

# Competition Act 1998

---

## Decision of the Office of Rail Regulation\*

### English Welsh and Scottish Railway Limited

Relating to a finding by the Office of Rail Regulation (ORR) of an infringement of the prohibition imposed by section 18 of the Competition Act 1998 (the Act) and Article 82 of the EC Treaty in respect of conduct by English Welsh and Scottish Railway Limited.

#### Introduction

1. This decision relates to conduct by English Welsh and Scottish Railway Limited (EWS) in the carriage of coal by rail in Great Britain.
2. The case results from two complaints.
3. On 1 February 2001 Enron Coal Services Limited (ECSL)<sup>1</sup> submitted a complaint to the Director of Fair Trading<sup>2</sup>. Jointly with ECSL, Freightliner Limited (Freightliner) also, within the same complaint, alleged an infringement of the Chapter II prohibition in respect of a locomotive supply agreement between EWS and General Motors Corporation of the United States (General Motors). Together these are referred to as the Complaint. The Complaint alleges:

*[...] that English, Welsh and Scottish Railways Limited ('EWS'), the dominant supplier of rail freight services in England, Wales and Scotland, has systematically and persistently acted to foreclose, deter or limit Enron Coal Services Limited's ('ECSL') participation in the market for the supply of coal to UK industrial users, particularly in the power sector, to the serious detriment of competition in that market. The complaint concerns abusive conduct on the part of EWS as follows.*

- Discriminatory pricing as between purchasers of coal rail freight services so as to disadvantage ECSL.

---

\*Certain information has been excluded from this document in order to comply with the provisions of section 56 of the Competition Act 1998 (confidentiality and disclosure of information) and the general restrictions on disclosure contained at Part 9 of the Enterprise Act 2002. Excisions are denoted by [...]. Where possible, following such excisions, wording has been added and this has been placed in square brackets and is in italics.

<sup>1</sup> Referred to within this document as ECSL or Enron.

<sup>2</sup> On 14 February 2001 and in accordance with SI 2000 No. 260 The Competition Act 1998 (Concurrency) Regulations 2000, the Regulator informed the Director that he wished to exercise his concurrent jurisdiction to investigate the complaint. Agreement by the Director to the transfer of the complaint to the Office of the Rail Regulator was given in a letter from the Director dated 20 February 2001.

- Operation of exclusive long-term supply contracts with power stations so as to foreclose ECSL's competitive prospects.
- Effective refusal to deal with ECSL in particular, in effect, refusing to agree a performance- based contract and effectively refusing to supply long-haul freight for coal.
- Attempt unfairly to influence the pricing policy of a key trading partner of Freightliner Limited ('Freightliner') and GB Railways Group Plc ('GB Railways'), namely General Motors<sup>3</sup>.

4. On 11 May 2001, the Regulator issued a notice to EWS requesting information and documents under section 26 of the Act, followed by a meeting with EWS in the offices of the Regulator on 24 May 2001. Further section 26 notices were sent to EWS on 24 May 2001, 10 August 2001 and 19 March 2002 together with a number of letters requesting information and clarification. Further meetings were held with EWS on 12 July 2001, 26 March 2002 and 16 October 2002. On 10 August 2001, the Regulator required information and documents of Freightliner Heavy Haul (FHH)<sup>4</sup> and ECSL, by means of a section 26 notice. This was followed by further letters requiring clarification and information and a second section 26 notice sent to FHH on 20 March 2002. The Regulator also met with both parties. Section 26 notices were sent to third parties including the generators and other freight train operators on 20 March 2002, followed by meetings with TXU, Powergen (now E.ON and referred to as such within the remainder of this document, unless the context demands otherwise) and British Energy (BE) taking place in April 2002, and further letters dated 20 September and 20 December 2002, requiring clarification and further information.

5. On 19 August 2002, a further complaint was made by FHH, alleging anti-competitive conduct by way, in particular, of rates offered to London Electricity Group plc (LEG) for rail freight haulage of coal to LEG's power stations at Cottam and West Burton. The Regulator considered that he had reasonable grounds to suspect that an infringement had occurred and that this conduct was part of a pattern of continuing anti-competitive conduct by EWS in the carriage of coal by rail.

6. Following FHH's complaint on 19 August 2002, the Regulator using his powers under section 27 of the Act, gave notice to EWS that his officers would be entering its premises at Doncaster and London<sup>5</sup>. A site visit at the Doncaster

---

<sup>3</sup> The Regulator rejected this part of the complaint. The case closure summary can be found on the ORR website.

<sup>4</sup> In April 2001, Freightliner split into two separate operating companies, Freightliner Limited (Freightliner) and Freightliner Heavy Haul (FHH). Freightliner Heavy Haul was established to compete in the bulk rail freight business, which included the carriage of coal by rail. For ease of reading this Decision refers to FHH as the competitor to EWS in the carriage of coal by rail in the UK rather than Freightliner, unless the context requires otherwise.

<sup>5</sup> The notice of intention to visit the EWS premises in London was withdrawn by letter of 22 October 2002.

premises took place on 22 October 2002. The Regulator required information arising out of documents provided at the site visit by means of a further section 26 notice dated 27 November 2002.

7. The Regulator issued a Notice stating that he was proposing to make an infringement decision in accordance with rule 14 of the Director's procedural Rules (the Director's rules)<sup>6</sup>, on 6 May 2004 (the Notice). In accordance with the Director's rules<sup>7</sup>, EWS was given the opportunity to make written and oral representations. EWS made written representations on 2 November 2004 (the Response) but declined its right to make oral representations.

8. E.ON and RWE npower (RWE<sup>8</sup>), the co-parties to coal carriage agreements to which the Regulator had found objection were also provided with an opportunity to make representations, by way of non-confidential copies of the Notice. Both RWE and E.ON submitted their representations on 2 November 2004. RWE also attended the offices of ORR on 5 October 2004. FHH was both provided with a non-confidential copy of the Notice and a non-confidential copy of the Response. FHH submitted its representations to both the Notice and the Response on 16 May 2005. Mr David Israel (an ex-employee of EWS) was invited to respond to extracts of a non-confidential copy of the Response, where EWS had commented on the accuracy and context of evidence provided by him. David Israel responded on 18 August 2005 and attended a meeting at ORR's offices on 2 September 2005.

9. A further section 26 notice was issued to EWS on 27 May 2005, with particular regard to EWS's cost model (the Frontier Model) and ORR's request to see internal exchanges relating to that. Further exchanges about that matter ensued over the period June to September 2005. Annex G1 provides detail regarding ORR's attempts to understand EWS's pricing generally and the nature of the EWS response.

10. ORR issued a Supplemental Statement of Objections (SO) on 14 March 2006<sup>9</sup>. EWS was provided with the opportunity to make written and oral representations<sup>10</sup>. Non-confidential versions of the SO were also provided to FHH, E.ON, RWE, Corus, British Energy (BE) and Drax Power Limited<sup>11</sup> (Drax). EWS responded to the SO on 20 June 2006 (the Supplementary Response). FHH responded on 5 June 2006.

---

<sup>6</sup> The Competition Act 1998 (Director's Rules) Order 2000 SI 2000 No 293.

<sup>7</sup> Rule 14(7) and rule 14(8) of the Director's Rules.

<sup>8</sup> RWE, previously Innogy and previous to that, National Power are referred to as RWE throughout the Decision unless the context demands otherwise.

<sup>9</sup> Issued pursuant to rule 4 of SI 2004 No.2751 The Competition Act 1998 (Office of Fair Trading's Rules) Order 2004, which came into force on 17 November 2004.

<sup>10</sup> Rule 5 of the Office of Fair Trading's Rules.

<sup>11</sup> Until August 2003 AES Drax, referred to as Drax throughout the Decision unless the context demands otherwise.

11. Subsequent to the Supplementary Response, ORR entered into discussions with EWS aimed at expediting the conclusion of ORR's investigation. EWS agreed that as a result of the significant reduction in the fine that it would otherwise have received (prompted by its co-operation in accepting that it had infringed the Act) and given that ORR did not, having considered EWS's representations<sup>12</sup>, reach any finding in relation to an EWS Board strategy to exclude any third party from the market or as to the amount of damage that may have been suffered by ECSL or FHH, EWS would accept the three findings of infringement now set out in this Decision.

12. A more complete chronology of the investigation can be found at Annex A. A summary of the structure of the EWS coal team and its chain of management from the period July 1999 to January 2003 can be found at Annex J, this includes a list of key EWS coal team employees during that period.

13. In this Decision, ORR concentrates on three particular allegations of abusive behaviour brought to its attention by the above complaints and extending over various time periods<sup>13</sup>.

- (a) Exclusionary contracts with industrial users of coal (1996-2005).
- (b) Discrimination against ECSL (May 2000 to October 2000).
- (c) Predatory behaviour directed towards FHH (July 2002 to December 2003).

14. ORR has concluded that the facts underlying the complaint of a refusal to deal and that of discrimination are the same and that the essence of the abusive conduct in question is discrimination on the part of EWS in relation to prices offered to ECSL. Taken together the conduct amounts to a sustained and deliberate campaign<sup>14</sup> by EWS to protect its own dominant position from competition and to disadvantage ECSL (perceived by EWS to act as a competitor to it) and FHH (a new entrant providing haulage of coal by rail). ORR does not, therefore, find an infringement that can be characterised as a refusal to deal with ECSL.

15. As stated above, ORR's finding is that all three types of infringing conduct set out in Parts A-C of Part II below form part of a continuing strategy to seek to exclude or restrict EWS's potential competitors' participation in the market for coal haulage

---

<sup>12</sup> EWS strongly disputed and on the facts that there had been any strategy emanating from the EWS Board and also that there was any evidence that quantified the degree to which FHH or ECSL had been affected by EWS's conduct.

<sup>13</sup> See Table 1 in Part II, below.

<sup>14</sup> EWS has contended that ORR's attempt to make a case involving a general overarching exclusionary strategy on the basis of what EWS maintains are disparate instances of abuse is wholly misconceived. EWS has denied and continues to deny that any such strategy was ever held or implemented by EWS, the EWS Board or any member of the Board or any member of the Coal Team.

by rail. ORR has not found it necessary to make a finding as to the precise level from which that strategy emanated. In particular, ORR has not found evidence of endorsement at Board level in relation to any of the infringing conduct and consequently ORR also finds that the EWS Board played no part in any strategy comprised of the various pieces of infringing conduct. As will be seen below, this has been taken into account in setting an appropriate penalty.

16. The Office of Rail Regulation (ORR) replaced the Office of the Rail Regulator on 5 July 2004<sup>15</sup>. ORR is led by a Board appointed by the Secretary of State for Transport. As the railway industry's economic regulator<sup>16</sup>, ORR's principal function is to regulate Network Rail's stewardship of the national network. ORR also licenses operators of railway assets, approves agreements for access by operators to track, stations, and light maintenance depots. A more comprehensive review of ORR's powers under the Railways Act 1993 (as amended) is contained at Annex B.

17. ORR exercises its powers under the Act concurrently with the OFT in respect of agreements or conduct relating to the supply of services relating to railways<sup>1718</sup>. ORR is also a National Competition Authority (NCA)<sup>1920</sup> for the purpose of applying Articles 81 and 82 of the EC Treaty. Article 82 provides that any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States.

---

<sup>15</sup> Railways and Transport Safety Act 2003.

<sup>16</sup> This continued to be the case during the period under consideration in this investigation. However, the Railways Act 2005, which achieved Royal Assent on 7 April 2005, transferred responsibility for rail-specific health and safety regulation from the HSC/E to ORR. From 1 April 2006, ORR becomes the combined safety and economic regulator for the railways.

<sup>17</sup> Defined in section 67(3ZA) of the Railways Act.

<sup>18</sup> See the Office of Fair Trading "*Application to services relating to railways*", A Competition Act 1998 guideline published with the ORR, OFT430, October 2005.

<sup>19</sup> The EC Modernisation Regulation which came into force on 1 May 2004 (Council Regulation EC 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty 16 December 2002 (OJ L1, 4.1.2003 p1)), decentralised the application of Articles 81 and 82 of the EC Treaty to National Competition Authorities and the courts of the Member States. Article 35 of the Modernisation Regulation requires each of the member States to designate National Competition Authorities for this purpose.

<sup>20</sup> Regulation 3 of the Competition Act 1998 and Other Enactments (Amendment) Regulation 2004 SI 2004 No 1261.

# The facts

---

## The Undertaking

### *English Welsh and Scottish Railway Limited*

18. In 1988, British Rail organised its freight sector into two distinct groups, Bulk Freight and Railfreight Distribution (comprising Speedlink and Freightliner Services). Rail Express Services Limited (Res) was already established at that time for the haulage of Post Office traffic.

19. At privatisation in 1993, Bulk Freight was reorganised into three separate limited companies for separate sale, Transrail Freight, Mainline Freight and Loadhaul (together known as Trainload Freight or the 'TLFs'). Similarly Railfreight Distribution was split into two companies for sale, Railfreight Distribution Limited (RfD) which dealt with international freight traffic through the Channel Tunnel and Freightliner Services (Freightliners) which dealt with intermodal container services travelling through UK ports.

20. In 1995, a joint venture company led by the American owned Wisconsin Central International, Inc. ('Wisconsin'), a wholly owned subsidiary of Wisconsin Central Transportation Corporation (WCTC)), which owned and operated railway assets in North America and New Zealand, was incorporated in the UK under the name of North & South Railways Limited (N&SR). In December 1995, N&SR purchased Res and in February 1996, it purchased the three TLFs.

21. In July 1996, N&SR became English Welsh and Scottish Railway Holding Limited (EW&SRH). In October 1996, Mainline Freight Limited and Loadhaul Limited were merged with Transrail Freight Limited (Transrail). On the same day all existing employees of Res were transferred to Transrail whereupon Transrail changed its name to English Welsh and Scottish Railway Limited (EWS), a wholly owned subsidiary of EW&SRH. In November 1997, EW&SRH acquired RfD, which it now operates under the name of English Welsh and Scottish International Limited (EWSI). EWS acquired the National Power coal haulage assets and operations in April 1998.

22. In January 2001, Canadian National Railway Company (CN) entered into a Merger Agreement providing for the acquisition by CN of WCTC. At that time the wholly-owned subsidiary Wisconsin held a 42.5% interest in EWS. The acquisition by CN of that 42.5% shareholding, following acquisition of WCTC, took place in October 2001. CN is engaged primarily in the rail transportation business in Canada and mid-America.

23. The principal activities of the EWS group of companies are, therefore, bulk freight (including commodities such as coal, steel, aggregates, and petrochemicals);

intermodal (including the movement of containers<sup>21</sup> and swap bodies<sup>22</sup>); international traffic via the Channel Tunnel; infrastructure maintenance support services for Network Rail; special passenger charter services; and also train maintenance and driver hire. In 2003 it moved over 100 million tonnes of freight each year and operated over 1100 trains per day. It had over 650 mainline locomotives, 18,500 wagons and employed approximately 6,000 people<sup>23</sup>.

24. Profit before tax and turnover for the financial years ending 31 March 2001 to 31 March 2005 were as follows:

**Table 1: EWS profit before tax and turnover**

<b>Financial year ending 31 March</b>	<b>Profit on ordinary activities before taxation (£m)</b>	<b>Turnover (£m)</b>
2001	29.3	498.1
2002	70.6	517.5
2003	57.1	494.6
2004	26.3	544.8
2005	29.8	472.4

25. As well as being able to provide haulage services EWS also acquired, when the British Rail freight businesses were purchased, a range of railway terminals and sidings either as owner or on a long term leasing arrangement from Network Rail<sup>24</sup>.

---

<sup>21</sup> Used for deep sea and intra-European shipment in container ships. Generally lifted from the top as they are transferred between ships, trains and lorries or direct from storage facilities at ports.

<sup>22</sup> Used for road, rail and barge shipment in Europe, most units are lifted from their bottom edges as they are transferred between modes i.e. from the rail wagon to the lorry or vice versa.

<sup>23</sup> <http://www.ews-railway.co.uk> ("About EWS" – April 2003) [23/2168]. EWS's web site (September 2005) [28/289] [www.ews-railway.co.uk/about/facts.html](http://www.ews-railway.co.uk/about/facts.html) records that EWS operates 8,000 services each week with nearly 500 locomotives and over 14,000 wagons. It records a staff compliment of 5,200 and states that it hauls over 100 million tonnes of rail freight every year.

<sup>24</sup> The 1993 privatisation of the railways in the UK led, in 1996, to the establishment of a public limited company called Railtrack, which owned and operated the rail infrastructure of Great Britain. In October 2001 the then Transport Secretary, Stephen Byers, was successful in petitioning the High Court to put Railtrack plc into Railway Administration. Network Rail Infrastructure Limited, the not-for-dividend body, formally took responsibility for the UK's track, signals and stations in October 2002. For ease, this document refers to "Network Rail" throughout, unless the context demands otherwise.

Indeed in 2003 it described itself on its website as: *“the second largest infrastructure owner in Britain [...]”*.<sup>25</sup>

26. EWS is able to offer a full service package, if required, including access to terminals where consignments may be split, transferred to road and/or stored. EWS will also sell terminal expertise to other network and terminal owners. Its 2003 website stated that it could: *“provide the full range of terminal management and operations capability, including rolling stock marshalling, shunting locomotives, drivers, and management. Current clients include passenger operating companies, manufacturers, and freight haulage and terminal operators”*.<sup>26</sup>

27. This comprehensive railway expertise means that EWS has the capability to provide a package of railway services beyond that of simply operating the train. EWS operates over 90% of the 400 sites currently owned by freight train operators<sup>27</sup>. A Statutory Instrument of 8 March 1994<sup>28</sup> exempted most freight sites from the licensing and access provisions of the Railways Act. Thus ORR cannot exercise its powers under sections 17-22C of that Act to direct the terms under which access is granted or directed. EWS advises, however, at paragraph 3.115 of the Response that:

“All of EWS’s yards and sidings and depot fuelling points are [...] subject to open access requirements and have been throughout the relevant time period.”

28. The powers available to ORR under the Railways Act, in respect of such facilities, are described at Annex B. However, recent developments in the UK regulatory framework, most notably, the Railway Infrastructure (Access and Management) Regulations 2005<sup>29</sup> which entered into force on 28 November 2005 create a presumption of access and provide the right for any applicant to apply for access to a range of services and facilities for the purpose of the operation of any type of rail freight services. Access can only be denied where there is a viable alternative by rail under market conditions. Any dispute may be referred, on appeal, to ORR.

29. The rail networks or facilities, which enable the loading and delivery of coal, are generally owned and operated by the coal supplier, ports (in the case of imported coal) or the generators. These private sidings are also listed within the Network Rail ‘*Guide to Freight Connections*’<sup>30</sup>. Coal suppliers may, for example, have rail network facilities at the colliery or at a disposal point where coal is taken by road from a variety of non-rail connected sources. There are examples where EWS has agreed

---

<sup>25</sup> <http://www.ews-railway.co.uk> (“Infrastructure Services”, October 2003). [23/2169]

<sup>26</sup> <http://www.ews-railway.co.uk> (“Rail Services”, October 2003). [23/2170]

<sup>27</sup> <http://www.freightcommercial.co.uk/connections>.

<sup>28</sup> The Railways (Class and Miscellaneous Exemptions) Order 1994.

<sup>29</sup> [http://www.opsi.gov.uk/si/si2005/uksi\\_20053049\\_en.pdf](http://www.opsi.gov.uk/si/si2005/uksi_20053049_en.pdf).

<sup>30</sup> <http://www.freightcommercial.co.uk/connections>.

to operate services at these facilities on behalf of the owner by means of a management agreement. [...] <sup>31</sup> [...] <sup>32</sup>: “[...]”<sup>33</sup>. The agreement appoints EWS as the train planner for all rail movements into [...], including the creation of weekly train schedules that cover the route of the train from loading to destination point. Thus, when such a management contract exists, another train operator must rely upon EWS to provide the appropriate loading and arrival slots to enable it to satisfy its own haulage contract with the generator.

30. EWS is not simply a rail freight haulage operator. If required, it can act as a vertically integrated undertaking having the capability to provide complementary inputs both for itself and third parties along the length of the rail transport supply chain.

## The complainants

### ***Enron Coal Services Limited***

31. ECSL, a subsidiary of Enron Capital & Trading Resources Limited (England), previously named Enron Europe Limited, a subsidiary of the Enron Corporation based in the United States of America, was established in London in 1999. In the complaint ECSL described itself as: “*responsible for all of Enron Corporation’s international coal and freight trading operations*”. Enron Coal Transportation Limited, an affiliate of ECSL, was established on 13 March 2000.

32. As described at Annex C, coal is supplied from a variety of sources: directly from deep and open cast indigenous<sup>34</sup> mines; from overseas via UK ports; and sometimes via coal processors within the UK<sup>35</sup>. Users of coal may consider a variety of coal purchasing options ranging from: (a) contracting directly with these sources of supply and separately with shippers (including the inland rail provider) and with ports for port capacity and services (full ‘DIY’ option); or (b) having one contract with a third party intermediary which will provide a price for traded coal or a price for ‘straight to stock pile’ arrangements which may include, inter alia, the cost of transport from origin to destination (‘End to End’ arrangements, commonly referred to as ‘E2E’ arrangements). There exist a range of other contractual options between these two.

