
Completed acquisition by Balfour Beatty Plc of Edgar Allen Limited

The OFT's decision on reference under section 22(1) given on 6 July 2006. Full text of decision published 27 July 2006.

Please note that the square brackets indicate figures or text which have been deleted or replaced with a range at the request of the parties or a third party for reasons of commercial confidentiality.

PARTIES

1. **Balfour Beatty Plc** (Balfour Beatty) is an international engineering, construction and services group. It is a specialist in the design, manufacture and supply of track products through its subsidiary, Balfour Beatty Rail Track Systems. In particular, Balfour Beatty supplies turnouts and certain individual components of a turnout to customers in the UK and abroad.
2. **Edgar Allen Limited** (Edgar Allen) was originally part of the Mowlem Group, which was recently acquired by Carillion plc.¹ Edgar Allen supplies turnouts and certain individual components of a turnout to customers in the UK and abroad. In particular, it manufactures cast manganese crossings (CMX) which are used in turnouts on high speed, heavily trafficked rail networks. Edgar Allen's UK turnover was £[] million in the 2005 calendar year.

TRANSACTION

3. Balfour Beatty (via its subsidiary Balfour Beatty Group Limited) acquired the entire issued share capital of Edgar Allen on 30 March 2006. The total net cash consideration for the deal was £9.5 million. The statutory deadline is 28 July 2006.

¹ This transaction was cleared by the OFT on 24/1/06.

JURISDICTION

4. As a result of this transaction Balfour Beatty and Edgar Allen have ceased to be distinct. The parties overlap in the supply of turnouts as well as the supply of certain individual components which form part of a turnout. In relation to the supply of turnouts in the UK, the parties estimate that this market is worth approximately £39 million. On this basis the parties have a combined share of supply of approximately [65 per cent to 75 per cent] (with an increment of [30 per cent to 35 per cent]). Therefore the share of supply test in section 23(2) of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

5. A turnout is a type of rail track configuration that allows trains to divert from one line to another. A simple turnout consists of three parts: a switch (which is the moving part which enables the initial redirection of a train from one line to another); the crossing (which is a fixed element where the two lines intersect); and the closure section (which connects the switch section to the crossing section). Turnouts are sometimes referred to as 'switches and crossings', although this term is also used to describe the individual components of a turnout.
6. The parties submit that the following components comprise a turnout: rail, bearers, fastenings, base plates, switch blades, check rails, slide chairs, cast blocks and crossings.
7. Crossings are a key component of a turnout. There are four different types of crossing which are currently used in the UK:
 - (a) CMX – these are the most expensive type of crossing and are used on heavily trafficked, main line networks
 - (b) steel monobloc – these crossings are typically used on tramways
 - (c) welded – these crossings are cheaper than CMX and are used extensively on the London Underground, and
 - (d) spliced – these are the cheapest type of crossing and are used on low loading and low speed areas e.g. private sidings and depots.
8. Pre-merger, Balfour Beatty was active in the manufacture and supply of steel monobloc, welded and spliced crossings and in the supply of CMX. CMX was the only crossing manufactured and supplied by Edgar Allen.

Product frame of reference

9. The parties overlap in the following areas:
- (a) the manufacture and supply of complete turnouts
 - (b) the manufacture and supply of rail fabricated components, including check rails and switch blades, and
 - (c) the supply of CMX. The parties do not overlap in the manufacture or supply of other types of crossing.
10. The European Commission (the EC) has previously considered the manufacture and supply of switches and crossings. In *Voest Alpine Stahl/Vossloh/VAE*², the EC defined a separate product market for 'track work switch systems' (as distinct from rails and rail fastening systems), which included track work switch systems used for trains, the underground and tram networks. In *Corus Group/Cogifer/JV*³, the EC described switches and crossings as component parts of a railway track system known as a turnout.
11. It is not clear from these decisions whether the EC considered that complete turnouts and the individual components comprising a turnout formed part of the same product market. In order to assess whether this is the case, the OFT has considered the extent to which demand- and supply-side substitution could take place between complete turnouts and the individual components comprising a turnout.
12. On the demand-side, the evidence before the OFT does not indicate that a significant number of customers would switch from purchasing individual components (for maintenance purposes) to complete turnouts and vice versa in response to a 5 to 10 per cent increase in price. Some smaller customers considered that demand-side substitution might be possible, however the labour costs associated with constructing a complete turnout would need to be considered.
13. On the supply-side, third party responses indicate that supply-side substitution would not be feasible in many cases and in certain circumstances a firm wishing to switch from supplying components to supplying complete turnouts would have very little advantage over a de novo entrant. Third party comment indicates this is primarily due to the need to gain Network Rail approval, which for the supply of complete turnouts is onerous.

