BREEDON AGGREGATES/AGGREGATE INDUSTRIES UK MERGER INQUIRY

Summary of hearing with Company A held on 29 October 2013

Background

1. [✄]

2. Company A believed that the local construction industry would see increased opportunities over the next few years due to the building of the ring road around Aberdeen and that at present the economy was buoyant. It stated that the local economy was slightly different from the rest of the country due to its reliance on the oil and gas industry and that when this area of the economy was successful, it cascaded down into the construction industry. Company A said that although the economy had generally been quite good over the last five years, competition in the construction industry had been intense.

3. Company A bought aggregates, ready-mix concrete (RMX)and asphalt products from both Breedon Aggregates (Breedon) and Aggregate Industries (AI) and the amount purchased depended on where the contract was located as the closest plant usually won the contract due to the fact that haulage costs were significant. The year before the merger, it had purchased similar amounts of the above materials from both companies and a greater amount from the third major producer in the area—Leiths. On the whole it believed that it bought a reasonably equal amount of RMX and bituminous products, and it purchased less aggregates. It had a longstanding relationship with all the suppliers in the area.

4. The prices for RMX, asphalt and aggregates were much lower in Tayside and the Central Belt than in the north-east of Scotland. Company A believed that this was due to the fact that the north-east had not suffered so much from the recession, but it speculated that there might also be more competition in other areas as well.

Competition

5. Apart from the three companies mentioned above, it did not believe that there were any other suppliers of significance. Whilst some existed on the periphery, within a 20-mile radius of Aberdeen, Breedon, AI and Leiths dominated the market. Those on the periphery tended to be smaller operators and they could not always supply the large volumes that were required. One or two of the smaller suppliers produced recycled aggregates.

6. To the north of Aberdeen there was Lovies which supplied RMX and aggregates (in the area comprising Pitsligo, Fraserburgh, North Ellon and Banff), but it did not have any bituminous plants. To the south of Aberdeenshire (and into Angus) there was Geddes, and in both of these areas Leiths did not have a real presence. Therefore as a result of the merger between Breedon and AI, a valuable competitor had been lost in both areas.

7. Company A purchased a very small proportion of its requirements from Geddes. Geddes' plant was small and it struggled to produce the material to a consistently high standard. For example, Company A felt that Geddes would be unlikely, or unwilling, to supply materials like mastic asphalt for highly prestigious contracts.

However, the materials procured from the smaller competitors were price competitive, even if they were only bought in small quantities.

8. Aberdeen Council had a quarry but it was not competitive in its pricing: often its ex-quarry price was higher than a delivered price from the three main suppliers.

9. Company A purchased the relevant products on a project-by-project basis and sought quotes from two to four suppliers. Due to various industry quality assurance schemes Company A did not have problems getting the correct quality of material and it felt that in the north-east of Scotland the three main suppliers were very similar as they all had hard rock quarries, asphalt plants and supplied RMX. Therefore price and service were the two issues on which suppliers competed and as service was similar across the three main suppliers, price was a key determinant. It felt that it had been in a good negotiating position prior to the merger because it had had the choice between three suppliers, and that this negotiating position had been significantly reduced as a result of the merger.

Product definition

10. Company A believed that on the whole crushed rocks were substitutable with sand and gravel, although occasionally a contract would specify natural aggregates, so they were not fully substitutable. It believed that it was more common to need crushed rock as a sub base than crushed gravel and whilst recycled aggregates could be used as a sub base on pavements, hard rock was needed on roads. Around 10 to 15 per cent of its projects could use recycled products.

11. Whilst it would consider switching to recycled aggregates if there was a price increase on primary aggregates, it highlighted the fact that the specification set out in its contracts with its own customers might exclude the use of recycled aggregates and there could be quality issues with recycled aggregates.

12. Company A said that there were no secondary aggregates (ie aggregates used as a by-product of other activities) in the north of Scotland and it believed that asphalt production always used crushed and hard rock. It could not think of an asphalt bituminous plant situated in a quarry that was not a rock quarry. Sand and gravel and crushed rock aggregates would be fully substitutable for use in RMX.

13. Company A did not use volumetric trucks for RMX and did not believe there was any general availability in the north-east of Scotland. Whilst volumetric trucks could mix small amounts of RMX as required, its projects required larger quantities than could be supplied by a volumetric mixer.