33. ECSL acted as a third party intermediary for coal purchase, offering a range of services from simply coal trading to E2E deals as described above. According to ECSL, a key business strategy for ECSL was to provide ‘delivered-to-stockpile’

---

<sup>31</sup> [...]

<sup>32</sup> [...]

<sup>33</sup> [...]

<sup>34</sup> Coal mined within the UK.

<sup>35</sup> Companies such as Bennet Group that procure imported and indigenous coal, and then prepare that coal for specific uses by processes such as blending, washing and/or screening.

deals, providing total management of the supply chain, from coal purchase at the loading port through delivery to the customer's stockpile. ECSL stated within the complaint that:

“The ability to land and handle coal at deep sea ports and to rail freight that coal to its destination (rail freight being the only practicable means of transportation) is key to the ability of ECSL to compete in the market for the supply of coal/coal services to UK industry and in particular to the power sector [...]”.

34. ECSL also assumed in the complaint that about 70% of the coal supply to UK power stations was provided under direct agreements between generators and coal producers, with the rail freight service contracts being concluded by EWS directly with the power stations. ECSL observed that the remaining 30% was provided to the power stations by intermediaries, with ECSL being by far the largest of these. At the time of the initial complaint, ECSL advised that it accounted for 50% of coal imports into the UK and 95% of the coal it supplied to its UK customers was sourced from other coal producing countries.

35. The failure of the Enron Corporation in the USA resulted in administration for its European subsidiaries. On 18 December 2001, the Enron Coal Trading Business comprising the coal trading book and relevant employees of ECSL and Enron Capital & Trade Resources Limited was acquired by AEP Energy Services Limited<sup>36</sup> (AEP).

### ***Freightliner Heavy Haul***

36. The 'Freightliners' part of Railfreight Distribution was privatised, through a 'management Buy-In'<sup>37</sup>, in 1996<sup>38</sup>. The management Buy-In team called itself Management Consortium Bid Limited and is commonly referred to by its initials, MCB. MCB owns the operating company Freightliner Limited (Freightliner), whose traditional business is the movement of maritime containers from ports (intermodal services). In 1999, Freightliner expanded the services it offered into bulk rail freight and established a division called Freightliner Heavy Haul (FHH), commencing with an eight-year contract with Network Rail. In April 2001, the intermodal and heavy haul businesses became separate operating companies, Freightliner (the intermodal business) and FHH (the bulk rail freight business). On 14 February 2003, the Regulator issued FHH with its own operating licence. Both Freightliner and FHH are owned by MCB. FHH was established to target<sup>39</sup> non-maritime business such as automotive, infrastructure and rail services and coal.

---

<sup>36</sup> AEP (American Electric Power Company) operated Fiddlers Ferry and Ferrybridge which it acquired from Edison Mission Energy from October 2001 until 30 July 2004, when these power stations were acquired by Scottish & Southern Energy plc (SSE).

<sup>37</sup> 'Management Buy-In' is the term applied when an outside management team buys a stake in an existing business.

<sup>38</sup> [www.freightliner.co.uk/](http://www.freightliner.co.uk/) ('Company Structure' October 2003). [23/2171]

<sup>39</sup> "About Freightliner Limited", submitted in response to tenders for coal and provided by FHH in its 29 April 2002 response to a section 26 notice of 20 March 2002. [5/302/18.2]

37. Between them, Freightliner and FHH currently own over 100<sup>40</sup> locomotives with just over 70 allocated to the heavy haul business. Freightliner also owns over 1750 wagons, predominately low platform wagons used for the transportation of containers for the intermodal business. FHH has stated<sup>41</sup> that by February 2003, it would own [...] wagons suitable for the haulage of coal<sup>42</sup>. As a group Freightliner and FHH operate around 400 trains daily with FHH being responsible for about half of these movements<sup>43</sup>.

38. Profit before tax and turnover for the Freightliner Group for the financial years ending 31 March 2001 to 31 March 2004 were as follows:

**Table 2: Freightliner Group, profit before tax and turnover**

<b>Financial year ending 31 March</b>	<b>Group profit on ordinary activities before taxation (£000)</b>	<b>FHH profit on ordinary activities before taxation (£000)</b>	<b>Group turnover<sup>44</sup> (£000)</b>	<b>FHH turnover (£000)</b>
2001	(620)		144.1	
2002	4.4	5.50	167.6	37.72
2003	10.8	7.89	185.9	56.85
2004	16.7	10.78	198.9	67.63

*Source: Rail Industry Monitor, TAS publications*

39. FHH, from establishment to February 2003, operated under the railway safety case<sup>45</sup>, operating licence and track access agreement of Freightliner. FHH entered the coal haulage by rail market on 1 January 2001 through a contractual relationship

<sup>40</sup> <http://www.freightliner.co.uk/heavyhaul/equipment.asp> and <http://www.freightliner.co.uk/heavyhaul/pooldetails.asp> (as at September 2005). [28/290]

<sup>41</sup> In a response dated 8 January 2003 to an ORR letter of 27 November 2002. [22/2075.8] Confirmation that FHH now owns [...] coal wagons received in an e-mail from Adam Cunliffe of FHH of 9 October 2003. [20/1901.1]

<sup>42</sup> This number was confirmed by FHH's response dated 16 May 2005 to an ORR information request of 15 April 2005. [27/228a]

<sup>43</sup> E-mail from FHH dated 9 October 2003 [20/1901.1] in response to e-mails from the ORR dated 9 October 2003.

<sup>44</sup> Turnover included a grant from the Strategic Rail Authority of circa £14 to £15m (2001: £13.6m; 2002 £15.7m).

<sup>45</sup> FHH received its own Railway Safety Case Certificate of Acceptance on 18 December 2002, applied for on 19 November 2001.

with ECSL for the haulage of coal from east coast ports to power stations located in Yorkshire's Aire Valley, signed in June 2000. FHH, however, actively competed for coal haulage contracts to supply Drax, BE and Edison Mission Energy (EME) and entered into discussions with TXU during the summer of 2000.

## **The product and services concerned**

### ***Rail freight haulage services within the UK***

40. A potential purchaser of rail freight services has a number of options available. If he owns his own wagons, for example, he can approach current freight train operators and ask for prices for a 'hook and haul' service whereby the freight train operator will simply supply the locomotive to haul the customer-owned rolling stock. Similarly, a freight train operator can also simply 'operate' the whole train on behalf of the customer should that customer own locomotives and rolling stock. Such arrangements are generally provided under a long term leasing arrangement and it is common to see the customer's logo or name painted on the side of the train. An example of this is the service provided to Foster Yeoman aggregates where EWS operates the train set on behalf of that company.

41. It is also common for the freight train operator itself to make the appropriate arrangements with Network Rail for access to the rail infrastructure and to hold the contract for access. The Railways Act also allows for customers to negotiate their own access and have a direct contractual relationship with Network Rail ('third party access rights'), but to date freight customers have not pursued this option. This observation has been made by EWS in its August 2002 response to DfT<sup>46</sup>, in respect of "*The European Commission's Second Railway Package Towards An Integrated Railway Area*". In that response it stated:

"[...] the European Commission proposes to allow end-users [...] to apply for track access. This would allow them to sub-contract rail haulage to the FOC<sup>47</sup> of choice. This situation already applies in the UK. However, little or no use has been made of this opportunity in the UK and EWS is uncertain that the Commission's proposal is an effective means of improving rail freight service quality."

42. EWS went on to state that:

"Rail freight operation is by definition not the core business of end-users and they may be unprepared to make full use of their track access unless obliged to [...]"

43. This view, that customers do not necessarily wish to have responsibility for the day-to-day management of the rail relationship, because it is not a core part of

---

<sup>46</sup> To be found on [www.ews-railway.co.uk](http://www.ews-railway.co.uk) ("*English Welsh and Scottish Railway, The European Commission's Second Railway Package Towards an Integrated Railway Area – Response to the Consultation Draft, August 2002*").

<sup>47</sup> Freight Operating Company.

their business, is borne out in responses by the generators discussed below, as is the lack of enthusiasm in owning rolling stock. The generators in practice contract out the whole of the rail service package to the freight train operator, from the owning and maintenance of the locomotive and wagons to the contractual relationship with Network Rail for access to the track.

### ***Becoming a freight train operator within Great Britain***

44. An undertaking that wishes to haul freight trains within the UK will require the appropriate operating licence from ORR to do so<sup>48</sup> and during the relevant period also needed to obtain Health and Safety Executive (HSE) approval of its safety case<sup>49</sup>. The acquisition of a licence and a safety case incurs initial and ongoing costs. The potential freight haulier will also need to take into account the time taken to complete each process.

45. Before a train operator may run a service on Network Rail's infrastructure, it requires track access. An operator gains rights to operate trains on the network by virtue of entering into a track access contract with Network Rail. Under the Railways Act, train operators may only enter into a contract giving them permission to use Network Rail's infrastructure, if ORR so directs. Once such a contract has been approved, the undertaking will have to bid, along with other users of the UK network, for his preferred timetable slots.

46. An undertaking will also need to invest in the appropriate locomotive and wagons for the type of freight it intends to haul and acquire the relevant clearances for that rolling stock to use the UK network. It will also require drivers trained and competent to operate the type of train and on the routes required by his business.

47. Annex B contains more details about each of these various requirements including details of the regulatory regime and how it impacts on those wishing to operate a rail freight service within the UK.

### ***Coal demand***

48. Department of Trade and Industry (DTI) published statistics<sup>50</sup> indicate that about 58.6 million tonnes of coal were consumed within the UK in 2002, with around

---

<sup>48</sup> Since 28 November 2005, the UK has also recognised licences granted by other European licensing authorities for this purpose, SI 2005 No. 2005 No. 3050 The Railway (Licensing of Railway Undertakings) Regulations 2005.

<sup>49</sup> The Railways Act 2005, which achieved Royal Assent on 7 April 2005, transferred responsibility for rail-specific health and safety regulation from the HSC/E to ORR. The railway safety case regime has also, with effect from 10 April 2006, been aligned with European requirements. Mainline freight undertakings will in future require a safety management system and safety certificate, rather than a safety case.

<sup>50</sup> Digest of United Kingdom Energy Statistics (DUKES) 2003 available from [www.dti.gov.uk/energy/inform/dukes](http://www.dti.gov.uk/energy/inform/dukes) (Chapter 2, Solid Fuel and Derived Gases, Table 2.7, "Supply and Consumption of Coal").

DUKES 2004 indicate that 62.4 million tonnes of coal were consumed within the UK in 2003, with around 83% of that total consumption (about 53.1 million tonnes) being used

82% of that total consumption (about 47.7 million tonnes) being used for electricity generation (the 'electricity supply industry' or the ESI'). Major power producers accounted for about 46.2 million tonnes and approximately 1.6 million tonnes was consumed by low capacity autogenerators owned by industrial undertakings providing power for their own industrial needs and Combined Heat and Power (CHP) plants which sell on the power that they produce<sup>51</sup>.

49. Non-ESI demand in 2002 amounted to approximately 10.9 million tonnes and included 6.5 million tonnes of coal used in the manufacture of coke or directly injected into blast furnaces.

50. Network Rail confirmed<sup>52</sup> that in 2002, 36.1 million tonnes of the 47.7 million tonnes of coal consumed by the major power producers were transported by rail. Network Rail<sup>53</sup> also indicates that in 2002, 4.5 million tonnes of non-ESI coal were transported by rail, 2.5 million tonnes of which was for the steel industry, transported from Immingham to Scunthorpe for Corus<sup>54</sup>.

### **Coal supply**

51. DTI published statistics<sup>55</sup> indicate that about 29.5 million tonnes of coal were produced within the UK in 2002, with around 16.4 million tonnes of this being produced from deep mines and 13.1 million tonnes from the open cast sector.

---

for electricity generation. Major power producers accounted for about 51.6 million tonnes and approximately 1.5 million tonnes was consumed by low capacity autogenerators owned by industrial undertakings providing power for their own industrial needs and CHP plants. Non-ESI demand in 2003 amounted to approximately 9.3 million tonnes and included 6.6 million tonnes of coal used in the manufacture of coke or directly injected into blast furnaces.

<sup>51</sup> For example, Alcan, a company of aluminium smelters, uses coal supplied by UK coal at its Lynemouth power station. Slough Heat and Power Limited in Berkshire is a CHP plant which provides power for an adjoining industrial site as well as for domestic use locally and the multi-fuel CHP plant on the Wilton International site in Teesside generates electricity and produces steam for on-site clients such as British Petroleum and ICI.

<sup>52</sup> E-mail dated 20 October 2003 from Martin Hunt of Network Rail in response to an ORR e-mail information request of 13 October 2003. [21/1920.1]

<sup>53</sup> E-mail dated 28 March 2003 from Network Rail to ORR, following an e-mail from the ORR dated 25 March 2003. [16/1442.4-16.1442.5]

<sup>54</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO. [33/677A.3]

<sup>55</sup> Digest of United Kingdom Energy Statistics (DUKES) 2003 available from [www.dti.gov.uk/energy/inform/dukes](http://www.dti.gov.uk/energy/inform/dukes) (Chapter 2, Solid Fuel and Derived Gases, Table 2.7, "Supply and Consumption of Coal").

DUKES 2004 indicate that around 27.8 million tonnes of coal were produced within the UK in 2003, with around 15.6 million tonnes of this being produced from deep mines and 12.1 from the open cast sector. In 2003 approximately 31.9 million tonnes of coal were imported into the UK.

52. In 2002 approximately 28.7 million tonnes of coal were imported into the UK. A more detailed breakdown of coal supply and identification of key sources of supply during the relevant period are contained at Annex C.

## **The Electricity Supply Industry**

### ***The major electricity generators within the UK - background***

53. The new electricity licensing regime for electricity companies was established along with the post of Director General of Electricity Supply (DGES) by the 1989 Electricity Act, which came into force in March 1990. The Central Electricity Generating Board (CEGB) was split into three companies, National Power and Powergen (fossil fuel generation) and the National Grid Company (NGC). EWS at paragraph 2.5 of its Response noted that:

“The government decided to allow only two generating companies – rather than a greater number – with the hope that the large size of National Power would allow it to absorb politically unpopular nuclear power stations. When it became clear that the nuclear power facilities could jeopardize the entire privatisation process, they were withdrawn from sale until a later date<sup>56</sup>.”

54. At the same time South of Scotland Electricity Board and North of Scotland Hydro-Electric Board were replaced by Scottish Power, Scottish Hydro-Electric and Scottish Nuclear. A history of coal power station ownership post 1990 is contained at Annex D.

### ***How electricity generators source coal***

55. Generating companies source coal according to the lowest delivered price, taking account both of the cost of the coal and the cost of transportation, and the costs associated with the qualities of the coal<sup>57</sup>.

56. BE has stated<sup>58</sup> that its objective when procuring coal is to receive the: *“lowest possible ‘delivered to power station’ cost. We have tended to allow our suppliers the freedom to determine the most practical and economical combination of coal source and means of transportation and reflect this in their offer”*.

57. E.ON<sup>59</sup> has explained that its coal demand is calculated weekly and forecast by means of its Fuel Allocation and Optimisation System (FAOS) which provides for E.ON the optimal volume of coal out of a given source to a given power station given

---

<sup>56</sup> BE’s acquisition of National Power’s Eggborough power station, Office of Gas and Electricity Markets News, Nov 1999, available at [www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/1794\\_r51.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/1794_r51.pdf) .

<sup>57</sup> Coal with a high chlorine content, for example, has a corrosive effect on boilers generating greater maintenance costs. Some types of coal generate more ash than others, increasing waste disposal costs.

<sup>58</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.7]

<sup>59</sup> Notes of meeting with E.ON on 11 April 2002. [5/367.3-4]

a range of variable and fixed factors. E.ON explained that it is quite possible that in some instances other factors will override the cost of haulage in providing for E.ON a more economical, thus more optimal, movement. TXU had a similar system<sup>60</sup>, 'The Coal Logistics and Supply Procurement Model' (CLASP) which was designed to help TXU to decide how best to satisfy power station demand from the available fuel supply points. As explained in the introduction to the CLASP model<sup>61</sup>: *"An optimisation process is carried out to minimise the total cost of meeting the power stations requirements subject to the quantities of fuels available and other constraints including any minimum or maximum levels of various attributes such as sulphur required by the power stations. The total cost is made up of supply costs associated with the fuel used and delivery costs based on the cost per tonne of this particular movement. There are two methods of operation – the short term model, designed to plan for the next weeks worth of movements at minimum transport cost, and the long term model, designed to plan several months or even years into the future and to assist in decisions about which long-term contracts to accept."*

### **How generators procure rail transportation**

58. New owners of power stations did not, however, immediately enter into coal supply and/or transportation contracts on their own behalf. The take or pay contracts between UK coal suppliers and Powergen, National Power and TXU (at that time Eastern)<sup>62</sup> continued in effect even following divestment of the power stations and, therefore, that coal supply continued as part of the divestment package.

59. Drax has stated<sup>63</sup> that: *"As part of the acquisition of Drax we had a 21-month take-or-pay coal contract with National Power covering virtually all our coal requirements up to September 2001. This contract was on a 'delivered price' basis into Drax i.e. National Power sourced the coal and arranged its transportation into the power plant."* E.ON has explained<sup>64</sup> that under various divestment agreements it continues to supply stations previously owned by it including Fiddlers Ferry and Ferrybridge. Similarly, TXU has explained<sup>65</sup> that it began to negotiate contracts on its own account to begin on expiry of the divestment coal contracts with Powergen and National Power in 1998. BE too has explained<sup>66</sup> that when it bid for Eggborough it had no previous core skills or knowledge of coal-fired generation and at that time

---

<sup>60</sup> TXU went into administration in November 2002.

<sup>61</sup> Supplied by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002. [385/528.1]

<sup>62</sup> UK Coal reports, for example, that, *"the contracts UK Coal acquired on the privatisation of British Coal for the supply of coal to electricity generators National Power, Powergen and Eastern, expired in March 1998. Replacement contracts were subsequently agreed for the supply of up to 109 million tonnes by 2003"*. [www.rjb.co.uk/top/docprof.htm](http://www.rjb.co.uk/top/docprof.htm).

<sup>63</sup> Drax response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/1.2]

<sup>64</sup> Notes of meeting with E.ON on 11 April 2002. [5/367.2]

<sup>65</sup> Notes of meeting with TXU on 18 April 2002. [17/1629.2]

<sup>66</sup> Notes of meeting with BE on 19 April 2002. [5A/329/A.2]

considered various coal procurement options. However BE retained contracts with National Power for the supply of coal which provided for a volume of coal to be delivered to the power station over a three year period, reflecting the number of coal supply commitments entered into by National Power, still current at the time of sale of the power station. Under the terms of that agreement National Power had contracted with EWS to undertake coal haulage. Thus the divestment arrangements contained a delivered coal deal. Similarly LEG has stated<sup>67</sup> that: *“Our purchase of Cottam included a contract for the supply of coal to be provided by its previous owner, Powergen, on a delivered basis. This has provided over two-thirds of the coal delivered to the power station over the first year.”*

60. The rail carriage contracts which EWS entered into with National Power<sup>68</sup> in 1998 and with Powergen<sup>69</sup> in 1996 (together referred to as the ‘legacy contracts’) reflect the complexity of movements required by those generating companies to supply power stations owned by them at that time. These contracts have continued in existence without notice being served by either party, even following subsequent divestments and acquisitions by new owners. EWS has continued to move coal under those contracts mainly in support of the delivered coal deals described above. EWS had an additional contract with EPET<sup>70</sup> (sometimes referred to as ‘Eastern’ and subsequently ‘TXU’<sup>71</sup>) dated 29 August 1997. This too is referred to as a legacy contract reflecting Eastern’s early entry into electricity generation in 1996 following the acquisition of High Marnham and Drakelow from Powergen and Rugeley, Ironbridge and West Burton from National Power.

61. Previous owners of the generating stations which have existing coal supply<sup>72</sup> and rail haulage contracts can and do act as third party intermediaries to the new owners of power stations, providing an ‘E2E’ price in competition with other third party intermediaries such as ECSL. Arbitrage between coal users is commonplace, incentivised in part by the existing coal supply contracts between generators and coal suppliers. Further the legacy rail contracts create incentives to resell, on an E2E basis, exploiting prices for coal haulage by rail in legacy contracts with EWS. ECSL mentioned, within the complaint, that E.ON and RWE operate as third party coal suppliers to power stations divested by them under the terms of the relevant agreements.

---

<sup>67</sup> LEG response dated 25 April 2002 to a section 26 notice of 20 March 2002. [23/2129.1]

<sup>68</sup> The contract expiry date is 1 April 2008 at the earliest, if nominated by EWS, or 1 April 2003 if nominated by [RWE] on 12 months’ notice.

<sup>69</sup> Contract expiry date 31 March 2003 at the earliest with 24 months’ notice.

<sup>70</sup> Terminable by either party on 12 months’ notice after 5 December 2001.