² Case No IV/M.1259 – *Voest Alpine Stahl/Vossloh/VAE*, 6 October 1998.

³ Case No COMP/M.2235 – *Corus Group/Cogifer/JV*, 19 December 2000.

14. Due to this lack of demand- and supply-side substitution between complete turnouts and individual components, the OFT has considered them separately.
15. The OFT has also considered the extent to which substitution could take place between the different components comprising a turnout. On the demand-side, each individual component fulfils a specific requirement and therefore demand-side substitution is not expected to occur.
16. The extent to which the supply of complete turnouts and individual components were linked was also considered. However, the OFT has not received any evidence to suggest that, for the vast majority of components, a customer would be more likely to source from the previous turnout supplier than another supplier. Therefore, the OFT has considered separately the supply of complete turnouts and the supply of individual components for maintenance purposes.
17. In relation to crossings, the parties submit that each of the different crossings have different specifications and are typically required by different types of customers. Moreover, the evidence before the OFT indicates that firms could not switch between the production of CMX (which requires access to a cast manganese foundry) and other types of crossings (which tend to be machined from rail or rail grade steel). The OFT has therefore considered CMX to be distinct from other types of crossings.

Geographic frame of reference

Turnouts

18. In Corus Group/Cogifer/JV the EC stated that the specificity of the UK railway standards and the slow transition to the adoption of CEN⁴ standards supported the view that the relevant geographic market was the UK (in line with the EC's decision in Voest Alpine Stahl/Vossloh/VAE). In addition, the EC noted that all the main suppliers of switches and crossings to the UK market were UK-based companies. However ultimately the precise relevant geographic market was left open.
19. The parties submit that the relevant frame of reference for the supply of complete turnouts is the UK. The evidence before the OFT indicates that customers would not import complete turnouts to the UK because bulky, lower value components (such as concrete or timber bearers) tend to be purchased locally, and only certain higher value components (such as crossings) may be imported for pre-assembly in the UK. This has been verified by third party responses. Therefore, for the

⁴ Comité Européen de Normalisation.

purposes of this investigation, the OFT considers the relevant geographic frame of reference in relation to the supply of complete turnouts to be the UK.

Rail fabricated components

20. The parties submit that the relevant geographic frame of reference for rail fabricated components (which include switch blades and check rails) is European wide. Although many UK turnout manufacturers source these components from European suppliers, the OFT has not found any evidence of UK end customers sourcing directly from European suppliers. The OFT has therefore adopted a cautious approach and considers the relevant geographic frame of reference in relation to the supply of rail fabricated components to be the UK.

