt that wild brine pumping exacerbated and scaled up subsidence problems.

<sup>2</sup>The Board is now regulated under the Cheshire Brine Pumping (Compensation for Subsidence) Act 1952.

<sup>3</sup>British Salt told us that NCSW paid a higher levy rate than the other brine pumpers as a result of its wild brine pumping. British Salt therefore put it to us that, in the event of an increase in claims to the Cheshire Brine Compensation Board in respect of subsidence damage (or an increase in the value of these claims, for example as a result of rising house prices), NCSW would have a higher level of exposure to these increases than the other brine pumpers.

<sup>4</sup>For example, BT, Transco, United Utilities, the British Pipeline Agency and British Waterways.

<sup>5</sup>Lotus Ltd v British Soda Co Ltd [1972] Ch.123.

10. NCSW extracts brine under a planning permission granted by the Cheshire County Council, as part of that Council's role as the Mineral Planning Authority for Cheshire. After a general review of NCSW's permission to extract brine in 1997, Cheshire County Council imposed new monitoring requirements on the company. This led to the installation of monitoring points at various positions around the Northwich site. The Cheshire County Council wrote to NCSW in December 2002 and January 2003 setting out the results of this monitoring and expressing its great concern which highlighted to the former shareholders that subsidence appeared to be occurring on NCSW's own land—[redacted]. The Cheshire County Council copied its letter of January 2003 to a number of statutory bodies excluded from making claims to the Cheshire Brine Compensation Board but which might have been affected by subsidence on the monitored land. [redacted].
11. The former shareholders told us that, as a result of the issues associated with wild brine pumping, NCSW had attempted to seek alternative supplies of brine over a prolonged period of time. It had approached ICI, its successor Ineos Chlor Limited (which acquired ICI's chlor-alkali business) and British Salt in order to allow NCSW to cease wild brine pumping and to grow its market share if possible. In all cases, these possible sources were not considered commercially viable and were not pursued.

### **Obtaining brine: our analysis**

12. In relation to NCSW's brine supply, and the concerns of the former shareholders about the risk of legal action from statutory bodies excluded from making claims to the Cheshire Brine Compensation Board, we were told that, following the letter from Cheshire County Council to NCSW in January 2003 about the results of its subsidence monitoring, no further letters have been sent by Cheshire County Council to NCSW on this subject, or to the statutory bodies which might have been affected by subsidence on the monitored land. We were told by the former shareholders of NCSW that the statutory bodies, which had been sent copies of Cheshire County Council's letter of January 2003, had not contacted NCSW. Further, there did not appear to be any other examples of Court challenges to wild brine extraction after the Lotus Shoe Company case in 1970. Whilst we were told that wild brine pumping did increase the risk of subsidence, the Cheshire County Council and the Cheshire Brine Compensation Board both told us that it was not straightforward to establish that a particular instance of subsidence was directly attributable to a particular case of extraction of brine by this method. This is because natural brine movements also cause subsidence (see paragraph 6 above).
13. Cheshire County Council told us that it would not have moved to revoke NCSW's brine extraction planning permission [redacted]. Given this, and the other factors set out in the previous paragraph, we considered it unlikely that NCSW would have had to stop its wild brine pumping in the short to medium term (although the former shareholders clearly perceived this to be a serious risk). It followed, therefore, that NCSW's inability to find an alternative source of brine was not relevant to our counterfactual.

### **Decreases in revenues: evidence**

#### ***Susceptibility to price deflation***

14. The former shareholders of NCSW told us that, despite NCSW's sales of higher value and margin salt products such as pharmaceutical salt, NCSW was dependent on the sale of PDV salt to cover its fixed and marginal costs as a 'price taker', ie it was forced to price no higher than the prevailing price in the market. This was because of its smaller size and its limited capacity. Therefore, the former

shareholders of NCSW had considered that any decline in the prevailing market price of PDV could have threatened the future of NCSW. British Salt also put to us that there was a risk to NCSW from the reduction in the achievable price for NCSW's pharmaceutical salt.