<sup>71</sup> TXU went into administration in November 2002.

<sup>72</sup> RWE has confirmed in its response dated 23 May 2006 to a non-confidential version of the SO that currently it holds no contracts to supply coal with divested power stations. [33/675]

62. A brief summary of the progress and chronology of the next generation of coal haulage contracts, or non-legacy contracts, which were negotiated with new power station owners EME, Drax and BE can be found at Annex E.

# Part I - Introduction to Market Definition and Assessment of Dominance

---

## Legal and economic assessment - market definition and dominance

### *Case law and Commission guidelines*

63. Section 60(1) of the Act sets out the principle that, so far as is possible (having regard to any relevant differences between the provisions concerned), questions arising in relation to competition within the United Kingdom are dealt with in a manner which is consistent with the treatment of corresponding questions arising in European Community law in relation to competition within the Community. In particular, under section 60 of the Act, the OFT<sup>73</sup> must act (so far as is compatible with the provisions of the Act) with a view to ensuring that there is no inconsistency with either the principles laid down by the EC Treaty and the European Court or any relevant decision of the European Court<sup>74</sup>. The discussion of market definition and dominance in this part therefore applies to both the Chapter II prohibition and Article 82.

64. The European Court of Justice, in *United Brands v Commission*<sup>75</sup>, set down that dominance refers to,

“[...] a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers”.

65. In order to assess whether an undertaking holds a dominant position, it is first necessary to define the relevant market on which that position might be held. The need to define a relevant market before assessing dominance has been established in European case law<sup>76</sup>.

66. For the purposes of Community competition law the relevant market usually comprises a relevant product market and a relevant geographic market. As stated in the *Commission Notice on the definition of the relevant market for the purposes of Community competition law*<sup>77</sup> (the ‘Commission Notice’):

---

<sup>73</sup> And the sectoral regulators given concurrent powers under the Act.

<sup>74</sup> The European Court is defined as the Court of Justice of the European Communities and includes the Court of First Instance (section 59(1) of the Act).

<sup>75</sup> Case 27/76 [1978] ECR 207, [1978] 1CMLR 429.

<sup>76</sup> For example, in *Continental Can Co Inc*, JO [1972] CMLR 199, see paragraph 32.

<sup>77</sup> OJ C372, 9/12/1997, page 5, paragraphs 7 and 8.

“A relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer, by reason of the products’ characteristics, their prices and their intended use.”

“The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.”

67. This definition reflects the case law of the European Court.

68. The standard approach to market definition, as outlined in the OFT’s market definition guidelines<sup>78</sup> is that of the ‘hypothetical monopolist test’, the principles of which are also described in the Commission Notice on market definition. The approach involves identifying a focal product, which would constitute a relatively narrow market definition, and considering the ability of a hypothetical monopolist of that focal product profitably to implement a non-transitory price rise of say 5-10% above the competitive level. If substitution would be enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. The market can also be widened on the supply-side to include goods and services from which other firms can swiftly switch in response to the price rise thereby constraining the hypothetical monopolist’s price to the competitive level. Having defined the product market, the process can then be repeated to define the geographical market both on the demand-side and on the supply-side. Similarly, a relatively narrow focal area is adopted initially and then widened to include other areas customers would purchase from in response to a small but significant price rise in excess of the competitive level, and other areas from which suppliers would switch into supplying in response to such a price rise.

---

<sup>78</sup> OFT 403 *Market Definition*.

# ***Part I - Market Definition***

---

## **Overview**

69. For the reasons set out below, ORR concludes that the relevant product market is the market for coal haulage by rail and the relevant geographical market is Great Britain. ORR further concludes that EWS is dominant in that market.

## **The relevant product market: demand side analysis**

### ***Demand-side overview***

70. On the demand side, ORR concludes that the relevant product market is that for the supply of coal haulage by rail. ORR has considered potential demand-side substitutes that might call for a wider market definition, but has not found evidence that these could provide an effective competitive constraint on a hypothetical monopolist of coal haulage by rail.

71. The demand-side analysis is structured as follows.

- (a) Introductory considerations relating to customer type, coal type, committed contracts and spot movements, and haulage by sea.
- (b) Substitution to other fuels for electricity generation.
- (c) Substitution to road haulage.
- (d) Substitution to river/canal haulage.

### **(a) Introductory considerations**

#### *Customer type*

72. On the demand-side, the supply of coal haulage to one customer would not be a substitute for coal haulage to another customer. However, on the supply-side, a firm supplying one customer can typically switch to supplying another sufficiently quickly and at little (or no) additional cost such that those customers can be defined as being within the same relevant market.

73. In the present case, the coal carried for the ESI is of the same types as that carried for other purchasers of coal haulage, and is hauled using the same equipment. There is no reason why a supplier of coal haulage by rail to some other purchaser could not switch quickly and easily into the supply of coal haulage to an ESI purchaser. For the same reason there are no grounds to distinguish between individual ESI purchasers of coal haulage by rail and other customers. It is true that there are some manufacturing processes which may require a higher quality, pure coal for which all coal consumed by power stations would not be suitable, however,

this requirement would dictate the source of the coal rather than the mode of carriage. The only relevant difference between purchasers of coal haulage by rail, either within the ESI or between the ESI and other purchasers, concerns the routes travelled and this is a matter of geography, to be considered in defining the geographical market.

74. With this in mind, although the concerns regarding the behaviour of EWS in the haulage of coal by rail for the ESI, it is not appropriate to consider the ESI customer group as a distinct market, even for the purposes of the hypothetical monopolist test.

75. EWS in its own internal strategy documents<sup>79</sup> quantified the amount of power station coal against other coal carried by rail by both value and volume. For the year 2001/2002 EWS anticipated a value for power station coal arising out of current contracts of £94 million (91% by value) and non-ESI coal as £9 million. Similarly, over the same forecast annual period, it anticipated a volume of coal carried by rail to power stations of 35 million tonnes (94% by volume) with a planned 2.2 million tonnes being hauled to other coal users. UK Coal has said that between 1 March 2000 and 31 December 2001 it sold 37.02 million tonnes of which 32.86 million tonnes (89%) were supplied to the electricity generators<sup>80</sup>.

76. Published statistics from the DTI<sup>81</sup>, set out in Table 3 below, indicate that in the period assessed within this Decision, demand for coal for electricity generation accounted for around 80% of the total demand for coal (including imported coal and including coal transported by all modes).

**Table 3: Demand for coal for electricity generation and total demand for coal (in thousand tonnes (ktes))**

	2000	2001	2002
<b>Total coal demand</b>	58,862	64,245	58,642
<b>Total coal demand from electricity generators</b>	46,198	50,928	47,712
<b>Total coal demand from electricity generators as a % of total coal demand</b>	78	79	81

Source: DTI DUKES

<sup>79</sup> EWS Coal Business Budget Commentary 2001/2002, compiled in February 2001 provided at documents 43-65 of file 7 provided by EWS in response to a section 26 notice of 11 May 2001, FHH entered the market actively in January 2001.

<sup>80</sup> UK Coal response dated 24 April 2002 to a section 26 notice of 20 March 2002. [5/294/1.1]

<sup>81</sup> Digest of United Kingdom Energy Statistics (DUKES) 2003, DTI [http://www.dti.gov.uk/energy/inform/energy\\_stats/coal/dukes2\\_7.xls](http://www.dti.gov.uk/energy/inform/energy_stats/coal/dukes2_7.xls).

77. Network Rail has provided<sup>82</sup> a breakdown of the split of coal haulage by rail, between the ESI and non-ESI users, stating that in 2002, 36.1 million tonnes of coal were transported by rail for the ESI, while 4.6 million tonnes of coal were transported for non-ESI users. This suggests that the ESI accounts for around 89% of coal haulage by rail, while the non-ESI accounts for just 11%. This split has been used in subsequent calculations in this document.

### *Coal types*

78. It has also been necessary to consider whether a relatively narrow market definition, for the purposes of the hypothetical monopolist test, should be based on different markets for the haulage of different coal types. AEP<sup>83</sup>, LEG<sup>84</sup>, Celtic Energy<sup>85</sup>, Drax<sup>86</sup>, SCCL<sup>87</sup> and Scottish Power agreed that different coal types do not impact on the transport decision. AEP has said: “[...] *the quality of the coal itself does not dictate the mode of transport*” while Scottish Power has stated,<sup>88</sup>: “[...] *the physical characteristics of coal utilised in power generation do not, in themselves, dictate the mode of transport*”.

79. BE, RWE and E.ON, however, have pointed out that there are particular circumstances where the characteristics or condition of the coal could affect the transportation decision. BE, for example, has stated<sup>89</sup>:

“[...] we confirm that usually the physical characteristics of coal do not in themselves, dictate the mode of transport. However, there may be circumstances when coal is more easily managed if delivered by road (for example if the coal has known quality deficiencies such as a low NCV<sup>90</sup> or high moisture content or when a coal is likely to cause handling problems at the power station). Under these circumstances road borne deliveries would enable smaller and more evenly phased delivery quantities that could

---

<sup>82</sup> Network Rail e-mail response of 20 October 2003 to an ORR e-mail information request of 13 October 2003. [21/1920.1]

<sup>83</sup> AEP response dated 27 January 2003 to an ORR information request of 20 December 2002. [12/1021/2.5]

<sup>84</sup> LEG e-mail response dated 14 May 2003 to ORR information requests of 20 December 2002 and 29 April 2003. [16/1560.2]

<sup>85</sup> Celtic Energy response dated 7 January 2003 to an ORR information request of 20 December 2002. [12/1205/1.2]

<sup>86</sup> Drax e-mail response of 14 January 2003 to an ORR information request of 20 December 2002. [12/1022/1.1]

<sup>87</sup> SCCL response of 23 May 2003 to a section 26 notice of 30 April 2003. [1516/151]

<sup>88</sup> Scottish Power response dated 24 January 2003 to an ORR information request of 20 December 2002. [12/1023/1.3]

<sup>89</sup> BE response dated 5 February 2003 to an ORR information request of 20 December 2002. [12/1029/1.3]

<sup>90</sup> Net Calorific Value.

potentially be blended on site as received. However, British Energy has not experienced any recent examples of this at Eggborough.”

80. RWE has advised<sup>91</sup>:

“Generally speaking the vast majority of the inherent physical characteristics of coal used for power generation will not dictate the mode of transport. However, coal with very poor handling characteristics such as coal which is very wet or inferior coals or slurries is better transported by road to avoid rail wagon discharging problems. Wet or inferior coal can tend to get stuck in the rail wagons and cause delays in unloading at power stations [RWE] has on occasion moved small quantities of coal with poor handling characteristics by road but in general [RWE] contracts are for coal which is suitable for rail and road vehicle discharge. The onus is thus imposed upon coal suppliers to ensure that coal will not cause handling problems. Thus coal handling issues tend to arise in periods of very wet weather.”

81. E.ON has also referred<sup>92</sup> to the existence of some physical characteristics of coal which would make road transport preferable,

“[s]lurry, for example, and coal with a high fines<sup>93</sup> content does not lend itself to discharge through hoppers. Tipping that sort of coal from a lorry is a better option, therefore. Accordingly, slurry and some marginal handling coal will not be suitable for rail transport in hopper wagons.”

Further,

“[...] some coals may require blending before burn due, for example, to the heat or sulphur content. Road haulage will, in general, tip such coals straight onto the stock pile whereas coal delivered by rail will require movement by conveyor from the hopper to the stock.”

82. However, even taking the views of BE, RWE and E.ON into account there is no reason to sub-divide the market into different coal types, even for the purpose of the hypothetical monopolist test. This is because, where they have argued that there are differences between coal types, the generators have suggested only that there are certain types of coal for which road is a strongly preferred method and for which rail might not be an effective substitute. The relevant question in defining the market for coal haulage by rail is whether a sufficient volume of coal already being transported by rail (on the basis of the competitive price) could easily be transported by some other means in such a way as to constrain a hypothetical monopolist of coal

---

<sup>91</sup> [RWE] response dated 26 February 2003 to an ORR information request of 20 December 2002. [12/1020/1.5]

<sup>92</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.2]

<sup>93</sup> Coal fines are sandy particles too small to burn, formed as a by-product of coal mining operations. They are lower in BTU's (British Thermal Units equivalent to 1060 Joules) than regular coal but can still provide efficient power if prepared correctly.

haulage by rail. The restriction to which the generators have referred suggests that some coal already travelling by road might not be easily switched to rail, but this is not relevant for the purposes of defining the market for coal haulage by rail. None of the generators have suggested there are some coal types for which road is a substitute for rail and others for which it is not.

83. Furthermore existing providers of coal haulage by rail, EWS and FHH, do not distinguish between different types of coal and none of those companies which have considered or are considering entry into provision of coal haulage by rail, such as Jarvis<sup>94</sup>, have made reference to the importance of different coal types, for example, in respect of rolling stock purchase. On this basis then, it is not appropriate to consider different relevant markets for haulage of different types of coal by rail, even for the purposes of an initial market definition for the hypothetical monopolist test.

#### *Committed contracts and spot movements*

84. As a final point before beginning the in-depth process of market definition, the appropriateness of any consideration of applying the hypothetical monopolist test separately to coal haulage covered by committed contracts and coal haulage carried on an ad hoc basis ('spot movements')<sup>95</sup> was considered. Several points are relevant here. First, to define separate product markets by contractual arrangements would be unusual and counter-intuitive. The product in each case, whether supplied under committed contract or on an ad hoc basis is exactly the same, in this case namely coal haulage by rail.

85. Second, on the demand-side, it is clear that for any piece of business, the customer has a free choice as to whether to enter into a contract with commitments on either side or whether simply to place that business with a haulier ad hoc according to its general conditions of carriage, depending on the relative merits. This view is supported by evidence from those generators, which in general move coal under committed contracts and on an ad hoc basis. AEP<sup>96</sup> for example, has advised that it will move coal on a spot basis and under contract generally depending on price and TXU<sup>97</sup> had used FHH in 2001 for some spot business while placing other volume with EWS under the terms of a contract.

86. Third, on the supply-side, since coal haulage by rail requires exactly the same equipment and expertise when provided under a committed contract as when

---

<sup>94</sup> From November 2004, Jarvis Facilities Limited became Jarvis Rail Limited and Jarvis Fastline Limited became Fastline Limited. For ease, the remainder of this notice refers to Fastline. Document and information requests from 8 May 2003 to that date were, however, addressed to Jarvis.

<sup>95</sup> Typically carried under general terms and conditions rather than a bi-party negotiated Coal Carriage Agreement.

<sup>96</sup> AEP response dated 27 January 2003 to an ORR information request of 20 December 2002. [12/1021]

<sup>97</sup> Note of meeting with TXU on 18 April 2002. [17/1629.5]

provided ad hoc, an existing supplier of one could quickly and easily switch into supplying the other so as to constrain a price to the competitive level.

87. On this basis, it was concluded that the hypothetical monopolist test should not be applied separately to coal haulage by rail under committed contract and on an ad hoc basis. Rather, the test should be applied to coal haulage by rail however it is provided contractually.

88. The hypothetical monopolist test in this case will therefore consider the ability of a hypothetical monopolist supplier of coal haulage by rail (to any customer) to raise price in excess of the competitive level, and consider the possible sources of substitution both on the demand-side and the supply-side which might render such a price rise unprofitable.

#### *Haulage by sea*

89. ORR's analysis of the product market considers only inland transportation of coal. It has not been appropriate in this analysis to consider the haulage of coal by sea. Rather, ports have been treated as sources of coal, points of origin for the route to the power station. To the extent that a generating company substitutes one port for another, perhaps in order to minimise the rail leg of the journey to power station, this is considered in the discussion of the relevant geographical market.

#### **(b) Substitution to other fuels for electricity generation**

90. The demand for coal haulage by rail is entirely derived from demand for coal itself. Coal is used as a fuel and, were the delivered price of coal to rise too much, users of coal might find it commercially viable to switch to other fuel sources. In the case of electricity generating companies, this might be gas, heavy fuel oil, or renewable sources. In order to place a competitive constraint on the pricing of coal haulage by rail, an attempt to raise the price of coal haulage by rail by 5-10% would have to cause sufficient substitution to other fuel types to make that price rise unprofitable.

91. There is a suggestion within contemporaneous documents provided by EWS in response to various section 26 notices that historically EWS considered the price of gas to be a threat to its business of the haulage of coal by rail. In a memorandum from Nigel Jones to Philip Mengel and Allen Johnson of 4 April 2000 entitled "*Recent Coal Pricing*"<sup>98</sup>, Nigel Jones referred to a period from 1994 to 1996 where the development of gas fired generating capacity saw the available market for coal reduce sharply and: "*the main perceived competition for EWS was the delivered price of coal versus the delivered price equivalent of gas, not road prices for coal delivery*". Similarly in a draft Board Paper dated 5 May 2000<sup>99</sup>, Nigel Jones stated: "*[g]as remains the principal competitor for coal as a fuel in electricity generation and*

---

<sup>98</sup> Document 422 of volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>99</sup> Document 434 of volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

so a *threat to EWS*". The notes of a Minerals Marketing team meeting held on 20 January 2000<sup>100</sup> recorded: "[h]igher rail freight rates could drive coal generation to gas" and assumed that: "£1.00 on rail freight rate equals 4p per gigajoule delivered to the station". Even within the EWS coal team, however, this assertion was viewed with some scepticism. In an e-mail from David Israel dated 4 May 2000<sup>101</sup> (in response to a call for briefing for Allen Johnson and Philip Mengel on pricing), Mr Israel wrote: "I take it this is to be truly factual, and not include the myth of 'train haulage versus gas pipeline' and other such myths spelt out by others".

92. A paper prepared for EME by Penspen in February 2001<sup>102</sup> reviewed the possible development of a natural gas connection to Fiddlers Ferry. The paper referred to a thirty-month project timescale and a cost +/-25% of £16m. A further paper (undated)<sup>103</sup> but based on January 1997 prices added non-pipeline related costs to this project referring to a total project cost of between £[...] and £[...] [...].

93. However, given the view expressed by BE<sup>104</sup> that: "[t]he domestic rail transport cost for coal is generally a small portion of the total cost of supply to Eggborough," and that: "a [...] % increase in the transport cost of coal by rail would, very roughly, result in an increase of [...] % to the total cost of supply", it seems highly unlikely that a small but significant increase in the price of transport would, by itself, trigger a costly major strategic shift to an alternative fuel supply.

94. This view is supported by the other responses received from the generators which exposed an absence of strategic planning for fuel switch in the event of a rise in transport costs. Much greater changes in the market as a whole than a 5-10% rise in the price of rail haulage would need to occur for such a switch to be considered.

95. BE has stated<sup>105</sup>, for example, that Eggborough's attractiveness within a predominately nuclear portfolio, is based on the fact that its flexibility means that its output can be varied in order to suit market conditions. BE considered<sup>106</sup> that a decision to: "switch to another fuel type would be of major strategic significance", based on: "a detailed analysis of the UK electricity market, the relative cost of fuels and the expected payback on the investment required to undertake such a project".

---

<sup>100</sup> Document 362 of volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>101</sup> Document 173 of file 7 to documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>102</sup> The AEP response dated 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/24.6 and 414/24.7]

<sup>103</sup> The AEP response dated 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/34.2]

<sup>104</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.14 to 5A/329/1.15]

<sup>105</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.5]

<sup>106</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.19]

96. TXU<sup>107</sup> confirmed: *“TXU’s power stations are not dual firing so that any switch to an alternative fuel would require significant adaptation”*. [...] <sup>108</sup>[...].

97. Drax has stated<sup>109</sup>: *“Drax is the largest and most efficient coal-fired power station in Western Europe and the whole configuration of the boilers and generating plant is designed to burn coal.”*

98. AEP has confirmed<sup>110</sup> that it has not undertaken any analysis on gas conversion since acquiring Fiddlers Ferry and Ferrybridge but has provided documents relating to studies undertaken by E.ON in 1996 on possible conversion, a project not carried through to completion. LEG<sup>111</sup> has advised: *“We have not, thus far, considered the possibility of converting Cottam to another fuel.”*

99. Market conditions also make switching currently unlikely for those with dual fired capability and once again transport costs are not explicitly factored into the response. RWE responded:

“Within [RWE’s]<sup>112</sup> existing generation capacity, switching from coal to another fuel type would only be carried out if there was a problem with coal handling/deliveries/plant and it was commercially viable to burn alternative fuels. Consideration would be given to burning alternative fuel if an arbitrage opportunity arose where it was more economic. [...]”

100. E.ON’s response<sup>113</sup>, however, appeared to take a more dynamic approach to fuel switch. It provided a commentary on the value of having flexibility within its portfolio of power station capability to suit different market conditions. It advised that its internal planning process ensured that it operates this portfolio in merit order taking into account factors such as the purchase cost of fuel, delivery costs to the power station and the efficiency of conversion. Nonetheless, although transport costs are explicitly identified, its subsequent example appears to minimise the impact that transport costs would likely have on this decision:

“To illustrate this, consider a period whereby the generated cost of a coal fired station is cheaper than a gas fired station. [...]”