CMX

21. The parties submit that the relevant geographic frame of reference in relation to the manufacture of CMX is at least as wide as Europe. The parties provided evidence to demonstrate that transport costs were a small proportion of the overall value of the product, ranging from between [0 per cent to 5 per cent] and [0 per cent to 5 per cent] (depending on from where in Europe the CMX is sourced). Moreover, pre-merger Balfour Beatty sourced CMX from Manoir, an independent foundry in France. Therefore, the evidence before the OFT does not indicate that transport costs would prevent European based suppliers from supplying CMX to UK customers.
22. However, CMX specifications differ across Europe and a European based supplier would need to invest in UK specific patterns in order to begin supplying to UK customers. In addition, such a supplier would need to gain Network Rail approval, which the parties submit would take a few months. Some of the third parties who were contacted by the OFT have indicated that CMX foundries based in Europe would need to work in collaboration with a UK based supplier in order to establish a pattern set suitable for the UK. This has been verified by Network Rail. Since European based CMX foundries have previously supplied UK end customers via a UK based turnout manufacturer, the OFT has considered the relevant geographic frame of reference in relation to the supply of CMX to be the UK.

HORIZONTAL ISSUES

Share of supply

Turnouts

23. Pre-merger, there were four main suppliers of complete turnouts to UK customers: Balfour Beatty; Edgar Allen; Corus Cogifer⁵; and Voest Alpine Engineering UK (VAE).⁶
24. In relation to the UK supply of turnouts, the parties have a combined share of supply of approximately [65 per cent to 75 per cent] (with an increment of approximately [30 per cent to 35 per cent]). The combined entity is more than three times larger than its next biggest competitor.
25. The parties note that the shares of supply have changed substantially over time. For example, in 1996 Balfour Beatty's share of supply was approximately [65 per cent to 75 per cent] but the parties submit that this was 'managed downwards' by Network Rail to its current level of approximately [30 per cent to 40 per cent]. Within the same period, Edgar Allen's share of supply has grown from approximately [5 per cent to 15 per cent] to its current level of approximately [30 per cent to 40 per cent].
26. One third party confirmed that shares of supply in this industry can change dramatically year by year because work tends to be project driven. The West Coast Mainline upgrade is an example of a large project which required 500 turnouts, which in an average year would represent approximately 90 per cent of UK demand for turnouts.

Rail fabricated components

27. In relation to the supply of rail fabricated components (which include both switch blades and check rails), post merger the parties have a combined UK share of supply of approximately [45 per cent to 55 per cent] (with an increment of approximately [10 per cent to 15 per cent]). The combined entity is almost twice as large as its next biggest competitor.

⁵ Corus Cogifer is a joint venture between Vossloh Cogifer, the second largest supplier of turnouts worldwide, and steel maker Corus.

⁶ VAE is part of the railway division of Austrian steel maker Voest Alpine.

CMX

28. In relation to the UK supply of CMX, the parties have a combined share of supply of approximately [90 per cent to 100 per cent] (excluding internal sales) with an increment of approximately [15 per cent to 20 per cent]. The combined entity will therefore supply almost all CMX in the UK.
29. Shares of supply in the UK as a whole mirror shares of supply of CMX to Network Rail, which is by far the largest customer and which accounts for in excess of 90 per cent of demand. Post merger the combined entity will supply approximately [] per cent of Network Rail's CMX requirements (with an increment of approximately [] per cent). Although each of the parties' shares of supply of CMX to Network Rail have changed over the past three years, it is clear that (combined) they have consistently supplied almost all of Network Rail's requirements.

Conclusion

30. In light of the combined share of supply estimates discussed above, the OFT has considered whether the merging parties will be able to exercise market power. In particular, the OFT has considered the following as possible constraints on the parties' behaviour:
 - (a) the ability of customers to switch to alternative sources of supply
 - (b) the threat of market entry and expansion, and
 - (c) countervailing buyer power.

Alternative sources of supply

Turnouts

31. The parties submit that Network Rail accounts for approximately 91 per cent of UK demand for complete turnouts and that the remainder of UK demand is split between the following types of customers: private sidings (3 per cent); light rail and tram (LRT) (1 per cent); London Underground (2 per cent); and new build (3 per cent).

Network Rail

32. Post merger, the parties supply approximately [] per cent of Network Rail's demand for complete turnouts. Network Rail has confirmed that it would consider switching to the parties' main competitors (listed in paragraph 23) in response to a 5 to 10 per cent price increase by the parties. [] On this basis, Network Rail would be able to switch approximately [] per cent of its business away from the

parties to other competitors (note that, by way of comparison, Balfour Beatty's pre merger share of supply was [30 per cent to 40 per cent]).

