

ANGLO AMERICAN/LAFARGE MERGER INQUIRY

Summary of hearing with Network Rail held on 18 October 2011

Background

1. Network Rail advised that most of the aggregate it procured via its Network Rail National Delivery Service (NDS) was railway ballast (a structural aggregate that railway sleepers rested upon and which was also used to cover railway sleepers to achieve permanent track alignment). Network Rail purchased aggregates for track purposes directly from aggregate suppliers and not through contractors, who were responsible for purchasing aggregates for use in more general civil engineering purposes (such as drainage or making concrete). Railway ballast was a higher-specification aggregate and was more expensive because it had the very specific structural purpose of transferring the load from the railway sleepers to the ground in a controlled way. Network Rail also purchased small quantities of sand and gravel.
2. Network Rail said its capital works programme, including general construction activities and track construction, was around £2.5 billion per year. This expenditure was fairly stable across the current control period, which ended in 2014. For the last five or six years, the tonnage of railway ballast Network Rail had purchased had been stable, at around 2 to 2.5 million tonnes a year.

Market definition

3. Network Rail said that secondary and recycled aggregates were not full substitutes for the primary aggregates it acquired for railway ballast, but their use, although limited, was increasing. Railway ballast deteriorated over time, so ballast already used for a period of time could not be recycled for use on high-speed lines but used aggregate could be used on lower-speed routes or lower-category routes. Depending on the route and other circumstances, rail ballast could last up to 15 years on high speed lines before it needed to be replaced.
4. Network Rail told us that the main driver for recycling railway ballast was cost. The recycling process consisted of screening out the smaller stones and washing the remaining ballast. The business case for recycling ballast included the fact that no aggregate tax was payable on reused aggregate. Some firms also purchased spent rail ballast, which they screened and washed and used in various products, including asphalt. Network Rail said it had a recycling team within its NDS, whose role it was to channel material to where it delivered best value, including selling product on or reusing it.
5. Network Rail told us that its use of aggregates was driven by asset condition. Once track condition deteriorated below a certain level it had to be renewed due to safety and train performance considerations, so it was a question of paying the market price for the materials required. Track renewal was safety critical work and therefore must take place. As such, price rises would not prevent such work taking place, although Network Rail would look for price efficiencies and value for money.
6. Network Rail said that it purchased the majority of its aggregates from Lafarge, followed by Midland Quarry Products, which was a joint venture between Tarmac and Hanson. Network Rail purchased smaller amounts of aggregates from Aggregate Industries (which had a quarry in Leicestershire), Cemex and then a number of other

suppliers. Network Rail considered that Lafarge and Midland Quarry Products competed closely for rail ballast, as both were the main suppliers, with large quarries in Leicestershire able to meet Network Rail's specification.

7. Network Rail told us that it had just completed a tender process for aggregates, receiving seven bids for rail ballast. Bidders included Lafarge, Midland Quarry, Aggregate Industries, Cemex, Cloburn, Hanson and Stema Shipping, which imported ballast from Norway. In evaluating the tenders, the selection criteria focused on delivered cost and environmental and sustainability requirements. Network Rail also looked at whether the bidder was a stable and reputable supplier, could meet Network Rail's technical specifications, had sufficient capacity to supply in volume, was able to deliver by rail and transportation costs. The bidder also needed to demonstrate compliance with Network Rail's standard terms and conditions of contract.
8. Network Rail had received a wide spread of bids, with the most expensive being two to three times the cheapest. Network Rail considered the bids in the context of its forecast for work in each geographical area and so would end up picking a range of suppliers to ensure that delivery costs were low. Network Rail said that it followed the procurement rules and conducted a negotiated procedure and awarded five year nil value frameworks. On contracts of this scale, Network Rail had achieved significant benefits through post-tender negotiations.
9. Network Rail told us that while importing aggregates was a practical option, it had never proven to be viable financially, with costs roughly twice as high as the best price on offer. The higher price of imported aggregate may reflect shipping costs and not the cost of the material itself.
10. Network Rail said that the price of aggregates was driven mainly by scale. A larger quarry delivering larger volumes had a significant price advantage over a smaller quarry. Prices were also driven by the ability of a quarry to sell the by-products of railway ballast production into other markets. It noted that aggregates for rail ballast tended to be more expensive than other aggregates due to the specification required by Network Rail, which tended to generate a lot of excess material.
11. Network Rail had been purchasing aggregates from Tarmac and MQP for some time. Assuming satisfactory performance, it expected its relationship with Tarmac and MQP to continue until such time as their quarries were exhausted. Network Rail noted that it had used other suppliers in the past until their quarries were exhausted.

Purchasing process

12. Network Rail told us that it negotiated its contracts on a five year framework which provided for an RPI uplift. Network Rail was presented with a price increase during the recent tender process, but had managed to eliminate it through negotiation. Network Rail said that as a customer it had an understanding of what drove its suppliers' price increases.
13. Network Rail told us that in addition to rail ballast, it also purchased other aggregates such as gravel and sand. Like rail ballast, these were acquired through framework agreements under the tendering process above.
14. Network Rail was not aware of ever having difficulty in getting quotes from suppliers for rail ballast and other aggregates. It could also not recall having any problems in getting the volume of aggregates it needed.

Barriers to entry/expansion

15. Network Rail said that there were several criteria for entry to the market for supplying rail ballast: access to the right stone, planning consent to open a quarry, a rail connection and product acceptance by Network Rail. Product acceptance was a process whereby Network Rail would want to trial an entrant's rail ballast in order to determine whether it had the required structural properties for use on a safety-critical rail system. This was a standard process that Network Rail ran for every new product it incorporated into its infrastructure and took between 6 and 12 months.
16. Once trialling was completed, the supplier was provided with a certificate of acceptance, which allowed Network Rail's procurement staff to purchase the product if the price was competitive (without a rail connection, delivery had to be by road which added to costs and affected how competitive supply could be).

The counterfactual

17. Network Rail said that it was not close enough to the strategies of Lafarge and Tarmac to speculate on what would happen to the two companies (and to the industry in general), if the proposed joint venture did not occur.

Concerns

18. Network Rail had concerns that the joint venture might reduce competition in the rail-connected marketplace through the merging of Lafarge's Mountsorrel quarry and Midland Quarry Products' Cliffe Hill quarry.
19. Network Rail noted that rail capacity was increasingly constrained as demand for rail grew, both from passengers and from freight users, so there were constraints on Network Rail's ability to transport ballast by rail from any particular quarry. The precise constraints depended on the specific circumstances of a quarry's location, what sort of rail loading facilities it had and whether Network Rail needed rail ballast from a particular quarry. The rail network was constrained not only around the South-East and Midlands but also in parts of the country where rail traffic might not be that high, due to signalling technology, etc.
20. Finally, Network Rail said that its chief concern was that the two companies supplying approximately 80 per cent of its rail ballast would no longer be in competition, should the joint venture go ahead.