---

<sup>107</sup> TXU response dated 9 April 2002 to a section 26 notice of 20 March 2002. [6/380(a).4]

<sup>108</sup> Middle Office Risk Critique (Draft) dated 4 March 1999 provided by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002. [385/516.1]

<sup>109</sup> Drax response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/1.5]

<sup>110</sup> AEP response dated 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/1.6]

<sup>111</sup> LEG response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5A/344a.5]

<sup>112</sup> RWE response dated 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.4 to 5/339/2.5]

<sup>113</sup> E.ON response dated 3 May 2002 to a section 26 notice of 20 March 2002. [351/1.16]

101. EWS at paragraph 3.21 of its Response agreed with the ORR's conclusion and stated: "*EWS agrees with the ORR's conclusion in paragraphs 133 to 143 of the Notice that substitution to other types of fuel is not a sufficient constraint on the price of coal haulage to include these fuels within the same market.*"

### **(c) Substitution to road haulage**

#### **Overview**

102. The most obvious potential substitute to coal haulage by rail on the demand-side is coal haulage by road, and ORR now considers this issue in detail.

103. ORR's analysis of substitution to road haulage is structured as follows.

- i. Industry views, and in particular the views of EWS, FHH, generators and coal suppliers.
- ii. Capacity constraints, and the resulting percentage of coal captive to rail.
- iii. Evidence suggesting that, even absent capacity constraints, some generators use road haulage only in exceptional circumstances.
- iv. Additional costs to generators from using road haulage.
- v. Other factors that make generators reluctant to use road haulage, namely safety and environmental considerations.

#### **(i) Industry views**

##### *The relevance of industry views*

104. In *Aberdeen Journals v The Director General of Fair Trading Supported by Aberdeen Independent Ltd*<sup>114</sup>, the then Competition Commission Appeal Tribunal stated that:

"In general, evidence as to how the undertakings in question themselves see the market is likely to be particularly significant." (Paragraph 103);

and

"In the Tribunal's view, contemporary evidence as to how the allegedly dominant undertaking itself views its competitors, and vice versa, may, depending on the particular circumstances, be of decisive importance when it comes to defining the market in any given case." (Paragraph 104).

105. The Competition Appeals Tribunal (the Tribunal) in *Genzyme Limited v The Office of Fair Trading*, has clarified that this position will very much depend upon the material cited and the facts of the case. It states:

---

<sup>114</sup> Case No 1005/1/1/01.

“Although, as the Tribunal said in Aberdeen Journals (No. 1), at paragraphs 103 and 104, contemporary documents showing how an undertaking views its competitors may constitute important evidence on the question of market definition, each case depends on its own factual circumstance.” (Case No:1016/1/1/03, 11 Mar 2004, paragraph 217)

### *The view of EWS*

106. ORR begins here by considering first EWS’s formal responses to ORR regarding road and rail competition. EWS’s contemporaneous view on the specific issue of road and rail pricing is discussed separately under the heading *Additional costs – price of road haulage compared to rail haulage*.

107. In responding to a section 26 notice, EWS stated<sup>115</sup>:

“Road haulage competes actively with rail freight, especially on flows up to about 45 miles. For instance, [E.ON] moves a significant volume of coal to power stations by road. Some stations actually prefer to receive coal by road because it arrives in small consignments and can be placed directly to the stock yard hopper without having to operate the rail unloading conveyors. Thus saving money on power bills and labour. Drax power station constructed a road to connect the station to the M62 for road deliveries in the 1980’s. Eggborough has facilities to enable it to handle large volumes of coal [by road]. Ferrybridge receives large quantities ([...]) by road from Immingham. West Burton also takes up to [...] by road.”

108. Further EWS estimated<sup>116</sup> that 50,000 tonnes of coal were transported from Liverpool to Fiddlers Ferry by road during the period 1 March 2000 to 28 February 2001.

109. In its Response EWS reiterated this view. In particular it drew attention to the distinction between long haul and short haul flows. It stated that road and rail are comparable in terms of price for flows up to 40 miles and therefore that approximately 40% of all ESI traffic carried by EWS is subject to price competition from road [paragraph 3.45].

110. EWS argued at paragraph 3.29 of its Response that road haulage provides a direct competitive constraint: “[...] *if EWS attempts to increase the price of existing arrangements, it may lose volume to alternative suppliers including road haulage*”.

111. In support of this view it cited exchanges it has had with customers, for example, the ITT from EME dated 26 June 2000 which advised tenderers:

“We are developing our draft purchasing strategy for coal to be delivered to Ferrybridge and Fiddler’s Ferry Power Stations for the calendar years 2001 – 2004. Factors affecting the choice of coal type and origin obviously include

---

<sup>115</sup> Letter dated 20 June 2001 in response to a section 26 notice of 11 May 2001.

<sup>116</sup> Letter dated 7 September 2001 in response to a section 26 notice of 10 August 2001.

the cost of inland coal transportation from port or mine, and the quality/reliability of the service provided...It should be noted that we have other transport options available to us, namely road and in some cases, canal.”<sup>117</sup>

112. While the above statements from EWS suggest that at least for shorter distance flows, road competes with rail, internal documentation from EWS (see below and also *EWS contemporaneous view of road versus rail pricing*) suggests otherwise.

113. At paragraph 3.72 of its Response EWS identified two internal documents which it purported showed that there existed in EWS a contemporaneous view that road competes actively with rail:

- A memorandum to the EWS board meeting on 14 July 1998, Road Haulage Industry Review<sup>118</sup> paragraphs 7.1 and 7.5 of which comment: “[t]he last decade has seen the development of increasingly sophisticated road hauliers/distributors [...] EWS needs to consider carefully how to address these different challenges and consider carefully how to address the gains that road freight has made”.

However, these comments were made as part of a wider whole industry review, including an assessment of sectors other than coal haulage where road does actively compete with rail.

- A coal/minerals report for March 2001<sup>119</sup>. After discussing a series of train cancellations the report states: “for the first time some companies are using road haulage, at a significant price premium to rail”.

However, this does not suggest road haulage is posing a competitive threat but rather implies that under normal conditions, where performance is at an acceptable level, road haulage is rarely used. This document supports the view that when road haulage is used, it is the result of a limitation or failing of rail haulage.

114. Furthermore, statements from customers made as part of negotiations over prices need to be considered in context, especially as the bulk of evidence from customers, coal suppliers and EWS’s only eventual competitor (FHH)<sup>120</sup> suggest that road haulage of coal would not constrain a hypothetical monopolist of coal haulage by rail, regardless of distance. EWS has not provided any internal documents which provide either strong or compelling evidence that road haulage provides a constraint on rail haulage at the competitive level (in particular, that the constraint is effective at the competitive level, not just at the monopoly level or at times of

---

<sup>117</sup> Document 19 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>118</sup> Document 120 of volume 2 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>119</sup> Document 3 of file 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>120</sup> See footnote 308 below regarding the potential 2007 entry of GBRfr.

shortage/unsatisfactory performance in rail haulage). On the contrary, contemporaneous internal documents indicate that EWS viewed road as only a limited threat and moreover that: “[t]he coal generation market is effectively captive to rail and EWS will continue to be the leading player in that market”<sup>121</sup>.

#### *Industry views – FHH*

115. FHH stated in relation to the Response<sup>122</sup>:

“[EWS] concludes [at paragraph 3.81] that the correct product market definition from the demand side perspective should be the carriage of coal by any means to each destination. In Freightliner’s experience, this is plainly incorrect. Road does not compete with rail to any meaningful extent and currently represents only 1 to 2% of the overall market. The reality of the market is that road represents a negligible proportion of the market and does not exert any competitive constraint upon rail operators.

The principal reason for this is a direct result of the physical characteristics of road and rail, with road clearly being unsuited to the transportation of large volumes of coal [...].”

#### *Industry views – generators and coal suppliers*

116. A small number of respondents did make reference to the occasional use of road haulage for short distance flows. However even in these limited examples the respondents stressed that road haulage could never provide more than their peripheral transport needs.

117. AEP has stated<sup>123</sup>: “AEP has never seriously considered the regular or substantial use of any alternative means of transport [to rail, for coal] [...] On limited volumes on very short routes or for very specific purposes, AEP may consider road haulage as a viable alternative to rail, however not as the primary mode of transport for coal supplies.” Further AEP has stated<sup>124</sup>: “[w]hen a train can be loaded, AEP uses trains [...]”.

118. Whilst stating that: “the only practical and economical means of coal transport is currently rail”, SCCL did note<sup>125</sup> that it has used road haulage for limited volumes

---

<sup>121</sup> Review of Anglo-Scottish Traffic (Undated, but on the basis of the content ORR assumes that it was written toward the end of 2001.) Documents 11-14 of documents provided by EWS in response to request 8 of a section 26 notice of 17 June 2005.

<sup>122</sup> FHH representations made on 16 May 2005 to a non-confidential extract from the EWS Response (paragraphs 2.15-2.16). [27/228d.7-8]

<sup>123</sup> AEP response dated 26 April 2002 to a section 26 notice of 20 March 2002 reissued on 4 April 2002. [414/1.5]

<sup>124</sup> AEP response dated 27 January 2003 to an ORR request for information of 20 December 2002. [12/1021/2]

<sup>125</sup> SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/22]

of coal as Scottish Power may from time to time contract with SCCL for delivery into Longannett power station from SCCL's open cast sites nearest the power station. RWE has also stated<sup>126</sup> that: "[r]ail haulage is cheaper than road except for shorter distances".

119. However most responses from customers stressed the impracticality of using road for the large volumes of coal required, and suggested that there were significant barriers to switching between rail haulage of coal and road haulage, meaning that road is not considered an effective substitute for rail. In particular no discernable pattern was evident in the responses suggesting that coal haulage by road actively competed with rail haulage across shorter flows.

120. The generators commented as follows:

- BE<sup>127</sup>: *"Road deliveries could not, in practice, be used to serve anything more than a limited proportion of overall coal supply requirements of the power station."*
- TXU<sup>128</sup>: *"TXU had always favoured the rail option. There were limits on the amounts of coal that could be transported by road, some formal and some more informal."* Further<sup>129</sup>: *"Roadborne deliveries have normally been arranged during periods of high demand when we cannot get sufficient trainloads delivered. However, we would not normally use road because of the additional cost and administration."*
- Drax<sup>130</sup>: *"[...] because of the volumes of coal required by Drax and the way we are set-up at the plant to receive coal means that we essentially have no option but to take all our coal by rail."*
- RWE<sup>131</sup>: *"Because of the nature of [RWE's] business, the volumes transported and the infrastructure in place plus environmental constraints, rail transport is the only plausible mode of transport."*
- E.ON<sup>132</sup>: *"Local infrastructure issues govern the extent to which [E.ON] can switch coal from rail to road; others are restricted to use only rail by local planning consents. All power stations have a limit on road haulage capability determined by the local road networks or the capacity of the road reception (i.e. weighing and sampling) facilities on the site. In addition, when supplying coal to a customer*

---

<sup>126</sup> RWE's response dated 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.3]

<sup>127</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.25]

<sup>128</sup> Minutes of the TXU meeting of 18 April 2002. [17/1629.3]

<sup>129</sup> TXU response 25 April 2002 to a section 26 notice of 20 March 2002. [385/559]

<sup>130</sup> Drax response dated 25 April 2002 to paragraph 10(b) of a section 26 notice of 20 March 2002. [5/317/1.4]

<sup>131</sup> RWE response dated 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.1]

<sup>132</sup> E.ON response dated 3 May 2002 to a section 26 notice of 20 March 2002. [351/1.11]

*(e.g. one of the purchasers of a power station formerly owned by [E.ON]), [E.ON] may have a contractual limit on the amount of road tonnage it can supply which is less than the actual capacity of the station, in order to allow the owner to undertake its own road movements.”*

- Scottish Power<sup>133</sup>: *“Unless there was a compelling commercial case otherwise, Scottish Power would first seek to utilise rail where possible for the reasons outlined above. It is unlikely that a 10% increase in the cost of rail transport would be sufficient to justify moving traffic from rail to road where rail capacity was available.”*
- International Power<sup>134</sup>: *“Rail is the preferred mode of transport of coal to Rugeley because the only alternative, road transportation, is not feasible for the volumes required.”*

And the coal suppliers responded as follows.

- SCCL<sup>135</sup>: *“To the extent that SCCL’s forward coal production is planned to be in the order of [confidential]<sup>136</sup> million tonnes per year, and that the greater [confidential] proportion of this tonnage will probably be destined for English power stations, the only practical and economical means of coal transport is currently by rail [...] the haulage by road of this volume of coal over the distances involved would be neither practical nor economical [...].” Further it has stated<sup>137</sup>: “[c]oal is extracted and despatched in a bulk materials handling environment. Economic transportation on land necessitates the use of the largest possible consignment tonnages that can be moved effectively, logic generally dictating the use of rail.”*
- Celtic Energy has explained<sup>138</sup> that planning permission restraints at the Fifoots Point Power Station restricted coal movements to rail borne traffic. Indeed it has stated: *“[...] under the circumstances of the letting of this [rail haulage] contract there was no lawful, practical or contractual option to consider alternative modes of transport due to the planning restraints at the Fifoots Point Power Station (which prohibited road traffic), and the nature of the coal reception facilities at Fifoots Point.”*

---

<sup>133</sup> Undated Scottish Power response to paragraph 10(b)(ii) of a section 26 notice of 20 March 2002. [5A/370/11.1]

<sup>134</sup> International Power response dated 14 April 2003 to a section 26 notice of 18 March 2003. [15/1394/2.1]

<sup>135</sup> SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/22]

<sup>136</sup> SCCL website refers to over 4 million tonnes. [www.scottishcoal.co.uk](http://www.scottishcoal.co.uk).

<sup>137</sup> SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/138]

<sup>138</sup> Celtic Energy response dated 7 January 2003 to an information request from the Regulator dated 20 December 2002. [12/1205/1.2]

- UK Coal<sup>139</sup>: *“UKC are permanently reviewing costs in an effort to be more competitive, an increase of [...] % in the price of rail costs would result in the reassessment of cost effectiveness of the movements where road could be a practical alternative, but [...] there are not many movements that UKC organise the transport [for] where road and rail compete head to head.”*

121. Further, a report commissioned by Freightliner<sup>140</sup> supports the view that road does not provide a competitive threat for large volume flows such as power station coal: *“For some very large volume flows (e.g. power station coal) road is not a viable mode and trainload railfreight as a mode has a quasi-monopoly.”*

122. A non-ESI user, Corus, has expressed a similar view:

<sup>141</sup>: *“In our opinion there is no practical, economic and environmentally acceptable alternative to rail transport for the volume movement of raw materials including coal. Our current policy is to try to increase modal switching from road transportation to rail”.*

### *Summary of generators’ responses*

123. The generators’ responses highlighted a number of recurring factors militating against the use of road haulage. Broadly these comprise the following.

- Capacity constraints, including:
  - direct physical limitations (capacity);
  - planning restrictions; and
  - local community restrictions.
- The difference in the overall price of road and rail haulage, including:
  - the additional costs of road haulage;
  - handling costs;
  - potential infrastructure costs of modal switch; and

---

<sup>139</sup> UK Coal response dated 24 April 2002 to a section 26 notice of 20 March 2002. [5/294/1.4]

<sup>140</sup> “[...]”. Provided by Freightliner in its response of 29 April 2002 to a section 26 notice of 20 March 2002. [5/302/2.5]

<sup>141</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO. [33/677A.2]

- the potential for fraud.
- Safety considerations.
- Perceived environmental impact.

124. Many of these factors are considered in more detail in the following paragraphs.

**(ii) Capacity constraints**

125. The primary factor that prevents generators from switching to using road haulage for the delivery of coal is simply the physical restrictions on the number of lorries that the power stations can receive. These restrictions come in a variety of forms. There are physical limits stemming from the delivery capacity of the power station, formal restrictions contained in planning constraints, and informal restrictions, for example self-imposed limits to reduce the risk of opposition from local residents. Given the number of lorries that would be required in order to deliver the volumes of coal that generators require, these restrictions act to severely constrain the generators choice of haulage method.

*Direct physical capacity constraints*

126. E.ON has explained<sup>142</sup> that local infrastructure issues govern the extent to which it can switch coal from rail to road, advising that some supply points, for example, are restricted to use only rail by local planning consents. As noted previously, E.ON further has explained: “[a]ll power stations have a limit on road haulage capability [...]”. It has stated<sup>143</sup> that Ratcliffe station, for example, has no planning consents or legal limits for the haulage of coal by road but the availability of weighbridges, tipping areas, wheel washes, and the [power] station road network restrict the number of road deliveries that can be accommodated. E.ON has further clarified<sup>144</sup> that this road network restriction amounts to [...] road movements per day<sup>145</sup> during the weighbridge opening hours, including both loaded and empty movements. It has also advised that a loaded road movement equates to approximately 20-30 tonnes of coal, depending on vehicle type.

---

<sup>142</sup> E.ON electronic response of 3 May 2002 to a section 26 notice of 20 March 2002. [351/1.11]

<sup>143</sup> E.ON response of 10 October 2002 to an ORR information request of 20 September 2002. [502/a.1]

<sup>144</sup> E.ON response of 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.1]

<sup>145</sup> E.ON has also explained that some of this road capacity will be taken up by the movement of oil (inbound) and ash (outbound). [12/1026/2.1]

127. LEG has advised<sup>146</sup> that the physical constraint on its capacity to receive coal by road is capped at [...] tonnes per week, which it has stated is equivalent to [...] lorry loads a week in respect of each station.

128. RWE has advised<sup>147</sup> that due to planning restrictions the total quantity of coal that can be moved by road to Aberthaw power station is [...] tonnes per week.

129. SCCL has stated that the only practical and economical means of coal transport is currently by rail. It refers to the exception of limited volumes of coal as Scottish Power may from time to time contract with SCCL for delivery into Longannet power station from SCCL's opencast sites nearest the power station. SCCL has, however, also advised of existing restrictions on the use of road. It has provided details of opening hours and restrictions at sites<sup>148</sup> which show, for example, that although Killoch disposal point allows road movements to and from the site between the hours of 06:00 to 17:00, the reception hours at Longannet dictate that any road delivery to that location has to be despatched from Killoch by 16:00<sup>149</sup>. A further example provided by SCCL is Knockshinnoch disposal point which allows road movements to and from the site between the hours of 07:00 to 17:00, but the reception hours at Longannet dictate that any road delivery to that location has to be despatched from Knockshinnoch by 15:30.

130. The importance of the volume limits on power stations' deliveries by road becomes clear when the scale of the coal deliveries to power stations is considered. On the basis that one train carries on average 1100 tonnes and is equivalent to 44 x 25 tonne lorry loads of coal tonnes, BE has provided<sup>150</sup> an estimate of how many lorries would be required to deliver the maximum weekly road delivery tonnage that could be managed into the station. It has advised that the power station opening times for receipt of road coal deliveries are currently restricted to 0700 to 1700 Monday to Friday and that it would expect opposition from the local community and authorities in the event of any significant variation to this operation. It has calculated that:

“[o]n this basis delivery of [...] tonnes of coal per week would involve [...] road consignments, which equates to [...] consignment every [...] minutes [...] The same quantity of coal could be delivered on just [...] trains per week ([...] per day)”.

---

<sup>146</sup> LEG e-mail response of 14 May 2003 to an ORR information request of 20 December 2002. [16/1560.2]

<sup>147</sup> Paragraph 8 of RWE's response of 26 February 2003 to an ORR information request of 20 December 2002. [12/1020/1.5]

<sup>148</sup> SCCL attachment to an e-mail dated 12 August 2003 in response to a section 26 notice of 30 April 2003, an e-mail of 21 July 2003 and a further e-mail of 4 August 2003. [20/1826.6]

<sup>149</sup> Longannet opens at 08:00 and accepts its last delivery at 18:00.

<sup>150</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.25]

131. BE's coal deliveries from 1 March 2000 to 31 December 2002 were approximately [...] million tonnes, amounting to approximately [...] trainloads. To carry the same volume of coal by road would likely require over [...] consignments. Expressed weekly, this equates to coal movements of just over [...] tonnes of coal, which would require [...] lorries to deliver it. Given the station opening hours this represents around one lorry every [...] seconds.

132. The potential number of road movements per generating company can be calculated, using similar equivalence assumptions. TXU's total coal burn from 1 March 2000 to 31 December 2001 was [...] million tonnes<sup>151</sup>. TXU has assumed<sup>152</sup> that one trainload is equivalent to around 40 lorries, which is broadly similar to BE's equivalence of one train to 44 lorries. Using the BE 'conversion rate', TXU's usage over that period would generate a total number of around [...] trains, equivalent to approximately [...] road consignments.

133. Over the period 1 March 2000 to 31 December 2002 RWE purchased a total of approximately [...] tonnes to supply its own and other power stations<sup>153</sup>. Using previous assumptions, this could be carried by approximately [...] trains, or just over [...] million road consignments, which equates to over [...] lorry loads a week<sup>154</sup>.