33. Third party competitors have confirmed that they currently have spare capacity to supply an additional [] per cent of Network Rail's requirements as described in paragraph 32. Moreover, these competitors are included on Network Rail's five year, zero volume framework agreements and therefore they are already approved suppliers to Network Rail. The OFT has not received any evidence during the course of its investigation to suggest that Network Rail would incur significant costs if it chose to switch to these competitors. []
34. The evidence before the OFT therefore indicates that Network Rail could and would switch (up to) [] per cent of its requirements to the parties' competitors in the short term in response to a 5 to 10 per cent increase in price by the parties. This would represent a significant loss of business for the merging parties of approximately £[] per year, such as to counter any incentive on the parties to increase price.

Smaller customers

35. The parties submit that smaller customers have a greater number of suppliers from which to choose. In addition to the parties' main competitors (who have verified that they have excess capacity), there are a number of other suppliers from whom each type of smaller customer can source turnouts:
- Private sidings: A number of companies throughout the UK own or operate private sidings, including industrial companies, train operating companies and freight operators. One second-tier supplier confirmed that they are able to supply turnouts to these customers.
 - LRT: Although the OFT has adopted a cautious approach and defined the relevant geographic frame of reference as the UK, in the case of LRT customers (who represent 1 per cent of UK demand for turnouts), the evidence before the OFT indicates that they are able to source from European based suppliers. This has been verified by an LRT customer.
 - London Underground: Metronet⁷ and Tube Lines are the London Underground concessionaires that are responsible for the provision of London Underground services. In addition to the parties' main competitors, the parties submit that the concessionaires can also source turnouts from Lillie Bridge, which used to

⁷ Balfour Beatty holds a 20 per cent share in Metronet.

be the internal supplier to London Underground, and which is now part of Metronet. Metronet has confirmed that Lillie Bridge is a manufacturer of turnouts as well as a number of the individual components comprising a turnout. Lillie Bridge currently supplies both Metronet and Tube Lines with turnouts.

- New Build: This includes any new track work in the UK, and the relevant customers in this segment are those considered above, as well the various infrastructure companies that are appointed to build the new track. None of the infrastructure companies that were contacted by the OFT during the course of this investigation submitted that the merger would have any direct impact on their business.

Rail-fabricated components

Network Rail

36. Post merger the parties supply approximately [] per cent of Network Rail's demand for rail fabricated components. The parties submit that rail fabricated components are interchangeable (as between different suppliers) because the designs which are used are owned by Network Rail. As noted at paragraph 16, the OFT has not received any evidence to suggest that customers would be more likely to source rail fabricated components from the previous supplier than another supplier.
37. In addition, third party competitors have confirmed that they currently have significant excess capacity and, as mentioned above, they are already Network Rail approved suppliers. One third party competitor submitted that it has enough spare capacity within its group to be able to satisfy all of Network Rail's requirements. The OFT has received no evidence during the course of its investigation to suggest that Network Rail would incur significant costs if it chose to switch to these suppliers. []

Smaller customers

38. The parties submit that each type of customer's demand for components of a turnout is similar to their demand for complete turnouts. As described above, London Underground, LRT and private sidings customers are able to source their turnout requirements from alternative suppliers; the same applies for a range of components (excluding CMX). This has been confirmed by third parties.