14. Mobile asphalt plants tended to be erected on larger contracts (requiring at least 40,000 tonnes of asphalt) and be contract specific. Therefore for a contract to surface a car park a mobile plant would not be needed, but if a motorway were being resurfaced, mobile asphalt plants would tend to be used. Mobile plants would therefore be an option for the upcoming construction of the Aberdeen ring road.

15. Occasionally Company A had a need for 24/7 asphalt supplies, but on the whole it was very rare.

Geography and transportation

16. Company A said that there was no constraint on how far aggregates could travel, but that the haulage would make it uncompetitive if they were transported over more than

20 to 30 miles. For RMX there was a time constraint of up to an hour and a half and asphalt was temperature dependent, so it would only stay at the right temperature for a couple of hours. Taking into account the geography of northern Scotland, a couple of hours would probably equate to around 60 miles, so RMX could potentially be transported from Aberdeen to Dundee or Banff. However, if there was a quarry halfway between the two, that plant would benefit from cheaper haulage and so be more price competitive. Therefore if materials had to be hauled too far, transport costs would outweigh the difference in quarry prices.

17. Generally (but not always) the quarry or asphalt plant that was nearest to the job was the one that offered the most competitive price as haulage was such a significant cost. Therefore Company A believed that it would be extremely difficult for a supplier from out of the geographical area to offer a competitive price.

18. All three major suppliers had plants that surrounded Aberdeen and all of them supplied into all parts of the city competitively. As they were within a 20-mile radius of Aberdeen, the difference in price came down to their own individual commercial decisions. The reason all three could compete was because of their spread of quarries around Aberdeen. Company A was concerned that with the reduction from three to two suppliers, prices would rise as Breedon would initially increase its prices and then Leiths would follow suit.

Asphalt surfacing services

19. Company A competed with both Breedon and Leiths for asphalt surfacing and general roadworks contracts and AI had also had a surfacing division, which had now closed down. AI had tended to focus more on surfacing whereas Breedon and Leiths undertook general civil engineering contracts as well. Company A had previously used them as subcontractors, but because it had its own surfacing teams it made little sense to use them for this purpose on a regular basis.

20. The geographic scope of the supply for asphalt surfacing services was local due to restrictions on supply, timing, transport and potential delays to supplies. Therefore, whilst a contractor could take its team to a different area for a job, they would source the materials locally. However, if this did happen there would be additional costs in terms of transport and lodging, so on the whole things would be kept local because it was the most economical. Whilst outside contractors came in to the area, they only did so for multi-million pound contracts. Contracts of this size represented about 10 per cent of the contracts it would price.

21. Company A could compete with both Breedon and Leiths even though it was not vertically integrated and it was told by both suppliers that it paid the same price for materials as their in-house contracting divisions.

22. Company A believed that Breedon’s role in the BEAR Consortium meant that it obtained certain contracts to maintain trunk roads as a matter of course and that this enabled it to allocate lower overheads (which in the case of Company A represented 12.5 per cent of tender costs) to the contracts that were put out to tender in competition with others, and thus enabled it to win a larger share of the contracting and supply market. In addition, despite the assurances it had received, Company A was concerned that Breedon charged less for materials supplied to its internal operation than to external customers.

Barriers to entry

23. Company A stated that the capital cost required to purchase the equipment necessary to produce RMX and asphalt would be high, unless the new entrant was a large operator somewhere else in the country which had spare capacity or wanted to move into the area strategically.

24. It was extremely rural around Aberdeen, so if a concrete plant were being set up it would probably not be able to service the whole area. Therefore due to the geography of the north-east a company would need to have several plants in order to compete. Whilst it would be possible for a company that already had a presence to expand, the situation had been fairly static over the last three years and it had been dominated by the main three operators.

25. To enter into the contract surfacing market, Company A thought that a hard rock quarry would be necessary to supply the materials as on surfacing contracts they represented a high proportion of the overall costs. There would be a considerable capital investment needed to get all the necessary surfacing equipment and Company A believed that to set up a company which would be able to carry out reasonably-sized surfacing operations, around £300,000 would be needed.

The merger

26. Company A did not see any benefits to the merger, but it believed that of the three products being looked at, aggregates was of the least concern due to the level of competition that existed on the margins.