134. The following Table illustrates the effect of coal haulage switching to road for power stations other than those owned by TXU during the relevant period. The implied interval between lorry deliveries is extremely short and the fact that such intervals are not realistic is confirmed by evidence from the generators themselves regarding the maximum road delivery capacity to their power stations (see below under *The percentage of coal captive to rail*).

---

<sup>151</sup> Presentation given by TXU at the meeting on 18 April 2002. [6/382]

<sup>152</sup> Notes of meeting with TXU on 18 April 2002. [17/1629.4]

<sup>153</sup> Data provided with the RWE response dated 26 February 2003 in response to an ORR information request dated 20 December 2002 following a section 26 notice of 20 March 2002. [12/1020-1.7-12/1020-1.46]

<sup>154</sup> For consistency, the lorry load equivalent calculations here have all been made on the basis of BE's figures. In their responses some generating companies applied their own lorry load equivalence calculations, but using these other figures makes no material difference to the calculations.

**Table 4. Coal deliveries by generator expressed as lorry load equivalents**

Power station	Generating company	Weekly coal deliveries (tonnes)	Lorry load equivalent*	Interval between lorries (mins)	Assuming delivery hours of
Longannet	Scottish Power	[...]	[...]	[...]	08:00-18:00, 5 days a week <sup>155</sup>
Cockenzie	Scottish Power	[...]	[...]	[...]	As above
Eggborough	BE	[...]	[...]	[...]	07:00-17:00, 5 days a week <sup>156</sup>
Didcot	RWE	[...]	[...]	[...]	08:00-20:00, 5 days a week <sup>157</sup>
Aberthaw	RWE	[...]	[...]	[...]	08:00-17:00, 6 days a week <sup>158</sup>
Drax	AES	[...]	[...]	[...]	08:00-17:00, 5 days a week <sup>159</sup>
Ferrybridge	AEP (now SSE)	[...]	[...]	[...]	06:00-18:00 Mon-Fri, 06:00-12:00 Sat <sup>160</sup>
Fiddler's Ferry	AEP (now SSE)	[...]	[...]	[...]	As above
Cottam	LE	[...]	[...]	[...]	08:00-20:00, 5 days a week <sup>161</sup>
Ratcliffe	E.ON	[...]	[...]	[...]	08:00-20:00, 5 days a week <sup>162</sup>
Rugeley	IP	[...]	[...]	[...]	As above <sup>163</sup>

<sup>155</sup> Paragraph 6 of Scottish Power response 24 January 2003 to an information request from the ORR dated 20 December 2002. [12/1023/1.2]

<sup>156</sup> BE response of 4 October 2002 to an ORR information request of 20 September 2002. [8/509.2]

<sup>157</sup> RWE response 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.3]

<sup>158</sup> RWE response dated 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.3]

<sup>159</sup> Drax response dated 27 September 2002 to an ORR information request of 20 September 2002. [8/511.1]

<sup>160</sup> "Review of Edison First Power Ltd.'s Coal Supply Strategy for The Lenders" dated June 1999, provided by AEP in its response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/12.43]

<sup>161</sup> No actual planning restrictions etc. known. Assumption of relatively lenient opening hours made.

<sup>162</sup> No actual planning restrictions etc. known. Assumption of relatively lenient opening hours made.

<sup>163</sup> In International Power's response of 14 April 2003 to a section 26 notice of 18 March 2003, it stated that there is no restriction on deliveries to Rugeley [15/1394/2]. However, it seems likely that in practice International Power would not deliver around the clock, being constrained at least by good neighbourliness. This calculation is therefore undertaken on the assumption of relatively lenient opening hours. If 24/7 opening hours are used, the interval between lorries would be increased to [...].

*\*Using equivalences in paragraph above, i.e. one lorry load equals 25 tonnes*

*NB calculations for TXU not possible as no information received on restrictions on road movements*

135. At paragraph 3.64 of its Response EWS argued that while it is factually true that: “*many power stations have limits on the quantity of coal that they can accept by road [...] the examples of Ironbridge, West Burton, and Longannet demonstrate that it is possible to modify power stations fairly cheaply to accept larger volumes of coal by road*”.

136. ORR does not consider that this argument undermines its conclusions. First, EWS has provided no details or evidence of the alleged modifications at the three named power stations, and neither their current nor previous owners have informed ORR of such modifications. Second, any costs necessary to adapt a plant to make it suitable for road haulage would be a switching cost that would not need to be incurred if the generator continues to use rail haulage, thus making road even less competitive. Third, even if a plant could be adapted relatively cheaply, the numerous other considerations that make generators reluctant to use road haulage would still apply. Fourth, none of the generators have indicated that they are inclined, or would be willing to undertake the necessary investment to permit more use of road haulage.

137. Fifth, FHH has suggested that certain additional road unloading stations are not used. In response to EWS’s submission<sup>164</sup>, FHH stated:

“EWS argues at paragraph [3.64] that certain power stations, such as Ironbridge, West Burton and Longannett, have modified their loading facilities in order to accept increased volumes of coal by road due to capacity constraints on the volumes of coal which can be accepted by rail any individual power station. In Freightliner’s experience, these additional road unloading stations are not used.”

138. Sixth, it seems likely that the taking and implementation of a decision by a generator to adapt plant to in order to increase road haulage capacity would take some time, making it unlikely that switching would take place quickly enough to be taken into account for the purpose of market definition (i.e. within one year).

139. In addition to the restricted physical capacity to accommodate sufficient lorries to deliver equivalent annual tonnages as by rail, FHH’s response dated 16 May 2005<sup>165</sup> (paragraph 2.16) indicates a significant differential in the unloading times between trains and lorries which will further constrain the scope to shift significant tonnages to road:

“Even where power stations hold the necessary loading and unloading facilities for trucks, the unloading of a full train of coal would take

---

<sup>164</sup> FHH representations dated 16 May 2005 to a non-confidential extract of the EWS Response (paragraph 2.25). [27/228d.11]

<sup>165</sup> FHH response dated 16 May 2005 to an ORR information request of 15 April 2005. [27/228(d).8]

approximately one hour, whereas the unloading of 42 trucks would take a time of up to three hours. It is therefore clear that road transport is not a viable commercial alternative to the transportation of coal by rail on any meaningful or long-term basis.”

### *Planning restrictions*

140. Given the vast numbers of lorries that coal deliveries to power stations could entail, it is hardly surprising that local authorities seek to impose restraints on road movements through planning constraints, and that local communities express concerns over road traffic. Customer responses have indicated that both factors are significant in their preference for rail haulage.

- LEG<sup>166</sup> has stated that in relation to Cottam power station: “[...] *we are subject to a local authority constraint which requires delivery of coal by road to be no more than [6]000<sup>167</sup> tonnes a week.*” It has clarified further<sup>168</sup> that although this constraint is an informal and thus unenforceable agreement with the relevant local authority it was generated by and is consistent with the: “*good neighbour*” policy of the power station (initiated by the previous owner, Powergen plc).
- TXU has provided<sup>169</sup> extracts from the National Power and Powergen divestment contacts which refer to the road delivery limitations at various stations. Further clarifications have also been provided by the purchasing parties<sup>170</sup>. TXU has also advised<sup>171</sup> that sometimes the expectation of complaints from local residents leads to TXU applying a lower limit in some circumstances. As an example of this TXU cited High Marnham as a station where local residents are particularly averse to deliveries by road. In one instance TXU bore the additional handling costs of using road for a short distance from a non-rail connected source point, then transferring that load to train for delivery into the station in order not to generate any anticipated complaints.

---

<sup>166</sup> LEG response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5A/344a]

<sup>167</sup> Clarificatory e-mail from LEG dated 26 November 2003 in response to an ORR e-mail request of 25 November 2003, confirming that the figure quoted in its earlier communication of [5000], should read 6000, as now amended. [23/2130]

<sup>168</sup> LEG electronic response dated 4 October 2002 to an ORR information request of 20 September 2002. [23/2132]

<sup>169</sup> TXU’s response dated 25 April 2002 to a section 26 notice of 20 March 2002. [385/3 and 385/4]

<sup>170</sup> The Joint Administrators for TXU have procured the following information direct from the generating stations: Weighbridge operations at West Burton mean that road borne coal can only be received Monday to Friday at a maximum volume of 2kt per day; Drakelow and High Marnham have no formal restrictions with the local authority but consideration for local residents limits deliveries to between 7 and 10KT a week and whilst Ironbridge also has no formal restrictions the local authority is concerned to limit delivery hours to between 7:00 and 18:30; Rugeley will only accept 25KT per week. [17/1598.7-17/1598.9]

<sup>171</sup> Notes of a meeting with TXU on 18 April 2002. [17/1629.4]

- SCCL has provided<sup>172</sup> a summary of planning restrictions at its various despatch and delivery points. It has stated, for example, that planning restrictions that apply to Ravenstruther<sup>173</sup> do not permit any vehicle to approach the site before 06:45 and loading must not start before 07:00. Similar planning restrictions that apply to Knockshinnoch<sup>174</sup> restrict the hours of road operation to between 07:00 to 17:00 and planning restrictions that apply to Chalmerston<sup>175</sup> restrict road movements to between 07:30 and 17:00.
- AEP has stated<sup>176</sup>: “[...] a local authority may, in granting a planning permission for construction/alterations to a power plant, require the entering into of a section 106 agreement (under the Town and Country Planning Act 1990) which restricts the number of HVO traffic movements generated by the plant [...]”. A later response confirmed<sup>177</sup> that there are in fact no formal restrictions placed on road movements to Fiddlers Ferry or Ferrybridge, but that there is an informal agreement with the local authority for both stations that restricts both the time of day that lorries may deliver to the plants and also the routes that any deliveries may take. A review conducted in June 1999<sup>178</sup> stated: “[...] the maximum level of lorry haulage capacity to the station [Ferrybridge] is 40,000 to 45,000 tonnes of coal per week. However lorry haulage capacity is constrained by the Traffic Management Plan agreed with the police and two local government authorities involved. This Agreement provides for lorry operating hours to be restricted to deliveries between 6 A.M. and 6 P.M during the five working days per week, and 6 A.M. to noon on Saturdays”. A Promeco report of August 1999<sup>179</sup> tells us that this restriction led deliveries to be restricted to [...] per week at [...]. The report, however, notes that [...] <sup>180</sup>[...].
- Scottish Power has referred<sup>181</sup> to constraints on deliveries by road into its Longannet power station. Although there are no formal planning constraints:

---

<sup>172</sup> SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/70]

<sup>173</sup> Planning permission reference P/LK/01870127P, provisions 18 and 20. [1516/70]

<sup>174</sup> Planning permission reference CD/81/56, provision 22. [1516/70]

<sup>175</sup> Planning permission reference 97/0582/FL, provision 45. [1516.70]

<sup>176</sup> AEP electronic response of 9 October 2002 to an ORR request for information on 20 September 2002. [8/514]

<sup>177</sup> AEP response dated 27 January 2003 to an ORR request for information on 20 December 2002. [12/1021/2.5]

<sup>178</sup> “Review of Edison First Power Ltd.’s Coal Supply Strategy for The Lenders” dated June 1999, provided by AEP in its response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/12.43]

<sup>179</sup> [...]

<sup>180</sup> [...]

<sup>181</sup> Paragraph 6 to the Scottish Power response dated 24 January 2003 to an ORR information request of 20 December 2002. [12/1023/1.2]

*“[d]eliveries of coal to Longannet by road are the source of significant complaints from the local community. Any coal traffic coming through Kincardine village exacerbates the congestion in the village and are readily identifiable as being associated with the power station. In accordance with our policy of being a good neighbour, we have a local agreement with the local community council to restrict the reception hours and number of vehicles delivering coal directly to the station by road to minimise the impact of our operations on the local community [...] Within the opening hours agreed with the local community and to ensure compliance with the operational safety requirements on site some 200 vehicles per day deliver coal directly to Longannet PS by road. This equates to some 5-5,500 tonnes per day [or just under 30,000 tonnes per week] depending on the size of vehicles employed and is equivalent to one vehicle arriving every 3 minutes during the road delivery reception hours”. This compares to average weekly deliveries of coal (all modes) of over 100,000 tonnes<sup>182</sup>.*

- RWE has stated<sup>183</sup> that its: *“power stations have limited road capability because of physical constraints and planning restrictions that alleviate the potential impact on local residents. Some coal sites cannot export by road because of planning constraints and some are not rail connected”*. It listed the following as examples of road or rail constraints:

*“Drax have refused to accept delivery of coal by road [...];*

*A significant part of our contractual allowance was used to transport coal to Eggborough from supply points that were not rail connected;*

*Didcot is only permitted to accept road deliveries to a maximum of 60 lorries per day and between 0800-2000hrs, Mon-Fri only<sup>184</sup>; and*

*“A restriction at Aberthaw limits road deliveries to the period 0800-1700 Mon-Sat.”<sup>185</sup>*

- UK Coal has indicated<sup>186</sup> that the decision to use rail is: *“more often as not dictated to by planning constraints and/or the existence of rail connections.”* UK Coal has cited the following by way of example:

---

<sup>182</sup> Calculation based on total road deliveries to Longannet March 2000 to December 2002 divided by number of weeks.

<sup>183</sup> RWE response dated 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.3]

<sup>184</sup> In its response of 4 October 2002 to an ORR information request of 20 September 2002, RWE has explained that this arises from a planning authority restriction imposed by the Vale of the White Horse District Council, which also prescribes approved routes for deliveries. [8/507.1]

<sup>185</sup> In its response of 4 October 2002 to an ORR information request of 20 September 2002 RWE has explained that this is a planning restriction imposed by the Vale of Glamorgan Council, which also prescribes approved routes for deliveries. [8/507.1]

<sup>186</sup> UK Coal response dated 24 April 2002 to a section 26 notice of 20 March 2002. [5/294/1.3]

- Site planning regulations which restrict Hicks Lodge to rail dispatch;
- Planning limitations on road dispatches from Butterwell;
- Site planning regulations at Gedling Tip Coal dictating all coal must be dispatched by rail;
- Planning regulations at Gascoigne Wood which only allow receipt of coal by rail; and
- Planning regulations restricting roadborne movements from Widdrington.

#### *Local community considerations*

141. Beyond physical restrictions and formal planning constraints the impact of the volume of movement necessitated by road haulage of coal on the local community is significant. Drax<sup>187</sup> has stated: *“We also need to consider the number of vehicle movements on site and around local villages. Road coal vehicles have to travel a considerable distance across the Drax Site and even if we tried to take say [confidential - less than 10% of our burn per week by road] this would be equal to one lorry every 8 minutes if they came in between 8am and 5pm, Monday-Friday.”*

142. Similarly Scottish Power has provided<sup>188</sup> a letter from Kincardine Community Council dated 29 November 2000 expressing concerns about the volume of road deliveries. Scottish Power has advised<sup>189</sup> that it operates a voluntary code of conduct with local community councils whereby, for example, it restricts the number of deliveries coming through Kincardine village to 200 vehicles per day Monday to Friday and up to 13:00 on a Saturday in emergency situations.

143. Further BE, whilst confirming<sup>190</sup> that there are no legal constraints that limit the volume of coal delivered by road to Eggborough and thus in theory road borne deliveries offer an alternative to rail, it is both practically difficult to increase road deliveries as discussed above and,

“[...] any attempt by British Energy to increase the amount of coal delivered by road would potentially attract complaints from the local community and other interested parties that could result in legal constraints being imposed on road-borne deliveries”.

---

<sup>187</sup> Drax response dated 27 September 2002 to an ORR information request of 20 September 2002. [8/511.1]

<sup>188</sup> Scottish Power response (undated) to a section 26 notice of 20 March 2002. [5A/370/10]

<sup>189</sup> Scottish Power response 3 October 2002 to an ORR information request of 20 September 2002. [8/499.1]

<sup>190</sup> BE response dated 4 October 2002 to an ORR information request of 20 September 2002. [8/509.2]

144. At paragraph 3.65 of its Response, EWS suggested that not all local authorities would prefer not to allow significant coal deliveries by road, and relies on a letter dated 13 March 1997<sup>191</sup> which it received from SCCL during contract negotiations. EWS set out the following passage:

“Scottish coal has a number of major decisions to make about which sites it intends to develop. A fundamental issue is whether those sites will be located for rail access or road haulage.”

145. EWS has used this quote out of context. The quote is taken out of a letter to EWS in which SCCL complains about its poor level of service, which had led to a less than the optimum volume moving through SCCL’s rail facilities. Far from implying a preference for using road haulage, it stated: “*With reasonable notice, rail facilities should provide us with the opportunity of moving bulk tonnage direct to our major customers. If they cannot, the costs of their operation and internal transport make us uncompetitive.*” SCCL then goes on to state: “*As an example, if we move coal into Knockshinnoch we do not want to be constrained by an output restriction of 4 or possibly 5 trains per day. The roads have an ideal capacity which we are forced to exceed.*” This seems to support rather than undermine the conclusion that planning and local community considerations limit the extent to which generators are willing to use road haulage.

#### *The percentage of coal captive to rail*

146. Given this evidence that capacity constraints limit the ability of generators to use road haulage, ORR has considered the extent to which coal haulage is effectively captive to rail. Using information from the generating companies about the restrictions faced by individual power stations and the total volumes of coal received by each power station during the relevant period, it has been calculated that even if all road capacity for coal deliveries were fully utilised, road deliveries could only account for no more than around 30% of all deliveries to power stations. Taking into account the possibility of barge and belt deliveries to some stations, this would leave just over 60% of all coal deliveries to power stations entirely captive to rail<sup>192</sup>.

147. EWS argued, at paragraphs 3.26(a)-(b) and 3.67 of its Response, that by considering rail captivity on an aggregated basis ORR is misinterpreting the significance of these figures, pointing out that at the level of individual power stations few generators are using even the (restricted) maximum road capacity that they can accommodate. Therefore the spare capacity still available means that road haulage provides an alternative at the margin and should be included in the relevant market.

---

<sup>191</sup> Document 60 of volume 1 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>192</sup> The percentage of coal deliveries entirely captive to rail was calculated as follows; by establishing what volume of coal road, barge and belt could carry if used at capacity, calculating the average weekly volume of coal delivered to all power stations, calculating what the remaining quantity of coal undelivered would be if road, barge and belt were fully utilised and establishing what this remaining volume would be as a percentage of the average weekly volume.

148. Whilst ORR recognises that the hypothetical monopolist test is concerned with the loss of sales at the margin, it rejects the assertion that in this case road provides a competitive constraint for rail haulage. The way in which the generators contract with rail haulage suppliers is important. Customers seek a minimum level of large and stable volumes of coal supply to their power stations. Only rail can deliver this, irrespective of whether any generators have the discretion to haul small volumes of coal to their power stations by road (e.g. for very short haulage distances). This is supported by the generators' responses cited in the section above entitled, *Industry views – generators and coal suppliers*. For instance the following comments from BE and Drax are repeated.

- BE<sup>193</sup>: *“Road deliveries could not, in practice, be used to serve anything more than a limited proportion of overall coal supply requirements of the power station.”*

And

- Drax<sup>194</sup>: *“[...] because of the volumes of coal required by Drax and the way we are set-up at the plant to receive coal means that we essentially have no option but to take all our coal by rail.”*

149. Even if a hypothetical monopolist of rail haulage were to face a credible threat that a generator could switch a small proportion of its coal haulage requirements to road, road cannot provide an effective competitive constraint on the coal haulage services that the generators are seeking. ORR finds no evidence that road haulage can displace rail haulage for a generator's coal haulage requirements.

150. Including road haulage in the relevant market could be misleading because it suggests that, contrary to the evidence set out above, individual generators are not dependent on rail for their coal haulage needs. To date no generator has sought a long-term, multi-route, large volume haulage contract with a road haulier.

151. Even in the context of spot flows it is not clear that road borne deliveries could have acted as a viable alternative to haulage by rail given the tonnages that generators were often looking to move.

152. For example given the quantity of coal FHH hauled to Cottam under a spot contract with LEG during 2002, it seems unlikely road could have provided anything more than a peripheral part of the haulage. FHH moved on average nearly [...],000 tonnes per month over the year, the equivalent of nearly [...] tonne lorries, which would have meant (applying the same assumptions used in Table 4 above) [...] lorry every 5 minutes.

153. When customers seek spot movements it is usually for a specified volume reflecting an unexpected movement and only some of these would be manageable by road. For example the UK Coal requirements assessed in the analysis of

---

<sup>193</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.25]

<sup>194</sup> Drax response dated 25 April 2002 to paragraph 10(b) of a section 26 notice of 20 March 2002. [5/317/1.4]

predation below came in three tranches. First, [...] tonnes over a maximum eight week period<sup>195</sup> commencing 2 September 2002<sup>196</sup>. Second, [...] tonnes due to commence late September<sup>197</sup>. Third, [...] tonnes taking the total haulage for UK Coal to [...] tonnes to be delivered by the end of December 2002.<sup>198</sup> Even the first of these alone, would translate to almost [...] tonnes per week, implying almost [...] tonnes per hour and therefore on the lorry load assumptions of above, [...] lorries per hour, i.e. [...] lorry every [...] minutes. To deliver the entire haulage requirements of all three tranches would involve [...] lorries per hour, i.e. one every [...] minutes.