CMX

Network Rail

39. Post merger, the parties will have a joint pattern set which will enable them to service virtually all of Network Rail's CMX demand. One third party competitor also supplies CMX to UK customers as a standalone product and it has submitted that, without developing further patterns, Network Rail would be able to switch in the region of 20 per cent of its demand to sourcing directly from itself. Network Rail confirmed that this competitor represents an alternative source of supply.
40. The OFT has also considered the extent to which Network Rail could source CMX from Manoir via another UK turnout supplier, rather than via Balfour Beatty. The evidence before the OFT indicates that there would be nothing to stop Manoir supplying Network Rail via another UK turnout supplier if Network Rail requested them to do so and that there have been examples of Manoir supplying Network Rail via another UK turnout supplier in the past. [] Furthermore, OFT has received no evidence to suggest that altering the supply chain in this way would lead to a material increase in costs.
41. On the basis of the evidence before it, the OFT believes that, post-merger, Network Rail would have the ability to obtain volumes of CMX from third party competitors similar in volume to that which it sourced pre-merger from Balfour Beatty, without facing a material increase in prices.

Smaller customers

42. The parties submit that, with the exception of Network Rail, there are only a few customers that require CMX (as they are generally used on the national rail network). Metronet is one other CMX customer, as CMX are also used (to a lesser extent) on the London Underground. Metronet submitted that it currently sources CMX from Balfour Beatty and another third party. This third party confirmed that it should be able to supply all the different types of CMX that Metronet and Tube Lines might require in relation to the London Underground, and that the foundry from which it sources CMX currently has spare capacity. Therefore, the evidence before the OFT indicates that Metronet would be able to switch supplier in response to a 5 to 10 per cent increase in price by the parties.

Barriers to entry and expansion

Turnouts

43. The parties submit that barriers to entry in relation to the supply of complete turnouts are relatively low. They submit that the most significant components of a turnout, (i.e. CMX and rail) are readily available from European suppliers or are sourced by Network Rail and then free-issued to its suppliers (i.e. bought as components by Network Rail and provided to the turnout supplier for inclusion in the complete turnout).
44. However third parties disagreed with this view. Third party responses indicate that barriers to entry for manufacture and supply are high due to the investment required in plant and machinery, the large timescale and costs associated with gaining supplier approval and the variety and complexity of the product (which requires suppliers to possess a high level of expertise).
45. The OFT has also considered the possibility of expansion by existing turnout manufacturers. As mentioned above, third party competitors are operating with surplus capacity []. These third parties have confirmed that they would be able to expand further if required to do so. The evidence before the OFT indicates that such expansion would be sufficient in terms of likelihood, scope and timeliness, to operate as a competitive constraint on the parties' behaviour post merger.
46. Therefore, although third party comment indicates barriers to entry for the supply of complete turnouts are high, the evidence before the OFT indicates that the possibility of further expansion by existing UK competitors (which has been confirmed by the competitors themselves) would act as a competitive constraint on the post-merger behaviour of the parties.

Rail fabricated components

47. As stated above, the OFT has adopted a cautious approach and considers the relevant geographic frame of reference in relation to rail fabricated components to be the UK, due to the lack of evidence of European based suppliers supplying these components to UK end customers directly. However, the OFT is aware of UK turnout manufacturers previously sourcing these components from Europe for inclusion in turnouts.
48. A European based supplier would need to gain access to the relevant UK specifications and switch some of its production to manufacture components complying with UK standards. However, the OFT has found no evidence that these costs would be significant. Furthermore, the evidence before the OFT

indicates that gaining Network Rail approval (if the European supplier already has approval to supply another network operator with that component) is not prohibitive. Therefore, the evidence before the OFT indicates that entry by European based suppliers is feasible, although one third party submitted that customers would be more likely to switch to other UK competitors with excess capacity than to source from European suppliers.