### ***Rationalization of customer base***

15. The former shareholders told us that, since the 1990s, many customers had decided to rationalize their supplier base in order to reduce costs. The former shareholders told us that they believed NCSW had lost the business of [X], as a result of such changes in purchasing behaviour.

### ***Increased competitive pressure from British Salt***

16. British Salt argued that, in the absence of the merger, it would have increased its efforts to attract some additional production volume by winning NCSW customers to try to replace the British Salt production volume lost as a result of the closure of the Albion Inorganic Chemicals chlor-alkali plant to take effect in November 2005. British Salt further argued that NCSW would have had no ability or incentive to respond to such targeted marketing efforts and that the former shareholders would therefore have been expected to accelerate their plans (see paragraphs 5.7 to 5.15) to exit the business.

### **Decreases in revenues: our analysis**

17. In relation to decreases in revenues, the effect, if any, on NCSW would have depended on NCSW's commercial response to such pressures. NCSW has demonstrated in the past an ability to take advantage of new business opportunities to maintain or increase its profitability. The former shareholders of NCSW told us that NCSW, as a small company, had been able to be particularly responsive to such opportunities, although we noted that the issues set out in paragraph 5.6 had led them to the view in 2003 that NCSW was not a viable economic entity in the medium term.
18. Decreased revenues could also result from increased competitive pressure from British Salt on NCSW in the absence of the merger due to British Salt's loss of the Albion Inorganic Chemicals UV sales. We considered that it was unlikely that such increased competitive pressure would fall exclusively on NCSW, given that British Salt would not have had access to NCSW's customer list and therefore would not have been able to apply such pressure in a targeted way only on NCSW's customers. Further, to the extent that British Salt serviced smaller customers through distributors, it would have been even more difficult for British Salt to apply increased competitive pressure selectively to NCSW in respect of such customers. There was no evidence that British Salt had applied similar targeted competitive pressure in the past, despite having had considerable excess capacity for at least the last five years.. However, the significant loss of UV volume might have given British Salt an incentive to seek to increase its PDV and compacted salt sales more generally, particularly as British Salt would have been faced with closing one of the effects in its plant (with the consequent loss of production efficiency) otherwise.

### **Scarcity of management resources: evidence**

19. The former shareholders of NCSW told us that an additional issue for NCSW had been an ever increasing burden of dealing with regulation and the authorities. As an

example, they pointed to the amount of NCSW management time that had been expended to achieve modifications to the application of the UK government's climate change levy so that it did not disadvantage NCSW as compared with British Salt and Salt Union.

20. The former shareholders also told us that the former Managing Director of NCSW, who was also a shareholder of NCSW, had intended to retire from the business when possible, [REDACTED], and that other family members of the board of NCSW had also made it clear that they had expected him to retire, at the latest, in accordance with the terms of his contract (which would have been reached in September 2007). The former shareholders had sought other members of the family to take over running of the business but with no success because of the problems the business faced. As well as creating uncertainty, the former shareholders also considered that the fact that no family successor could be identified would have made it difficult to interest potential buyers in purchasing the business.

### **Scarcity of management resources: our analysis**

21. The former shareholders told us that both the burden of dealing with adverse regulatory changes and their inability to identify a suitable successor for the former Managing Director of NCSW had represented risks to the future commercial viability of NCSW. In this context, we noted that NCSW had in fact been able to bring in additional management resource in the past when necessary. For example, the former shareholders told us that an additional manager had been brought in during the 1990s to cover some tasks previously carried out by the former Managing Director of NCSW and to handle particular initiatives. One former NCSW shareholder (who had also been a non-executive director) acknowledged that it was possible that a few other shareholders (who were less involved with the business) might have considered the possibility of appointing an external manager following the retirement of the former Managing Director, had the business been trading favourably at that time. However, we were told by that shareholder and another (who had also been a non-executive director) that they thought it was not feasible to appoint an external manager to replace the former Managing Director on his retirement because of the risks that the business faced. Taking into account the former shareholders' strategy of seeking a managed exit from the business, we considered that the date by which the former Managing Director of NCSW would have reached his contractual retirement age (September 2007) was a focal date for the former shareholders.