154. It does not necessarily follow, therefore, that from a practical consideration, spare road capacity at some power stations provides the competitive constraint which EWS has submitted. More likely it is evidence that the additional constraints, which make road haulage an impractical substitute for rail, are preventing generators from using even the limited physical road delivery capacity available.

**(iii) The use by some generators of road haulage only in exceptional circumstances**

155. As noted above a number of customers have chosen not to utilise road haulage even within the constraints of the limited capacity available to them. This limited use of road haulage even within its strict confines becomes even more apparent when it is considered that to the limited extent that road haulage is utilised to transport coal, often it is a choice borne out of necessity and not because it is regarded as an alternative to rail haulage. For example:

- The quote from BE below<sup>199</sup>, cited by EWS at paragraph 3.33 of its Response, by way of supporting its submission that generators have a choice of mode available to them, in fact stresses that when road haulage is most often used it is as a supplement to rail haulage rather than as a direct substitute.

“The use of alternative transport modes would be considered by British Energy if: an economic benefit could be achieved; increased delivery capacity **could not be met through the use of rail transportation alone; transport flexibility was required which could not be achieved through the use of**

---

<sup>195</sup> See e-mail from Mr White dated 23 August 2002 (documents 67-69 of documents provided by EWS at a section 27 site visit of 22 October 2002. ('the site visit')).

<sup>196</sup> Taken from e-mail from UK Coal 22 August 2002. (document 64 of documents provided by EWS at the site visit).

<sup>197</sup> See e-mail from Mr White dated 23 August 2002. (documents 67-69 of documents provided by EWS at the site visit).

<sup>198</sup> See e-mail exchange between Mr White, EWS, and Martin Higgins of UK Coal of 12 September 2002 (document 99 of documents provided at the site visit); e-mail from Phil Cairns of UK Coal to Mr White dated 17 September 2002 (document 105 of documents provided at the site visit); and e-mail from Mr White to Mr Purves of 18 September 2002. (document 108 of documents provided at the site visit).

<sup>199</sup> BE response dated 20 March 2002 to a section 26 notice dated 20 March 2002. [5A/329/1.14-5A/529/1.19]

**rail transportation alone (e.g. movement of coal to a delivery point which is not rail connected)."** (Emphasis added.)

- In weekly reports<sup>200</sup> Trading Managers in TXU referred periodically to the extra costs incurred when road is used in circumstances when rail cannot deliver. A weekly report dated week ending 2 February 2001, reported that road transport has had to be arranged because of the limited availability of train paths from Bristol to Rugeley, noting that: "*[a]lthough road haulage is costing an extra £[...]t (equivalent to £[...]MWhr) this is preferable to running out of coal*". In a weekly report dated week ending 2 March 2001<sup>201</sup> it is stated that during a particular period of high demand from the generators, the allocation of trains to TXU by EWS from Immingham to West Burton had been restricted to just over half of those ordered, resulting in an investigation of road alternatives. It is also noted in the report that: "*[r]oad rate likely to be double the rail rate (at £ [...]t)*".
- RWE also referred<sup>202</sup> to an instance where it moved coal by road from Bristol to Aberthaw when Railtrack infrastructure failed and station stocks were low.
- During the winter of 1999 and the summer of 2000, where EWS failed to deliver agreed volumes of coal by rail<sup>203</sup>, E.ON [...] <sup>204</sup>.
- SCCL also referred to the failure of rail infrastructure sometimes leading, in extremis, to the use of road. It stated<sup>205</sup>:

"Other than possibly on the very shortest delivery routes (where road transport starts to become competitive against rail) [...] it is unlikely that a [...] % increase in the cost of rail transport would lead SCCL to switch from rail to road transport under normal circumstances. There have however been

---

<sup>200</sup> Structured Gas & Fuel Trading Weekly Reports provided by TXU in its response dated 25 April 2002 to a section 26 notice of 20 March 2002. [385/170.2]

<sup>201</sup> Structured Gas & Fuel Trading Weekly Reports provided by TXU in its response dated 25 April 2002 to a section 26 notice of 20 March 2002. [385/171.2]

<sup>202</sup> RWE's response of 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.4]

<sup>203</sup> In a letter from E.ON to EWS dated 22 November 1999, (provided by E.ON in its response of 10 May 2002 to a section 26 notice of 20 March 2002), E.ON stated: "*As you are well aware, EWS has failed to perform reliably since 1996 for all of the various reasons we have sought to understand at our monthly performance review meetings [...] The rapid deterioration in recent weeks (since EWS started moving large volumes for Enron/Edison First Power Ltd.) and the lack of assurance provided by EWS as to future performance [...].*" [351/99.1]

<sup>204</sup> Various letters from E.ON to EWS and the minutes of meetings between E.ON and EWS to discuss Train Performance written and held between November 1999 and June 2000 provided by E.ON in its response dated 10 May 2002 to a section 26 notice of 20 March 2002. [351/88.1; 351/91.1;351/94.1;351/96.1;351/97.3;351/103.1-2; 351/101; and 351/100]

<sup>205</sup> SCCL response of 23 May 2003 to a section 26 notice of 30 April 2003. [1516/139]

instances where failure of the rail infrastructure has forced the use of road transport, recent examples including:

- Burnton viaduct repairs
  - Tunnel collapse at Falkirk
  - Embankment subsidence in various locations
  - Viaduct en route to Killoch Disposal Point
  - Settle and Carlisle upgrade
  - Various derailments on the network.”
- Rail performance issues, which result in some volume shift to road, are also noted in EWS’s own internal documents. In a Board Report dated March 2001<sup>206</sup>, EWS referred to a level of train cancellations of between 40 and 56 trains each week in 4 of the previous 6 weeks. This is the same report discussed above which noted that: “[f]or the first time some power companies have started using road haulage, at a significant price premium to rail”. Although in the same document EWS also acknowledged that: “[...] by and large customers, coal shippers and ports have not complained [at the level of train cancellations]. Coal suppliers have frequently run out of coal first.” This is repeated in the 2001 Board Report<sup>207</sup>, where EWS reported: “[p]ower companies are using road haulage at a significant price premium to rail, to move coal because rail is unable to meet demand”.
  - AEP noted<sup>208</sup> three exceptional circumstances where lorries have been used in the past:

“When AEP purchased Ferrybridge power station in late 2001, AEP inherited a coal stockpile very near total stocking capacity for that station. AEP had no choice but to pursue a strategy of emergency diversion of some of its contracted coal flows. AEP diverted the train flows first, but was left receiving barge coal. As there are no other power stations in the area able to discharge barges and Ferrybridge is unable to load trains, road transport was the only practical choice for removal of this coal from site.”

And

“In mid 2001, AEP understands that Edison Mission Fiddlers Ferry did use road haulage for a limited purpose. Fiddlers Ferry had purchased some Russian coal from a supplier (from the vessel Alexandraki) and had it transported by rail into the station. After the coal arrived at the station, it was found that the coal was contaminated with rocks and that the coal needed to be returned to Liverpool for screening before it could be burned. As Fiddlers Ferry is unable to load trains at the station, road haulage was again the only

---

<sup>206</sup> Provided at document 3 of file 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>207</sup> Extract to be found at document 703 of volume 6 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>208</sup> AEP response dated 27 January 2003 to an ORR information request of 20 December 2002. [12/1021/2.4]

choice. During that time period, AEP understands that Mission did use road transport for additional coal as well, as under those circumstances it was most efficient for the trucks to be moving coal both directions (to and from the station) [...] In early 2002, because of the recent bad experience with contamination, AEP did continue to use a small amount of road transport on the Liverpool Bulk Terminal - Fiddlers Ferry route to ensure there would be trucks on site to cope with any potentially contaminated coal if necessary. This was for a relatively small volume and has now ceased, in part because the costs of this road haulage were roughly [...] percent greater than rail.”

And

“When finishing off a stockpile at a port when there is substantially less than a full trainload of coal left at that port, AEP will occasionally consider the use of trucks rather than run a train to deliver that coal. AEP would only do this occasionally (particularly into the Aire Valley) because the costs of this road haulage are generally substantially more than the cost of the same trip by rail. In all cases, AEP would prefer to reach agreement with a rail company to run that partial load when the train would otherwise not be utilized or to make special arrangements to load two different types of coal on the same train. When these options are unavailable, AEP would only then consider using road transport.”

**(iv) Additional costs to generators from using road haulage**

156. Even where it is physically possible for generators to make the substitution from rail to road, there remain other significant barriers to doing so, a significant difference being the additional costs associated with road haulage and the relative prices of road and rail. The responses by the generators suggest that these costs comprise: the additional handling costs associated with what is seen as a more resource intensive mode of transport; costs associated with fraud; and the potential infrastructure costs of modal switch.

*Additional costs: power station coal delivery design*

157. Typically the unloading facilities at power stations are focussed around deliveries of coal by rail. At paragraph 3.73 of its Response, EWS stated that it is unclear why the existence of such bespoke rail unloading facilities might be relevant when considering market definition. However, as described by the generators themselves, this will clearly have implications in terms of increased handling costs, contributing towards the preference of generators to receive deliveries by rail and predicating against a switch to road.

- In a Coal Ink Consultancy report<sup>209</sup> commissioned by Deutsche Bank as part of the acquisition process for the Drax power station, it is stated: *“Rail transportation is favoured by power plant operators since most of their systems were designed around rail movements. Transfer of coal to the power station bunkers is direct*

---

<sup>209</sup> Report entitled “Coal Supply to Drax Power Station” dated May 2000 provided in the Drax response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/3.48]

*and by careful scheduling the power plants can minimise the amount of coal put out to stock. Double handling of coal is therefore avoided.”*

- Drax has advised<sup>210</sup>: *“All the reception facilities at the power station are designed for virtually 100% rail deliveries of coal. The only time that we would consider even very limited road borne deliveries of coal into the station would be in emergencies e.g. rail strike or if a small coal supplier had no access to rail loading facilities and could supply coal [...] at a delivered price that was competitive with rail hauled coal.”* In a later response<sup>211</sup> Drax quantified road deliveries at some 0.5% of its total deliveries from a small supplier who has no loading point and stated: *“[...] this is only on the margins given the totality of our annual coal burn”*.
- Scottish Power has noted<sup>212</sup> the unsuitability of its Cockenzie power station for accepting deliveries of coal by road: *“Cockenzie was not designed to receive coal by road. The layout of the coal plant is such that it is difficult to handle road vehicles and therefore deliver any significant volumes of coal by road. Cockenzie has received limited volumes of coal by road but only when rail capacity is unable to meet demand and is very rarely utilised. The coal plant is therefore not staffed on a regular basis to handle coal by road.”*
- BE has referred<sup>213</sup> to the construction, at Eggborough, of: *“a purpose built private rail siding, specifically designed for the delivery of coal to the power station. The siding forms a complete loop (known as the “Merry-Go-Round” system) which enables the continuous forward flow of rail traffic through the siding to maximise throughput capacity”*. BE has explained<sup>214</sup> that the: *“Eggborough plant is designed to enable deliveries of coal from rail to be discharged direct to boiler feed without further intervention. Alternatively discharge can be made direct to stockpile by conveyors”*. BE has also said<sup>215</sup>: *“[i]nvestment required in plant/facilities to support change in transport mode”* would be a consideration in any assessment made of the viability of modal switch. BE has also noted<sup>216</sup>: *“[...] the power station operations required in support of road delivery are considerably more resource intensive (and therefore more costly) than those required for rail delivery [...]”*. It includes, within these additional costs, the costs of weighbridge operation, quality management, the additional transaction costs incurred by the increased number

---

<sup>210</sup> Drax response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/1.2]

<sup>211</sup> Drax response dated 27 September 2002 to an ORR information request of 20 September 2002. [8/511.1]

<sup>212</sup> Paragraph 6 of Scottish Power response dated 24 January 2003 to an ORR information request of 20 December 2002. [12/1023/1.3]

<sup>213</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.6]

<sup>214</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.25]

<sup>215</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.15]

<sup>216</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.26]

of deliveries and other additional coal handling activities which result from a less automated alternative<sup>217</sup>.

- Corus has stated<sup>218</sup>: *“Given that Corus already has significant facilities designed for rail receipts, it would be more costly to switch to road.”*
- TXU supported this view and explained<sup>219</sup> that automated rail delivery systems at its power stations meant that coal could be conveyed direct from train to boiler. It went on to explain that road movements lead to additional administrative costs both at station level and at headquarters. These additional costs arise firstly because, for one shipment, TXU may have to deal with 4 or 5 different road hauliers because one haulier is unlikely to have sufficient capacity for the whole requirement. Secondly, the administrative costs are higher because the sheer number of road deliveries required generates more invoicing and transaction activity than is required by the large volume of coal hauled by rail out of one contract. TXU referred also to the additional costs incurred by the manual sampling of road delivered coal which on rail is carried out automatically and also noted its experience of the additional monitoring costs which are incurred to avoid the reputational damage to TXU of drivers using short cuts or unauthorised routes. TXU also reported a problem in the different relationship it has with road hauliers, as compared to rail hauliers. Whereas train operators own coal specific assets and are dependent on a rail system which demands at least weekly advance planning of movements, road hauliers have the ability and tendency to transfer resources to the highest paying job on any given day which can lead to large swings in the daily volumes delivered to the power station.

158. Nevertheless, there are exceptions to this. E.ON has advised<sup>220</sup>, for example: *“Some coals may require blending before burn due, for example, to the heat or sulphur content. Road haulage will, in general, tip such coals straight onto the stock pile whereas coal delivered by rail will require movement by conveyor from the hopper to the stock.”*

159. There are not only additional costs associated with unloading coal hauled by road, but there is some evidence that additional costs may be incurred when loading coal into a road vehicle. Scottish Power has supplied<sup>221</sup> a fax from Clydeport dated 24 November 2000, for example, which referred to the additional cost of hiring in plant (front loading shovels).

---

<sup>217</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.25]

<sup>218</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO. [33/677A.2]

<sup>219</sup> Notes of a meeting with TXU on 18 April 2002. [17/1629.4]

<sup>220</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.2]

<sup>221</sup> Letter in the Scottish Power [undated] response to a section 26 notice of 20 March 2002. [5A/370/8.1]

*Additional costs: the potential for fraud*

160. In their consideration of rail versus road haulage, the generators also take into account the potential for fraud. TXU explained<sup>222</sup> that road delivery, being less automated, gives opportunities for fraud which do not exist to the same extent on rail. This generates costs either in the loss, as a result of the fraud itself, or in the extra resources required to prevent fraud occurring. TXU, at the same meeting, referred to the current lack of weighbridges for road deliveries which can lead to unchecked lighter than invoiced loads. To prevent this TXU would need to establish and staff weighbridges on site. TXU also referred to the possibility of road loads which consisted of materials other than coal, incurring more sampling costs.

161. TXU's views were supported by RWE<sup>223</sup>: *"On site, one train presents fewer logistical problems than many lorries. It also presents less potential for fraud and requires less sampling."*

*Additional costs: the price of road haulage compared to rail haulage*

162. Of course it is not just the additional costs associated with the handling and administration of coal haulage by rail that determines the choice of mode. Even more important is the direct relative price of the two methods of haulage. Generators have provided details of rates quoted to them by rail hauliers and by road haulers and a summary of average price differentials is given in Table 5 below.

163. The Table shows that road haulage prices are significantly in excess of rail haulage prices. If road haulage prices are more than 110% of the rail haulage price, then, other things equal, a rail haulier will not be constrained from implementing a 10% increase in price by a credible threat that customers will substitute to road haulage.

---

<sup>222</sup> Notes of a meeting with TXU on 18 April 2002. [17/1629.4]

<sup>223</sup> RWE response dated 26 April 2002 to a section 26 notice of 20 March 2002. [5/339/2.3]

**Table 5. Comparison of Road and Rail Rates for Coal Haulage**

<b>Origin</b>	<b>Destination</b>	<b>Road rate as a % of rail rate</b>
Bentinck	Ratcliffe	107%
Bristol	Aberthaw	253%
Clipstone	Cottam	90%
Clipstone	Ratcliffe	98%
Clipstone	West Burton	158%
Daw Mill	Drakelow	177%
Daw Mill	Ironbridge	186%
Daw Mill	Ratcliffe	100%
Daw Mill	Rugeley	173%
Harworth	Cottam	105%
Harworth	Ferrybridge	118%
HIT	Ferrybridge	235%
HIT	Rugeley	241%
HIT	West Burton	194%
Hull	Eggborough	171%
Hull	Ferrybridge	200%
Hunterston	Cockenzie	230%
Hunterston	Longannet	184%
Kellingley	Ferrybridge	171%
LBT	Drakelow	145%
LBT	Fiddlers Ferry	130%
Maltby	Cottam	145%
Maltby	High Marnham	145%
Maltby	West Burton	129%
Oxcroft	Ratcliffe	98%
Portbury	Drakelow	214%
Portbury	Rugeley	201%
Prince of Wales	Ferrybridge	128%
Rossington	West Burton	116%
Rufford	Ratcliffe	93%
Seymour	Ratcliffe	98%
Silverdale	Fiddlers Ferry	157%
Swains Park	Ratcliffe	107%
Swansea	Aberthaw	247%
Thoresby	Cottam	91%
Thoresby	Ratcliffe	101%
Welbeck	Cottam	106%
Welbeck	Ratcliffe	115%

*Note: price differentials are averaged for a particular origin-destination pair where more than one contemporaneous road and rail price is available*

164. From the routes analysed, in 66% of cases the road price was greater than the rail price by 10% or more<sup>224</sup>. This suggests that a haulier of coal by rail will not, in general, be constrained by a credible threat of substitution by customers in response to a 10% price increase above the competitive level.

165. EWS argued at paragraphs 3.35 to 3.45 of its Response that this analysis misrepresents the competitive constraint imposed by road haulage, as it fails to account for the distance of the journey. It has submitted that for shorter journeys road acts to constrain the price of rail haulage. The distinction between short and long-haul routes is discussed in the next section.

166. At paragraphs 3.46 to 3.61 of its Response, EWS criticised the sample of routes used arguing that the discrepancies in the data rendered the analysis meaningless. EWS stated at paragraph 3.49:

“In order for the ORR to prove its assertion that road and rail haulage of coal do not compete in the same market it has to show that the efficient cost of the two alternatives are not comparable for any subset of routes that constitute a material volume of traffic. The ORR has argued at paragraph 625ff of the Notice that there is no reason to expect the efficient cost of rail haulage to vary dramatically between similar routes. It is assumed that the same argument applies to road haulage.”

167. EWS stated at paragraph 3.50:

“Inspection of the data reveals massive – and inexplicable – variation in the data, which can not be reflective of efficient costs. It is therefore clear that that the data underlying is unreliable and the ORR should not base any conclusions on it.”

And at paragraph 3.38 that the analysis is:

“[b]ased on a fallacy of comparing average road haulage prices with average rail prices”.

168. The relevant concern from the perspective of the SNIPP test is the relative prices that a customer faces for the haulage of coal either by road or rail on a given route. It is prices that customers respond to, not costs incurred by suppliers. Variation in prices on a given flow over time or on similar flows at the same time could reflect variation not only in efficiently incurred costs, but also other supply-side factors and, further, demand-side factors. For example, a request for road haulage at short notice when a road haulier is capacity constrained would likely result in a higher price because (a) the customer is likely to be more price insensitive (due to the late nature of the order) and (b) the haulier could face higher costs than normal (for example overtime payments or costs stemming from shifting capacity to meet the order). Indeed, in its Response regarding price discrimination, EWS argued that

---

<sup>224</sup> Note that these statistics cannot be recovered from the preceding Table, only from the raw data.

where contractual circumstances differ (such as performance regimes, contract duration, volumes, timing, etc.) this can explain differences in prices. It is surprising, therefore, that EWS did not appear to consider that even for the same flow, there might be significant price variation between time periods and similarly variation in prices between what might appear to be similar flows (based on distance).

169. ORR recognises that the above Table is not based on a large sample, the total number of observations was 92 for a total of 38 origin-destination pairs, implying an average number of observations per pair of just over 2. Nevertheless, ORR does not consider that the sample should, therefore, be rejected. In particular, in order to ensure that the sample captured at least all the road prices likely to constrain rail pricing, generators were specifically asked to identify road and rail prices where they were aware that the road price was less than 110% of the rail price. So the sample is, therefore, skewed towards those origin destination pairs where the road and rail price are closer, rather than being biased towards road and rail prices being more divergent by a significant amount i.e. by more than 10%.

170. TXU<sup>225</sup> has indicated that Liverpool to Rugeley was cheaper by road than by rail but since it did not give particular prices, this has been omitted from the Table. Further, TXU has qualified this information by advising that this circumstance of a cheaper road haulage price is: *“based on particular circumstances where hauliers have been able to match return flows with other customers”*.

171. RWE, however, has stated<sup>226</sup> that: *“We are not aware of any instances when the price of coal haulage by road was less than 110% of the price of coal haulage by rail.”* This is a particularly significant comment given the volume of coal hauled under the RWE contract. As can be seen in Table 2 in part II A of this Decision, *Assessment of abuse of dominance – Exclusionary contracts*, the RWE contract with EWS was the largest single coal haulage contract between 2000 and 2002, covering 15% to 43% of all coal hauled by rail during the relevant period. This implies that for a very significant proportion of coal hauled by rail there was no comparable road haulage price.