CMX

49. In relation to the supply of CMX, the evidence before the OFT indicates that barriers to de novo entry are high. This has been confirmed by third party responses. The parties submit that although the costs associated with setting up a new CMX foundry would be significant, there are a number of independent foundries in Europe that could make investments in order to begin supplying UK customers with CMX. However, third party responses indicate that practically speaking, a European based CMX supplier would be unable to supply UK customers without working in collaboration with a UK based turnout supplier. This is because the European suppliers would need to draw on the UK manufacturer's expertise and the manufacturer may also need to 'finish' the CMX before supplying it to the end customer (if this capability does not exist in-house).
50. However, the evidence before the OFT supports the contention that an independent foundry based in Europe could work in collaboration with a UK based turnout manufacturer to begin supplying UK customers since this has happened in the past. For example, Manoir has been working in collaboration with Balfour Beatty. In addition, one third party competitor has previously worked with another CMX foundry in order to supply over 250 CMX to UK customers.
51. In order to assess the feasibility of European suppliers working in collaboration with UK based turnout manufacturers, the OFT has considered the costs associated with developing a set of patterns, and the willingness of both independent foundries and UK turnout manufacturers to work together.
52. The parties provided evidence to demonstrate the cost of developing a pattern set, which was not dissimilar to the cost suggested by two third parties, and which the OFT believes is not enough to constitute a significant barrier to entry. Moreover, one third party competitor has verified that it could work with independent CMX foundries in order to supply CMX to UK based customers. This has been supported by the submissions of independent CMX foundries based in Europe.
53. Therefore, although third party comment indicates barriers to de novo entry in relation to the supply of CMX are high, the evidence before the OFT indicates, if

the merging parties were to increase the price of CMX, a CMX foundry could work in collaboration with a UK turnout supplier to start supplying UK customers and there have been two examples of this occurring in the past.

Countervailing buyer power

54. The parties submit that Network Rail has the ability to exercise countervailing buyer power in relation to its purchases of complete turnouts, rail fabricated components and CMX. []
55. Network Rail represents approximately 90 per cent of UK demand for turnouts, rail fabricated components and CMX, and approximately [75 per cent to 85 per cent] of the parties' combined business in relation to these products.
56. It is clear that Network Rail is a very large buyer; however this alone does not demonstrate that it possesses countervailing buyer power. The joint OFT, DTI and Competition Commission report on 'Ex post evaluation of mergers'⁸ notes that the price a buyer is able to obtain depends upon the relative bargaining strengths of the two parties. This in turn depends upon what is known in economic literature as the 'threat points' of the two parties. These threat points must be credible and represent the next best option for both the buyer and the seller should an agreement fail to be reached.
57. The OFT has considered a number of threat points for Network Rail:
 - (a) Threatening to switch suppliers: As discussed above, in relation to complete turnouts third party competitors have confirmed that they have considerable excess capacity and Network Rail could feasibly switch a significant proportion of its demand to these competitors in response to the parties increasing prices. This is also the case in relation to rail fabricated components. In relation to CMX, the evidence available to the OFT indicates that Network Rail could switch some of its demand to an existing third party competitor and/or to Manoir supplying via another UK turnout manufacturer, as discussed above. In the opposite direction, the parties may threaten to withdraw supply; however this is not expected to occur given that Network Rail represents [75 per cent to 85 per cent] of their turnover for the supply of the products in which they overlap. Therefore, the evidence before the OFT indicates that the threat of

⁸ 'Ex-post Evaluation of Mergers', March 2005 OFT, Competition Commission and DTI.

Network Rail switching a significant proportion of its business away from the parties is credible, and as it is such a large customer of the combined entity, this is likely to place it in a strong position during price negotiations post merger.

- (b) Threatening to take its turnout requirements in-house: The parties submit that this is a potential threat which requires them to demonstrate good value for money. Network Rail has already taken in-house its procurement of turnouts, both for maintenance and renewal purposes. In addition, it has taken in-house its requirements for rail maintenance. The parties provided evidence to demonstrate that Network Rail would not rule out the possibility of taking its turnout manufacturing requirements in-house if its suppliers failed to deliver to targets (although it is not expected that Network Rail would take its CMX manufacturing requirements in-house due to the costs associated with setting up a manganese foundry).

Network Rail's ability to intervene in the market is also evidenced by its involvement in a project to establish a new in-house facility to assemble turnouts (rather than the current practice of assembling turnouts at the facilities owned by the turnout suppliers). The parties submit that there is a possibility that some of the components of a turnout may also be manufactured at this new facility.

