

Our ref: TDT/NT02041/Rep/0001

Date: 05 April 2012

Your ref:

Inquiry Manager
Aggregates Market Investigation
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Dear Sir

UK Aggregates Market – Minerals Owners Perspective

The following comments are submitted as evidence in respect to the aggregates market competition investigation.

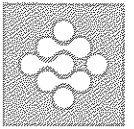
Wardell Armstrong acts on behalf of many large land and minerals owning clients who have granted rights to extract aggregates to all five of the major aggregate companies active within the UK, and many of the smaller regionally based operators. The firm employs one of the largest teams of Chartered Minerals Surveyors in the UK, and clients include the Crown Estate, The Church Commissioners for England, The Forestry Commission, Isle of Man Government and many private landed estates.

Whilst colleagues within the firm provide planning and environmental services to aggregate companies, our Minerals Estates Management Group exclusively provide property services to land and minerals owners. The companies subject to this investigation are our clients' tenants with whom we frequently negotiate rents and royalties based on sale price and local market conditions. Wardell Armstrong has been providing minerals estates services for 175 years and is considered to be expert in this field. Although it is appreciated that the purpose of this investigation is not to determine whether land owners are receiving market rents from aggregate producers, competition within markets is intrinsically linked to rents paid and accordingly land owners also have an interest in ensuring that competition is free and fair.

Land Tenure of new aggregate sites

Most quarrying companies have a portfolio of both freehold and leasehold sites. The freehold sites are however more likely to have been acquired through the mergers and acquisitions process that has resulted in 70% of aggregates production being concentrated with five major producers. These sites are more likely to have been worked over many years, and although some still have significant consent reserves many will be nearing the end of production within current Minerals Local Plan periods. As the Investigation will appreciate, minerals are a wasting asset. For the reasons referred to below, replacement





sites for existing operations and for potential market entrants are more likely to be leasehold preceded by an option agreement. From a mineral operator's perspective, why purchase a site when a royalty agreement will allow aggregates to be purchased from the landowner as production/sales occur? Whilst the considerable uncertainty of the planning process can be addressed by an option agreement for a sale or a lease, there is no guarantee that there will be a viable market for the quarry's products at the end of the considerable development period required to open a new site, 20 years in some cases.

From a landowners' perspective, whilst a capital sum at the commencement of the development may initially appear attractive the discounts applied to future royalty incomes to determine the Net Present Value on which a sale price would be based are very high with respect to aggregates, as they are in all minerals valuations. For a hard rock quarry with an anticipated life of fifty years, the landowner may only receive a capital payment based primarily on the first ten years production. For the majority of landowners granting a minerals lease is a more attractive proposition than an outright sale.

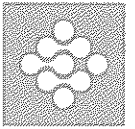
The provision of new sites

Whether by sale or lease, replacement sites from existing operators or sites for new market entrants are dependent firstly on local geology (minerals can only be worked where they are found), secondly by other pertinent restrictions detailed in an Environmental Impact Assessment, and finally by the landowner's willingness to permit aggregates extraction. Whilst quarrying is still a financially attractive land use, recent increases in agricultural value and proposed changes to the taxation of minerals income may result in fewer sites being made available for aggregates extraction in the future.

When advising a landowner on which aggregates company would be best placed to develop a particular deposit a Minerals Surveyor should consider market conditions over price offered. Whilst an open tender can be of assistance where there are several potential parties, in many cases the rationale for favouring one company over another in a particular local market is often clear. It would clearly not be in a landowners' interest to grant their minerals rights to a company which already has significant consented reserves at the same location. There would be little incentive to promote the new site through the planning process or open the site once consent was granted. A company with existing market share but limited permitted reserves would however prove an ideal tenant as the landowner could be reasonably sure that every effort would be made to obtain planning permission to work their aggregates.

Defining Local Markets

What constitutes a market for aggregates is, as identified in the Statement of Issues, often defined by transport costs. Aggregates are a relatively heavy (1.5 to 2.5 tonnes per m³) bulk material. The majority is still transported by road, most commonly in 20 tonne loads. The further the load travels from the point of origin the greater the transport cost as a percentage of the overall price delivered. One often overlooked effect of the £2.10 per tonne Aggregates Levy has been to increase the potential radius of the market area from point of origin by increasing the price per load net of transport costs, although this effect will have been offset to some extent by the increase in fuel costs since the introduction of the Levy. Whilst some aggregate products are more valuable than others, and the sources of aggregate not evenly distribute, as a 'rule of thumb' market area is often considered to



be within 40 road miles from the quarry. Although some quarries are fortunate to be connected to the rail network, most quarries are some distance from a rail connection and constructing a link would be prohibitively expensive.

In the Anglo American/Lafarge joint venture preliminary report a similar conclusion was noted with respect individual quarries, adopting a 30 mile radius from the site (rather than 40 road miles). The OFT then went on to link any overlapping market area in to the same local market. This has had the effect in some areas of linking a chain of overlapping markets into an area in excess of 100 miles in length where the quarries at the two ends of the chain could not reasonably be considered to be in competition.

With respect to the four 'Hypotheses for Investigation' I would comment as follows. The comments are predominantly with regard to aggregates rather than RMX or cement.

Theory of harm 1: High levels of concentration and barriers to entry mean that suppliers can exercise unilateral market power.