172. Moreover, internal contemporaneous documentation from EWS indicates that road prices were only considered to compete with rail prices in limited circumstances. In EWS’s Minerals Business Plan 2000<sup>227</sup>, EWS stated:

“There is not the same strategic threat from road as there is from rail borne competition. In some of our current contracts, particularly npower [RWE], rail is cheaper than road over all distances. In most cases rail becomes much cheaper as distance increases. We know that from Immingham to the three Aire Valley power stations, 65 miles, rail is over £1/tonne cheaper than road.

---

<sup>225</sup> TXU response dated 9 April 2002 to a section 26 notice of 20 March 2002. [6/380(a).2]

<sup>226</sup> Paragraph 7 of RWE response dated 26 February 2003 to an information request from the ORR dated 20 December 2002. [12/1020/1.5]

<sup>227</sup> Appendix 3, *“Business Plan, Power Station Coal 2000 –2003”* to the Business Plan 2000 provided at document 342 of volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

From the North East to the Aire Valley, 100 miles, rail is over £2.50/tonne less. On long haul flows from Scotland to England road is over double the rail rate – and in some contracts more. On distances up to about 30 miles road and rail are often similar in price [...]”.

*Additional costs: long versus short flows*

173. Although EWS argued that for short distances road and rail compete, it is not clear from EWS’s submissions to ORR and its own internal documents precisely how it defines “short”. For example, in its response to a section 26 notice dated 20 June 2001<sup>228</sup>, EWS stated that:

“Road haulage competes actively with rail freight, especially on flows up to about 45 miles.”

EWS internal documentation cited above (the Minerals Business Plan 2000) considered that:

“On distances up to about 30 miles road and rail are often similar in price [...]”

In its Response EWS stated at paragraph 3.45:

“[...] customers frequently feed back qualitative information about competing road bids for possible rail contracts. This information leads EWS to believe that road and rail can be comparable in price terms for journeys of around 40 miles or less, depending on the exact local circumstances”.

174. Aside from precisely how short is defined, as a matter of principle, to accept EWS’s view that short distance flows face effective competition from road haulage, whilst flows over a certain distance do not, would on its own imply that from a demand side perspective there are two distinct markets, one for short flows which would include the haulage of coal by both road and rail and a second rail only market for longer journeys.

175. However EWS further argued, at paragraph 3.43 of its Response, that not only are shorter journeys constrained by road haulage, but that there exists a chain of substitution between shorter and longer haulage trips by rail that would ensure that all routes of any length make up a single market constrained by road haulage.

176. EWS submitted that as road competes with rail for shorter journeys and because generators will readily switch between routes of different lengths (given that it is the delivered price of coal that dictates the choice of route and not the price of haulage per-se (paragraph 3.41)) those competitively constrained shorter journeys will act to constrain the price a monopolist rail supplier can charge for longer rail journeys. If the hypothetical monopolist were to increase the price of the longer journey (where the rail price is higher initially and therefore makes up a higher proportion of the final delivered rail price) the generators will switch to using the shorter flow with its competitively constrained price.

---

<sup>228</sup> In response to a section 26 notice of 11 May 2001.

177. It is important to probe carefully any market definition dependent on a chain of substitution, as it is necessary to establish that the chain holds in practice and not merely in theory. A break in any link in the proposed chain would suggest that separate markets exist. The European Commission guidelines on market definition note<sup>229</sup>:

“From a practical perspective, the concept of chains of substitution have to be corroborated by actual evidence, for instance related to the price interdependence at the extremes of the chain of substitution, in order to lead to an extension of the relevant market in any individual case.”

178. Fundamentally, it does not appear that coal haulage by road competes with coal haulage by rail for any distance, particularly in light of the evidence regarding capacity constraints and customer evidence (discussed above).

179. Notwithstanding the above fundamental reasons for why road and rail are not in the same relevant market even for shorter flows, the pricing analysis is inconclusive. Arguably, this single analysis in isolation does not allow rejection of the hypothesis that road and rail might compete, however, it does not provide good evidence that they do. Certainly, the hypothesis that road haulage constrains rail prices on longer flows can be rejected. This can be seen from the following Table 6.

180. Considering only those origin-destination pairs of 40 miles or less, with at least two price observations, indicates that for 50% of these origin-destination flows, the road price exceeded the rail price by 110% or more on average. For the origin-destination pairs over 40 miles apart, with two or more observations, the proportion with an average road-to-rail price differential of 110% or more was 78%.

---

<sup>229</sup> The Commission Notice on the definition of the relevant market for the purposes of Community competition law (OJ C372, 9/12/1997, page 5, paragraph 58).

**Table 6. Road and rail origin-destination pairs where more than one price comparison is possible**

<i>Flow</i>	<b>Distance by rail (* denotes ORR estimate, otherwise from EWS Standard Cost Model or Frontier)</b>	<b>Average price differential</b>
Thoresby - Cottam	34	91%
Seymour - Ratcliffe	*32	98%
Oxcroft - Ratcliffe	*37	98%
Clipston-Ratcliffe	*68	98%
Daw Mill - Ratcliffe	*43	100%
Thoresby - Ratcliffe	*37	101%
Harworth - Cottam	35	105%
Welbeck - Cottam	31	106%
Swains Park - Ratcliffe	*33	107%
Bentinck-Ratcliffe	*18	107%
Welbeck - Ratcliffe	*41	115%
Harworth - Ferrybridge	28	118%
Prince of Wales - Ferrybridge	4	128%
Maltby - West Burton	*28	129%
LBT - Fiddler's Ferry	*29	130%
Maltby - Cottam	28	145%
Kellingley - Ferrybridge	5	171%
Daw Mill - Rugeley	*32	173%
Daw Mill-Drakelow	*24	177%
Hunterston - Longannet	110	184%
Daw Mill - Ironbridge	*46	186%
HIT - West Burton	*91	194%
Portbury - Rugeley	*136	201%
Hunterston - Cockenzie	*97	230%
HIT - Rugeley	*128	241%

*Additional costs: customers' views of the price of road haulage compared to rail haulage*

181. The conclusion that road haulage prices are simply too high to represent a competitive constraint on rail haulage prices is also borne out in more general statements from the generating companies and coal suppliers. For example:

- SCCL<sup>230</sup> has stated: *“Rail is invariably the cheapest means of transport available to both SCCL and its customers.”*
- A *“Review of Edison First Power Ltd.’s Coal Supply Strategy For the Lenders”* dated June 1999<sup>231</sup> noted: *“LBT has the capacity and license to load up to 250,000 tonnes per year of coal into lorries. However low rail freight rates*

<sup>230</sup> SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/138]

<sup>231</sup> A consultancy report commissioned by Edison First Power Limited and provided by AEP in its response dated 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/12.42]

*generally are more competitive than lorry rates. EFPL does not plan to use lorries to transport any significant tonnage to Fiddlers Ferry.”*

- AEP has stated<sup>232</sup>: *“AEP itself has not made any substantial contracts for use of road [...] transport services. As such, and because road haulage is generally substantially more expensive (for instance [...] per tonne from Immingham to Ferrybridge for haulage by road vs. £[...] for rail) AEP does not request quotes for road haulage on a regular basis. When a train can be loaded AEP uses trains.”* This last statement is especially significant since it suggests, for AEP at least, that road is largely used in situations where rail cannot be used, i.e. that where road is used it is not in competition with rail.
- Drax also has advised<sup>233</sup> that it does: *“[t]ake a bit of coal now by rigids [rigid sided lorries] [from a small private drift mine with no rail loading point] but this is only on the margins given the totality of our annual coal burn”*. Drax’s total annual coal burn<sup>234</sup> stands at [...] million tonnes of coal per annum, so that the little it receives from lorries represents less than [...] % of deliveries.
- Corus, a non-ESI user, has stated<sup>235</sup>: *“[...] rail transport clearly outscores road transport”* and includes in its list of factors of why this is so: *“[c]ost, with rail being substantially cheaper”*.

*Additional costs: EWS’s contemporaneous view of the price of road haulage compared to rail haulage*

182. EWS has stated in its 2000 Business Plan<sup>236</sup>: *“EWS’ recent coal pricing policy means that the competitive threat from road is limited except on strategic or other grounds.”*

183. EWS has also acknowledged in its own internal documents that road does not constitute a significant restraint on its pricing, in part because of the price differential between the two modes. In an e mail to Allen Johnson of 15 May 2000<sup>237</sup>, Nigel Jones stated: *“ESI coal prices are generally well below road prices because the threat over the past five years has been open access rail, not road. eg in S Wales the road rate from S Wales supply points to Aberthaw averages[ ... ]/tonne whilst the rail rate is under [ ... ]/tonne.”*

---

<sup>232</sup> AEP response dated 27 January 2003 to an ORR information request of 20 December 2002. [12/1021/2.4]

<sup>233</sup> Drax response dated 27 September 2002 to an ORR information request of 20 September 2002. [8/511.1]

<sup>234</sup> Drax response of 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/1.2]

<sup>235</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO. [33/677A.2]

<sup>236</sup> Provided at document 342 of volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>237</sup> Provided at document 176 of file 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

184. A further factor in road pricing appeared to be a shortage of tipper trucks and escalating fuel prices during relevant period. In the “Notes of a Minerals Marketing Team Meeting” held on 20 January 2000<sup>238</sup>, EWS recorded a: “reduction in the number of tipper vehicles in some parts of the country but not in Scotland”. It also recorded that: “[g]enerally road rates are increasing as a result of fuel price increases. Unlikely that road can provide capacity to meet volume requirements”.

**(v) Other factors that make generators reluctant to use road haulage, namely safety and environmental considerations**

185. The generators identified two other factors that make them reluctant to use road haulage, namely safety and environmental considerations.

*Safety considerations*

186. Drax has advised<sup>239</sup> that it has a policy of refusing delivery of coal by articulated lorry due to a number of previous incidences where articulated lorries have fallen over whilst tipping coal. This has the additional effect of more cost since as Drax has observed<sup>240</sup>:

“The volume of coal that can be transported in rigid bodied vehicles is less and hence delivery costs go up and in almost all cases this makes the delivered cost prohibitive and uncompetitive.”

187. Corus has made a similar observation<sup>241</sup> regarding safety, reporting that it has had [...] instances of tipper lorries falling over in the past [...] years.

188. TXU has referred<sup>242</sup> to additional health and safety concerns arising out of road deliveries which, TXU has advised, are partly the result of less automation and partly the result of the sheer numbers of lorries required to deliver the sorts of volumes of coal that can be delivered by a single train. TXU has referred too to the potential for lorries tipping over and incidences of speeding on power station roads. TXU has also observed that sub-contracting between lorry hauliers also leads to health and safety briefings being diluted or entirely omitted.

*Environmental considerations*

189. Actual and perceived environmental impact is also a factor in modal choice. Electricity generators are conscious of their environmental image and keen to

---

<sup>238</sup> Provided at document 362 of volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>239</sup> Drax response dated 27 September 2002 to an ORR information request of 20 September 2002. [8/511.1]

<sup>240</sup> Drax response dated 27 September 2002 to an information request of 20 September 2002. [8/511.1]

<sup>241</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO. [33/677A.2]

<sup>242</sup> Notes of a meeting with TXU on 18 April 2002. [17/1629.4]

improve it where possible. Rail haulage is seen as a more environmentally friendly method of transportation than road haulage so that the use of rail for coal haulage is seen as a way of reducing public concerns about the company's environmental impact. SCCL<sup>243</sup> has stated: *"Rail is less sensitive environmentally than road haulage, for both SCCL and its customers."* Corus listed<sup>244</sup>: *"noise, fumes, dust, and omissions"* as the environmental effect of using road and a factor which results in: *"rail transport clearly [outscore] road transport"* for the movement of raw materials including coal.

190. The Coal Ink report (dated May 2000), provided by Drax<sup>245</sup>, assessed road transport as one of the environmental considerations associated with the UK Coal Industry. It stated, as an example, that Ferrybridge (within 10 miles of Drax) *"[...] has suffered problems with the local populace regarding lorry transportation into the plant. Coal movements by road were restricted to handle this problem and re-routing adopted. This issue should be examined as part of the due diligence process for Drax"*.

191. A note prepared by Mel Thorley of TXU dated 4 April 2002<sup>246</sup> briefing "Middle Office" on the proposed contract with Freightliner stated: *"Rail has always been our preferred option for coal transport – being more environmentally friendly, less manpower intensive in handling at power stations and cheaper than the alternative of road transport."* TXU also explained<sup>247</sup> that, although not subject to any formal environmental requirement, it monitored levels of CO<sub>2</sub> emissions in connection with its business and that the number of road deliveries required to effect the same tonnage as one train inevitably leads to higher emissions per tonne of road hauled coal.

192. In a report commissioned for Edison First Power Ltd., Promeco<sup>248</sup> stated: *"All road vehicles delivering to Ferrybridge are required to be painted in an easily identifiable livery together with conspicuous I.D. numbers so that any specific vehicle giving rise to a dust, noise fumes etc. nuisance can be readily identified."*

193. A 1999 report which looked at the prospects for future coal supply to the coal fired power stations of Yorkshire<sup>249</sup> stated: *"For environmental reasons, rail and canal are preferred over road traffic. The government operates a scheme of capital grant aid for rail or canal, where it can be demonstrated that investment can reduce road*

---

<sup>243</sup> SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/138]

<sup>244</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO. [33/677A]

<sup>245</sup> Drax response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/3.1]

<sup>246</sup> TXU response dated 25 April 2002 to a section 26 notice of 20 March 2002. [385/197.1]

<sup>247</sup> Meeting notes of the meeting with TXU of 18 April 2002. [17/1629.4]

<sup>248</sup> *"Review of the Materials Handling Facilities at Fiddlers Ferry and Ferrybridge power stations"* dated 27 August 1999, provided in the AEP response of 26 April 2002 to a section 26 notice of 20 March 2002. [414/13.19]

<sup>249</sup> [...]

*traffic.*” The existence of such grant aid reflects a general view that rail is considered to be a more environmentally friendly option.

194. EWS submitted, at paragraphs 3.74 and 3.75 of its Response, that neither safety considerations nor environmental considerations preclude power stations from receiving coal by road and, because power stations continue to use road haulage for part of their deliveries they: “[...] *have no additional bearing on the substitutability of road for rail haulage*”. However, ORR has not suggested that these two considerations mean that road is precluded entirely from hauling coal, simply that the cumulative effect of these restrictions, along with the others already discussed, contributes to the clear preference of the generators to use rail haulage where it is available.

#### *Conclusion on substitution to road haulage*

195. For the reasons set out above, road haulage of coal does not represent a close substitute for rail haulage and does not fall within the relevant product market.

196. In summary, as a result of capacity constraints, a large proportion of coal haulage is effectively captive to rail. This undermines the ability of road haulage to act as an effective substitute for rail haulage in particular because only rail haulage can provide the large and stable volumes of coal supply sought by generators. Even where capacity constraints do not operate, road haulage generally imposes significant additional costs on generators. This is in part as a result of the fact that, for many routes, road haulage prices are materially greater than the rail haulage price. Further, road haulage tends to impose other costs as a result of power station delivery design and the risk of fraud. Generators are also reluctant to use road haulage in the light of safety and environmental considerations. Finally, the conclusion that road haulage does not impose any significant competitive constraint on rail haulage is supported by the views of generators and FHH, with many generators indicating that they would use road haulage only for low volumes and/or in exceptional circumstances.

#### **(d) Substitution to river/canal haulage**

197. The ability to substitute coal haulage by river or canal for haulage by rail is limited by the proximity of a power station and a source point to a suitable river or canal.

198. AEP (now SSE<sup>250</sup>) is the only generating company to have significant capacity to accept deliveries by barge, with Ferrybridge power station capable of receiving coal supplies from local mining operations by barge using the River Aire. [...] <sup>251</sup>[...], that compares to the annual maximum 6.5 million tonnes per year that can be accommodated by rail. During the period March 2000 to December 2002, AEP received almost [...] million tonnes by barge, representing around [...] % of the total

---

<sup>250</sup> Fiddlers Ferry and Ferrybridge were acquired by Scottish and Southern Energy plc (SSE) in July 2004.

<sup>251</sup> [...]

amount received by AEP at Ferrybridge over the period and 2.5% of the total amount of coal delivered by all modes to all UK power stations.

199. EWS submitted at paragraph 3.78 of its Response that canal at Ferrybridge offers a real alternative to rail. However, that position seems to overstate the scope for barge to compete with rail, even at Ferrybridge.

200. A further report by Promeco<sup>252</sup> reviewed the feasibility of alternatives to rail should current and potential future rail capacity constraints: *“jeopardise the economic performance of Yorkshire power stations.”* The premise for the review was that: *“[t]hese alternatives [...] do not need to match the rail transport cost. They could be acceptable as a strategy to minimise power station unit generation cost, in which fuel cost is but one ingredient.”* The report acknowledged that: *“[p]ower station load factor is probably more significant in the economics of generation, and shortage of fuel supply can be a main cause of a reduction in this factor.”* It took as one of the subjects of its analysis a theoretical movement out of Hunterston port. The study’s conclusions were that an additional [...] million tonnes per annum could be transported from Hunterston via Hull and by canal<sup>253</sup>, at a transport cost of around 20% more than rail. The report concluded that this figure represented: *“about 7% on delivered fuel cost, and may be worth consideration, in the short term, to effect security of supply.”* This suggests that any increase in the use of barge would be considered only for short-term strategic reasons.

201. Furthermore a response by AEP (owner of Fiddlers Ferry and Ferrybridge from October 2001 to July 2004) shows how barge transport is limited not only by whether a barge route exists from a source point to the power station, but also whether a physically possible barge route is actually economical<sup>254</sup>:

“AEP has not seriously considered the use of barge transport as there are only two mines on the canal with barge loading facilities: Caroline; and Kellingly. Caroline is shut as of December 2002. AEP is not currently receiving any Kellingly coal, and the barge unloader is scheduled to be decommissioned in the near future. Supply from downstream on the canal, for instance from Humber International Terminal, has been found to be completely uneconomical, with tides and shallow draughts being the principle reasons for its expense relative to rail. AEP has not received price quotes for this barge route as this is not a route on which bulk transport barges currently run at present (so it is not a simple matter of making a phone call) and problems found by initial examination were so substantial that further investigations were deemed unnecessary.”

---

<sup>252</sup> The prospects for future coal supply to the coal fired power stations of Yorkshire provided by AEP in its response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/43.13-414/43.14]

<sup>253</sup> Requiring capital outlay on barge loading equipment at Hull, new barges and a new discharge facility at Ferrybridge to allow simultaneous rail and canal deliveries.

<sup>254</sup> AEP response of 27 January 2003 to an ORR information request of 20 December 2002. [12/1021/2.4]

202. The fact that only one power station, Ferrybridge, is barge connected, together with the evidence that even at Ferrybridge barge cannot provide full and effective competition to rail, leads to the conclusion that coal haulage by barge should not be included in the product market on the demand side.

### **The relevant product market – conclusion on demand-side**

203. For the reasons set out above, demand-side analysis suggests that the relevant product market is that for coal haulage by rail.

### **The relevant product market: supply side analysis**

#### ***Supply-side overview***

204. ORR's conclusion from its demand-side analysis is that the relevant product market is the market for coal haulage by rail. The possibility that operators of rail freight services outside the coal haulage sector would have the capability to switch easily to the provision of coal haulage services and provide an effective competitive constraint on current suppliers of coal haulage by rail, is rejected. The main reasons for this finding are discussed below and include the need for a rail freight operator (not currently active in coal haulage) to obtain appropriate wagons and gain the necessary access to the rail network.

205. EWS stated that it believed the threat of substitution into supply of coal haulage by rail to be real. It stated<sup>255</sup> that there have been a number of entrants to UK rail freight services in recent years and this should be taken as an indication that the costs of setting-up and operating a rail freight service are unlikely to represent a significant barrier to entry. However, the hypothetical monopolist test is here being applied to coal haulage by rail and not rail freight generally. There has been only one entrant into the provision of coal haulage by rail, FHH. It is significant that although there are other companies that have considered entry, they have decided against it<sup>256</sup>.

206. The supply-side analysis is structured as follows.

- First, certain points relating to supply-side analysis in the Commission's Notice on market definition and the OFT's Guidelines, are highlighted.
- Second, industry views as to the possibility of supply-side substitution are considered.
- Third, the following barriers to entry which prevent or deter undertakings from entering into the market for the haulage of coal by rail, are identified and assessed.

(a) Wagon procurement.

---

<sup>255</sup> EWS response dated 20 December 2001 to an ORR letter of 21 November 2001.

<sup>256</sup> See footnote 308 below regarding the potential entry in 2007 of GBRfr.

- (b) Existing capacity, wagon build costs and lead times.
- (c) Risk associated with wagon purchase.
- (d) Access to infrastructure.
- (e) Track access charges.
- (f) Demand volatility.
- (g) Stabling sites.