- (c) Threatening to impose substantial costs on the supplier by retaliating in alternative product markets: Network Rail is Balfour Beatty's second largest customer. The supply of turnouts (and individual components comprising a turnout) represents only a proportion of Balfour Beatty's business with Network Rail and the parties submit that if they were to increase prices, Network Rail would be able to retaliate in other business areas where the parties' shares of supply are lower. Network Rail confirmed that it is now dealing with Balfour Beatty (as well as its other suppliers) on a 'strategic' level across the whole range of products and services supplied. Furthermore, Network Rail has stated that the parties would need to consider the effect of any price increase on their overall relationship with Network Rail.

- (d) Threatening to sponsor entry or further expansion of competitors: The parties submit that Network Rail's ability to sponsor expansion is demonstrated by Edgar Allen's growth as an integrated supplier of turnouts. They submit that Network Rail managed Edgar Allen's share of supply from under [5 per cent to 15 per cent] to its current level of around [30 per cent to 40 per cent]. In addition, Network Rail has

submitted evidence of it encouraging a third party to increase its supply of complete turnouts by awarding it part of a significant contract.

In relation to CMX, Network Rail submitted that it encouraged a relationship between a UK turnout supplier and an independent foundry, who were able to work together to supply them with over 250 CMX. (see note 1)

58. In addition to the factors outlined above, a further indication of Network Rail's ability to exercise countervailing buyer power is the existence of its framework agreements with each of the main UK turnout manufacturers. Network Rail negotiates five year, zero volume framework contracts based on a competitive tender and list prices are non negotiable over the five year period. (see note 2) These agreements may confer Network Rail with more buyer power than would otherwise be the case, as it gives them control over the price setting process over a prolonged period.
59. Therefore, the balance of evidence before the OFT indicates that Network Rail possesses a considerable amount of buyer power, in particular as a result of: (i) its ability to switch a significant proportion of its business away from the parties; (ii) its ability to take its requirements in-house; (iii) its ability to retaliate in markets where Balfour Beatty is also a supplier to Network Rail; and (iv) its ability to encourage entry and expansion.

VERTICAL ISSUES

60. The combined entity will be active in the provision of turnouts as well as certain components comprising a turnout (e.g. switch blades, check rails and CMX). The OFT has considered whether, by virtue of its increased share of supply of components, the combined entity may be able to foreclose companies that supply complete turnouts. This ability depends on whether the parties' competitors source from either of the parties and whether they have alternative sources of supply. Third party competitors have confirmed that they have the in-house capability to produce rail fabricated components. In addition, one third party has submitted that it sources CMX from independent foundries in France and Italy and another has submitted that CMX is now free-issued to them by Network Rail. Therefore, the evidence before the OFT indicates that the parties' ability and incentives to foreclose the supply of complete turnouts by refusing to supply (or raising their rivals' costs) for CMX and/or rail fabricated components have not changed as a result of this merger.
61. The OFT has also considered whether a supplier of individual components would find it uneconomic to supply remaining competitors and customers (for

maintenance purposes) directly in the event that the parties ceased to source components from such suppliers, given the parties' size in the downstream supply of turnouts. However, the OFT has not received any evidence during the course of its investigation which suggests that this is the case.

62. The OFT received a complaint from one third party that post merger, Edgar Allen would source all of its cast iron component requirements from Balfour Beatty. The OFT has therefore considered whether the parties may be able to foreclose the supply of cast iron products. The parties submit that many iron foundries could supply cast iron components for inclusion in turnouts because these products are relatively simple to cast. They further submit that demand for cast iron turnout components represents less than 1 per cent of UK demand for cast iron products more generally. In addition, one third party has submitted that it sources cast iron components from a number of different iron foundries, indicating that a foundry does not need to rely on an individual customer's business. Therefore the evidence before the OFT indicates that the parties will not be able to foreclose the supply of cast iron products.
63. In light of the above, the OFT does not consider that this transaction raises any vertical issues.