The high level of concentration is self evident. This position has developed over the period 1992 to present as a direct result of increased planning and environmental regulation. The barriers to entry of new suppliers is also self evident. Notwithstanding the lack of availability of new sites, no aggregates operator would consider (for example) trying to develop a sand and gravel deposit of less than one million tonnes. We have clients who have sites which have been turned down on this basis. The planning and development costs are considered too great on a per tonne basis. If an operator were in a position to exercise unilateral market power then no deposit would be considered too small as these additional costs per tonne could be passed on to their customers. This is clearly not the case.

Theory of harm 2: Coordination between producers reduces or prevents competition.

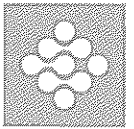
Whilst it is reasonable to assume that acquisitions and mergers, and joint ventures such as Midland Quarry Products (Tarmac/Hanson) and the proposed Tarmac/Lafarge JV have reduced competition I am not aware of any evidence where this has been used to increase prices. In Northumberland and County Durham the reverse has been observed where two major operators have on occasion significantly reduced prices to win greater market share. This has often been to the detriment of smaller regional supplier who do not have the advantages of economies of scale. This will have benefited customers in the short term but whether this will be of benefit in the longer term is less clear.

Theory of harm 3: Vertical integration and exclusionary behaviour

Vertical integration clearly gives a competitive advantage to those companies in a position to supply aggregates to their own RMX and asphalt plants. Mineral surveyors are often required to determine what portion of a quarry output is inter-company sales and what is sold directly to the market. This can have a significant bearing on royalty rent reviews. I am however not aware of any impact vertical integration or exclusionary behaviour may have on competition.

Theory of harm 4: Policy and regulation

Whilst policy and regulation have brought significant environmental improvements to the UK aggregates industry, it is self evident that those same policies and regulations over the previous twenty year period have also prevented, restricted and distorted competition. In



my view Government policy and regulation has lead directly to the concentration of the aggregates industry in a few mostly foreign owned multinational companies.

From the Planning & Compensation Act 1992, the Environment Act 1995, and EU Directive on Environmental Impact Assessment the cost of obtaining and maintaining an extant mineral planning permission has increased to become a significant barrier to market entry. This has provided a competitive advantage to companies in a position to take advantage of economies of scale to absorb some or all of the additional costs. More recently, the increase in fees charged by Local Authorities for determining and monitoring minerals planning permissions (2005), and the introduction in to UK law of the EU Mining & Waste Directive (2006) have added further costs to the industry.

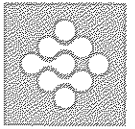
In addition to planning regulation, the introduction of the Aggregate Levy in 2002 has had a directly impact on aggregate prices. Whilst frozen for many years following introduction, it has recently been increased to £2.10 per tonne, and now comprises approximately 15% to 20% of the average sale price of aggregates to consumers (net of VAT). The percentage varies across a range of aggregate products and regions as the Levy is applied as a flat rate irrespective of value. One initial consequence of the introduction of the Levy was the increase in low value quarry products (for example scalping) being used on site as restoration material. In many cases there will have been a direct substitution for recycled aggregates which can be sold net of the Levy. The quantity of construction and demolition waste being recycled as aggregates will not however have been increased by the Levy as Landfill Tax (now £56/tonne) has already resulted in maximum recycling from either construction or restoration purposes.

Consumers' choice between the use of primary, secondary and recycled aggregates is determined by end use and specification, rather than price. The aggregates used in any particular project must be fit for purpose and comply with the Building Regulations.

The Statement of Issues also identifies the issue of operators applying for planning permission then holding the sites undeveloped, and considering whether this behaviour is intended to restrict supply or keep rivals out of the market. This behaviour is however more readily explained by the long delays in the planning (and appeal) process, and the likelihood that market demand will have changed by the time operator has an implementable consent. We act for a number of landowning clients whose aggregates are yet to be worked for this reason. The minerals operator is however still required to pay the minimum or certain rent for these sites.

A related issue is Mineral Planning Authorities continuing to include within minerals land bank calculations sites which whilst have planning permission are very unlikely to be worked within the Local Plan period. Land banks of consented reserves can be used by Local Authorities to justify refusal of new aggregate site consents and could therefore be considered to be creating artificial barriers to entry and distorting local markets.

Some of these issues will be addressed by Location Authorities' response to the new National Planning Policy Framework. It is however too early to determine whether the NPPF will reduce or increase the time/expense of the minerals planning process. The removal of



detailed guidance in many areas of minerals planning is likely to lead to greater uncertainty and therefore potentially greater delay.

Conclusions

As previously noted, as a consequence of tightening environmental and planning controls on the aggregates industry the supply side has been increasingly concentrated with a few foreign owned multinational corporations controlling the majority of UK aggregates. Increasing costs, and reduced recession lead demand, have inevitably led to decreasing investment. The investigation may wish to consider whether there is evidence to suggest that the major aggregate producers are taking profits which would previously have been reinvested in new UK sites to develop new facilities in countries with lower environmental and planning standards than the UK. If this were to be the case then aggregate prices will inevitably increase when demand rises again and outstrips supply.

To encourage aggregate companies to invest in new sites and provide a long term security of supply, whilst simultaneously discouraging artificially low prices to drive out local competition the investigation may consider recommending that a minimum price for aggregates may be desirable in some local market areas.

Trusting that the above is of assistance, I would happy to assist further in the investigation if required or expand on any of the points outlined above.

Yours Sincerely
For Wardell Armstrong LLP

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