THIRD PARTY VIEWS

64. Customers, including Network Rail, were generally unconcerned about this transaction. One major competitor as well as some smaller competitors raised general concerns about the unilateral effects of this merger. These concerns have been addressed above.

ASSESSMENT

65. The parties overlap in the manufacture and supply of complete turnouts and rail fabricated components and in the supply of CMX. Post-merger the parties are the biggest single supplier of each of these products in the UK. The parties' combined share of supply is approximately [65 per cent to 75 per cent] for complete turnouts, [45 per cent to 55 per cent] for rail fabricated components and [90 per cent to 100 per cent] for CMX. However, the evidence before the OFT indicates that shares of supply in this industry can change significantly year on year.
66. In addition, the OFT has considered a number of possible constraints on the parties' behaviour post-merger, including the ability of customers to switch to alternative sources of supply. The evidence before the OFT indicates that customers could switch to alternative suppliers for at least a significant proportion of their requirements for each of the product overlaps. This ability of customers to

switch to alternative suppliers is expected to operate as a competitive constraint on the parties' post-merger behaviour.

67. The OFT also considered barriers to entry and expansion in relation to each product overlap. The evidence before the OFT indicates that barriers to de novo entry in relation to the manufacture and supply of turnouts are high. However, the evidence before the OFT indicates that the possibility of further expansion by existing UK competitors is sufficient in terms of likelihood, scope and timeliness to act as a competitive constraint on the parties' post-merger behaviour. The evidence before the OFT also indicated that entry by European based suppliers in relation to rail fabricated components is feasible, although one third party submitted that customers would be more likely to switch to other UK competitors with excess capacity than to source from European suppliers. Finally, in relation to the supply of CMX, third party comments suggest that barriers to de novo entry are high. However, the evidence before the OFT indicates that if the merging parties were to increase the price of CMX, it is expected that an existing CMX foundry would work in collaboration with a UK turnout supplier to start supplying UK customers. Therefore the scope for further entry or expansion as outlined above is also expected to operate as a constraint on the parties' post-merger behaviour.
68. In addition to the factors discussed above, the evidence obtained by the OFT suggested that Network Rail possesses a considerable amount of countervailing buyer power which is further expected to constrain the parties' post-merger behaviour. This arises as a result of: (i) its ability to switch a considerable amount of its business to competitors; (ii) its ability to take its requirements in-house (although this is not expected to occur in the case of CMX); (iii) its ability to retaliate in other markets where Balfour Beatty is a supplier to Network Rail; and (iv) its ability to encourage entry and expansion. A further indication of Network Rail's ability to exercise countervailing buyer power is the existence of its framework contracts (where list prices are bid infrequently and the value of the contract is very large) (see note 3) which gives Network Rail control over the price setting process over a prolonged period.
69. Overall, despite the high shares of supply for the parties post-merger in each of the products for which they overlap, the OFT has therefore found that no horizontal concerns arise from this merger in light of the factors discussed above.

70. The OFT also considered a number of vertical issues. In particular, the OFT considered whether the combined entity would be able to foreclose companies that supply complete turnouts by virtue of its increased share of supply of components. The evidence before the OFT indicated that the parties' ability and incentive to foreclose such supplies has not changed as a result of the merger. In addition, the OFT considered whether the merger would result in the foreclosure of suppliers of individual components but received no evidence to suggest this was the case. Consequently the OFT does not consider that this merger raises any vertical concerns.
71. As regards third party views, customers including Network Rail were generally unconcerned about this transaction. A small number of competitors raised general concerns about the unilateral effects of the merger which have been addressed in the OFT's assessment of potential horizontal concerns.
72. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the United Kingdom.

DECISION

73. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.

NOTES

1. Network Rail notes that it has encouraged more than one supplier to develop relationships with independent foundries.
2. Network Rail notes that its framework contracts are not binding on its suppliers.
3. See Note 2.