### *Commission Notice and OFT Guidelines*

207. Having defined the product market on the demand-side, it is necessary to consider whether it is appropriate to widen that market definition on the supply-side to include other products from which existing suppliers might quickly and easily switch into the provision of coal haulage by rail. As on the demand-side, the sources of substitution should only be included in the market definition if substitution will be sufficient to constrain a hypothetical monopolist from profitably raising prices in excess of the competitive level. The Commission Notice on market definition states<sup>257</sup>:

“Supply-side substitution may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy. This means that suppliers are able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices.”  
(Paragraph 20)

And:

“When supply-side substitutability would entail the need to adjust significantly existing tangible and intangible assets, additional investments, strategic decisions or time delays, it will not be considered at the stage of market definition.” (Paragraph 23)

208. The importance of recognising additional outlays or delays likely to restrict supply-side switching is also emphasised in the OFT’s guidelines on market definition<sup>258</sup>:

“Supply side substitution can be thought of as a special case of entry – entry that occurs quickly (e.g. less than one year), effectively (e.g. on a scale large enough to affect prices), and without the need for substantial sunk

---

<sup>257</sup> OJ C372, 9/12/1997, page 5.

<sup>258</sup> Office of Fair Trading, Market Definition (OFT403), 2004.

investments. Supply side substitution addresses the questions of whether, to what extent, and how quickly, undertakings would start supplying a market in response to a hypothetical monopolist attempting to sustain supra competitive prices.” (Paragraph 3.15)

It goes on to state at paragraph 3.18:

“The OFT will not factor supply side substitution into market definition unless it is reasonably likely to take place, and already has an impact by constraining the supplier or the product or group of products in question. What matters ultimately is that all competitive constraints from the supply side are properly taken into account in the analysis of market power. Whether a potential competitive constraint is labelled supply side substitution (and so part of market definition) or potential entry (and so not within the market) should not matter for the overall competitive assessment.”

#### *Industry views as to the possibility of supply-side substitution*

209. A paper prepared on behalf of Freightliner in 1999<sup>259</sup> considered the economics, margins, and competitive dynamics of bulkhaul in order to provide a view on whether it was an attractive business proposition for Freightliner. The report stressed that the likely response by the incumbent operator, EWS, would shrink the size of that opportunity and that margins would fall significantly as customers renewed contracts over the following 5-10 years. It concluded: [...].

210. As purchasers of coal haulage by rail, the electricity generating companies have considered the potential for competition, and, in particular, possible entry into provision of coal haulage by rail. In their responses they drew attention to the long lead times for such entry, which they see as being primarily due to rolling stock requirements. This is important since, as noted above, a source of supply-side substitution is not usually included in the relevant market if that substitution would not take place within one year of the rise in price.

211. A paper produced by Promeco<sup>260</sup> on behalf of Enron International in 1999 assessed the viability of competing operators, including the possibilities for entry. It concluded: “[a]lthough GB Railways has a good reputation in the industry, it has yet to launch its freight business and, **given the lead time for the delivery of freight locomotives, the earliest it is likely to be on the scene is over a year away.** Freightliner and Direct Rail Services are, for varying reasons, unlikely to compete for the work, leaving only EWS. There is therefore little alternative to going with EWS in the short-term.” (Emphasis added.)

---

<sup>259</sup> Paper prepared by [...], provided by FHH with its response dated 29 April 2002 to a section 26 notice of 20 March 2002. [5/302/2.3]

<sup>260</sup> Provided by AEP in its response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/14.10]

212. EME<sup>261</sup> in February 2000 considered: “EWS’s monopolistic position as the UK’s rail freight provider” and discussed possible entry. However, it concluded: “[t]o summarise, unlike other service industries, there are limited alternatives for hauling large volumes of coal. Much of the current system, infrastructure and working practices, have been inherited from British Rail. Change is evident, albeit at a pace unable to cope with the rapid changes that we see in the UK generation industry [...] Freightliner has stated that it would require a minimum of nine months to one year lead time before any rail plans can be finalised. Other new entrants would require similar planning periods.”<sup>262</sup>

213. BE in its Business Plan for the year 2000/2001<sup>263</sup> noted, “[EWS] are currently also a monopoly business which does not have to offer competitive prices or terms in its contracts. [However] [c]ompeting suppliers are likely to enter the market later this year [...]” In its Coal Strategy Paper for 2001/2002<sup>264</sup>, however, it noted under the heading “Market Dominance”: “[i]n rail supply there is already a monopoly supplier, EWS. If EWS changed strategy and decided to raise prices, there is little BE could do in the short-run as any new competitor would need to order new rolling stock.”

214. At privatisation of the railways in 1994, Corus explored the market to find alternative rail operators and held discussions with a number of undertakings including DRS, National Power and Irish Rail. It records<sup>265</sup>: “[t]he best potential fit alternative operator we found was that of [...]. During extensive discussions we were able to ascertain their capability, their cost structure, and likely timescales for starting the IBT to Scunthorpe flows. Competitive on price, [...] needed 15 months to get established and procure sufficient locomotives and wagons. They wanted a contract length of at least 10 years. In summary, it was possible to switch providers in 1994/5 but there was a significant risk assessment to be made, and a fairly long lead-time.” This experience fully supports the conclusion that entry by rail hauliers not currently in the market for rail haulage of coal by rail in Great Britain should not be used to widen the market from the supply-side. The necessary conditions highlighted in both the Commission Notice and OFT Guidelines (discussed above) that the alternatives should be capable of entry quickly and without incurring significant additional costs or risks in response to small and permanent changes in relative prices, do not exist here.

---

<sup>261</sup> Rail Freight Study Report dated February 2000 provided by AEP with its response of 3 May 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [415/4.4 and 415/4.6]

<sup>262</sup> E-mail from Anglia Railways to EME dated 19 July 2000 [00415/9]: “Also, as I explained on the telephone we will not be ready to start in January 2001. Our most realistic timescales are nine/ten months from contract signature. This is because of our need to recruit staff, obtain locomotives and wagons and establish an operational presence in Scotland of Northern England”. Provided by AEP in its response of 3 May 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002.

<sup>263</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/2.6]

<sup>264</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/3.4]

<sup>265</sup> Corus response to a non-confidential version of the SO. [33/677A.2-3]

215. It is not sufficient simply for supply-side substitution to be likely (even in the short-run and with no significant investment) in order to justify widening the market definition to include that source of entry. For the market definition to be widened it must be the case that entry from that source is likely to constrain a hypothetical monopolist, in this case of coal haulage by rail, from raising price above the competitive level. This raises the question of capacity. In the short-run and without significant investment, the new entrant must be able to achieve a scale sufficient to allow it to take enough sales from the hypothetical monopolist to render a price rise above the competitive level unprofitable.

216. Drax has recognised this issue<sup>266</sup>: “[u]ntil FHH or other market entrants develop the capability to take over the large volumes of coal movements currently handled by EWS then it [EWS] will be an indispensable trading partner.” TXU has similarly noted<sup>267</sup> the importance of capacity in new entrants’ ability to win business from EWS. Although FHH entered the market in January 2001, writing in April 2002, TXU considered that only “recently” were they “becoming a viable alternative”. TXU also noted that FHH’s initial contract with ECSL and its lack of equipment meant that it was unable to offer at the outset the full range of flows.

217. SCCL observed<sup>268</sup>: “[...]” SCCL further noted<sup>269</sup>: “EWS [represents] an indispensable trading partner in so much as they are currently the only operator capable of undertaking delivery of the full volume of SCCL’s rail-borne production.” It considered EWS’s strength to lie in its extensive route knowledge, its stock of personnel of all categories, its access agreement, its flexibility and the fact that it is not 100% dependent upon coal.

#### **(a) Barriers to supply-side switching - Wagon procurement**

218. Any entrant into the provision of coal haulage by rail will need to secure access to coal wagons (see Annex B *Becoming a railfreight operator in Great Britain*). EWS stated at paragraph 3.86 of its Response that, “[w]agons can be easily bought from a number of suppliers in Europe. National Power, for instance bought wagons in Finland; Freightliner bought its wagons in Poland (as the ORR has noted); and EWS bought its wagons from a company based in York (Thrall Europa).” At paragraph 3.95 it cited a number of recent wagon orders. However, it is not that new wagons are not available to purchase; rather that the difficulties involved in securing that access have been suggested as a barrier to entry into the market for coal haulage by rail by all existing rail freight companies and indeed has been commented upon in EWS’s own internal documents. The barrier to entry associated with wagon procurement is twofold: first, lack of availability of older wagons and infrastructure restrictions on use of larger, newer wagons; and second, sufficient

---

<sup>266</sup> Drax response of 25 April 2002 to a section 26 notice of 20 March 2002. [5/317/1.3]

<sup>267</sup> TXU response of 9 April 2002 to a section 26 notice of 20 March 2002. [5A/380(a).3]

<sup>268</sup> SCCL response of 23 May 2003 to a section 26 notice of 30 March 2003. [1516/22.2]

<sup>269</sup> SCCL response of 23 May 2003 to a section 26 notice of 30 March 2003. [1516/22.3]

existing coal wagon capacity and the sunk costs and lead times associated with new build.

219. EWS, at paragraphs 3.95 to 3.101 of its Response put forward arguments as to why it considered that these difficulties are only minor impediments and certainly not sufficient to prevent existing rail freight operators from entering into the supply of coal haulage quickly and easily. However, a detailed examination of the risks and difficulties associated with the purchase of coal wagons suggests that throughout the relevant period, this remained a significant barrier to entering the market for coal haulage by rail.

#### *Infrastructure restrictions on use of larger, newer wagons*

220. Access to the older, smaller, hopper wagon provides EWS with a significant strategic advantage, particularly given its holdings of this asset. EWS, at year-end 31 March 2003, owned over 6,000 coal hopper wagons<sup>270</sup> including over 2,500<sup>271</sup> of the HAA variety. Not all power stations have modified the station infrastructure (including the weighbridges) to allow acceptance of the newer, larger HHA/HTA wagons, and in some cases weight restrictions on the infrastructure necessary for access to a power station will prevent their use. While it is possible that modification of wagons currently used for aggregates traffic would provide a smaller, versatile, coal wagon alternative, these wagons are either in private ownership (hailed by EWS for the aggregates industry) or owned by EWS itself.

221. Although BE, LEG and Drax confirmed<sup>272</sup> that their power stations can accept all bottom discharge rolling stock currently in use for the haulage of coal in the UK, TXU<sup>273</sup> has advised that a Network Rail imposed weight restriction on the access bridge to Ironbridge power station effectively prevents the use of the new generation of heavier four-axle bogie wagons. Celtic Energy also advised<sup>274</sup> that only the older "Type 47 HAA wagon" is suitable for the coal reception facilities at Fifoots. This is confirmed by Vic Danks, the Plant Manager of AES Fifoots Point, who has stated<sup>275</sup>,

---

<sup>270</sup> From information provided by EWS as an obligation within its licences, Condition 11 of its non-passenger and network licence and Condition 13 of its passenger licence. Return for year ending 31 March 2005 provided by EWS to ORR by e-mail dated 29 April 2005. Holding y/e 2003 was 6880, y/e 2004 was 5990, y/e 2005 5097.

<sup>271</sup> Information provided by Network Rail Rolling stock Library, current at June 2003, see also Table 3 in Annex B *Becoming a Rail Freight Operator within Great Britain*.

<sup>272</sup> BE response dated 5 February 2003 [12/1029/1.3], LEG e-mail response of 14 May 2003 [16/1560.2] and Drax e-mail response of 14 January 2003 to an ORR information request of 20 December 2002. [12/1022.1 to 12/1022.2]

<sup>273</sup> TXU response via administrators Ernst & Young dated 3 June 2003 in response to a section 26 notice of 20 December 2002 and the letters of 21 March 2003 and 7 May 2003. [17/1598.10]

<sup>274</sup> Celtic Energy response dated 7 January 2003 to an ORR information request of 20 December 2002. [12/1205/1.1]

<sup>275</sup> Vic Danks response dated 31 January 2003, via the administrators KPMG, in response to an ORR information request of 20 December 2002. [12/1024/2]

*“[a]t the time the [coal carriage] contract was negotiated AES were unaware of an alternative carrier with the correct size wagons and hence EWS were the only viable carrier. (Freightliner, for instance, has larger wagons which cannot be used).”* Finally, Scottish Power has advised<sup>276</sup> that although both Cockenzie and Longannet power stations can handle both the HAA and HTA wagons at the reception sidings, the rail network constraints on the route to Longannet, prevent use of those larger wagons.

222. Fastline confirmed this view<sup>277</sup> and has said that initially it had planned to procure between [...] and [...] class 66 locomotives and the associated amount of HHA coal hopper wagons to service markets including those in Scotland. [...] Contemporaneous notes of a meeting with Network Rail on 28 January 2003<sup>278</sup> stated that the Forth Bridge was discussed and that, *“EWS are the only UK owner of single axle coal wagons [...].”* It was also noted that the alternative route, via Perth, entailed an extension of the journey by 60 miles and an additional 2½ hours, with the additional requirement to call at the EWS owned sidings at Perth to effect a turn around. [...].

223. EWS acquired the British Rail stock of the older wagon type at privatisation and the second hand market for these wagon types does not include potential sources from other countries because gauging issues mean wagons for use abroad cannot be used in the UK.

224. In an undated paper prepared by ECSL for EME<sup>279</sup> which examined *“The factors involved in the fuel supply strategies of Fiddlers’s Ferry and Ferrybridge plants UK”*, ECSL addressed the risks of rail dependency given: *“[t]he UK rail coal haul is monopolized by EWS”* who were: *“unable to guarantee any level of service”*. ECSL then discussed briefly the alternative strategy of constructing an in-house freight haulier through the purchase of coal wagons and locomotives. ECSL observed, however: *“[t]his is a difficult option, as the coal cars which were built to be compatible with UK coal loading and unloading equipment have been out of production for several years. The majority of the existing cars are held by EWS, who is unwilling to sell them at any price”*.

225. In a further undated paper<sup>280</sup>, ECSL expressed a similar view:

*“All coal-fired power stations in the UK are designed to take the HAA coal hopper wagon. The HAA was designed and put into service by British Coal in the 1960’s and still serves as the primary delivery vehicle for rail-transported*

---

<sup>276</sup> Paragraph 7 of Scottish Power response dated 24 January 2003 to an ORR information request of 20 December 2002. [12/1023/1.3]

<sup>277</sup> Fastline response dated 19 June 2003 to a section 26 notice of 8 May 2003. [16/1538/4.2]

<sup>278</sup> Provided by Fastline in its response of 18 June 2003 to a section 26 notice of 8 May 2003. [16/1538/31.1]

<sup>279</sup> The AEP response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002. [414/41.7]

<sup>280</sup> The AEP response of 26 April 2002, reissued on 4 April 2002. [414/42.1]

coal. The HAA was manufactured at several facilities throughout the UK, the last wagons being produced in 1993 by RFS Engineering in Doncaster. EWS inherited around 11,000 HAA (36 ton<sup>281</sup>) 2 axle bottom-discharging coal wagons when it acquired the 3 coal hauling companies of British Rail in 1995. At the time, the total coal haul in the UK was around 50 million tons. Since 1995, coal burn (hence haul) has declined about 50 percent. EWS undertook a program to dispose of excess HAAs through conversion into box cars, stripping for spare parts, or selling old units for scrap. At present, it is estimated that EWS still retains about 6500 HAA's [sic] in its fleet, of which 10 percent (around 650) are sitting idle in various railroad stockyards throughout the country. National Power also maintained a small fleet of 102 ton coal cars which were manufactured by Powell-Duffryn in France. These were purchased by EWS in the mid-1990s. At present, EWS has owns [sic] every HAA in the UK and is unwilling to sell any HAAs or the National Power cars to third parties at any price."

226. This unwillingness to sell coal wagons was borne out by an exchange of correspondence between Fastline and EWS. Fastline wrote to EWS on 19 May 2003<sup>282</sup> expressing interest in: "[...] purchasing a number of your redundant MGR [Merry-go-round] wagons". EWS responded to this offer on 11 August 2003<sup>283</sup> with: "[...] EWS does not anticipate that any of the above [MGR wagons] vehicles will be coming up for sale at the moment."

227. However, EWS submitted at paragraph 3.98(b) of its Response that spare wagons have subsequently become available and that it was in negotiation with Fastline to sell it 80 HAA wagons. These negotiations were confirmed by Fastline, in its response of 23 June 2005<sup>284</sup> (at paragraph 3): "Fastline has received a price from EWS for the purchase of 80 HAA wagons at £[ ... ]k per wagon. We were convinced that the price quoted by EWS was very expensive, however the need to enter into negotiations with EWS was negated as a result of the above decision [not to enter coal haulage by rail]."

228. However, during the relevant period EWS did not sell any surplus coal wagons to either existing rail operators or potential entrants.

229. EWS submitted at paragraph 3.100 of its Response, that the effect of it holding all the HAA rolling stock is not in fact material, as: "[w]ith the exception of Wilton and Longannet power stations, it is possible for all power stations to accept

---

<sup>281</sup> This is an American measure slightly different to the UK tonne. The payload of an HAA wagon is [...] tonnes (information taken from EWS's [...] Cost Model).

<sup>282</sup> Letter provided by Fastline with its response of 18 June 2003 to a section 26 notice of 8 May 2003. [16/01538/80]

<sup>283</sup> Letter from EWS to John Protheroe at Fastline dated 11 August 2003, provided by Fastline to the ORR in October 2003. [21/1795A]

<sup>284</sup> Fastline representations dated 23 June 2005 to a non-confidential extract of the EWS Response. [27/266.1]

*the larger HTA wagons and EWS believes the cost of converting stations to accept the HTA wagons is at most £100,000.”*

230. EWS also submitted that: “[...] *it is possible to build new HAAs [...]*” and claims (without supporting documentary evidence) that: “[...] *it has obtained verbal cost estimates and expressions of interest from manufacturers during previous reviews of options for new coal wagons*”. FHH, however, strongly disagrees<sup>285</sup>:

“EWS has consistently refused to lease wagons to Freightliner and Freightliner is therefore required to order new wagons to conduct its business. This position is clear in respect of the HAA wagon. In order to access Longannett, it is essential to use HAA wagons due to their lighter load in order to be able to cross the Forth Bridge. Freightliner does not have access to HAA wagons and therefore requested leasing of such wagons from EWS. These requests have been refused. Freightliner is unable to source any new build HAA wagons and alternatives are unproven. Furthermore, Freightliner would be unable to secure leasing arrangements in respect of the HAA even if it were able to obtain these wagons from EWS. Leasing companies will not offer operating leases for HAA wagons as they will not take the risk associated with an asset which is nearing the end of its useful life. Any operator therefore wishing to source HAA wagons, assuming that EWS would be prepared to sell wagons to new entrants which has not been the experience of Freightliner, would therefore need to finance such a purchase from its funds, a position which is unheard of in respect of market entrants.”

231. Whilst the number of power stations restricted to HAA wagons is few, EWS also points out, at paragraph 3.18 footnote 75 of its Response, the number of routes across the network which can only be served by HAA wagons is as high as 40. Furthermore any cost for converting a power station to use HTA wagons (even if EWS’s estimate is correct), will still mean that the entrant is going to be at a disadvantage vis-à-vis an incumbent, as the incumbent’s wagons require the generator to make no additional outlay in converting its facilities whereas using the entrant means incurring significant switching costs. Finally, even if all power stations were able to take the new HTA wagons the barrier imposed by restrictions on the rail network infrastructure would still remain.

#### **(b) Barriers to supply-side switching – Existing capacity, wagon build costs and lead times**

232. Because there is already sufficient coal wagon capacity in the UK to carry the coal that moves by rail, leasing companies have shown reluctance to make opportunistic purchase of the newer wagon type. Thus a potential new entrant needs to enter into direct purchase with the manufacturers representing both an upfront cost and a significant time lag between placing an order and taking receipt. This is borne out by discussions within EWS’s own contemporaneous documents. For

---

<sup>285</sup> FHH representations dated 16 May 2005 to a non-confidential version of the Response (paragraph 2.36). [27/228D.14]

example, in a memorandum to the Board dated July 2000<sup>286</sup>, which inter alia reports on a G.E. Capital industry seminar held on 28 June 2000 to: “*gauge interest in lease fleet of coal hoppers*”, it is remarked: “[*t]he general consensus was that there were currently sufficient wagons in the system, particularly given EWS current investment in a new fleet, and that the industry could not afford to support additional speculative investment*”.

233. Documentation provided by EWS has shown that EWS certainly appreciated the importance of coal wagons in this market. An internal e-mail dated 8 March 2001 referring to the EWS Business Plan<sup>287</sup> gave an indication of the volume of assets needed to fulfil the national coal haulage business. “*The Coal business planned to utilise 5,788 wagons this year [...] The most significant business is power station coal which utilises roundly 86% of the wagons used in the Coal Business.*”

234. At section 4 of its Minerals Business Plan 2000<sup>288</sup>, EWS undertook a competitive analysis of the coal and other minerals sector. Whilst noting: “[*t]here is currently no on-rail competition in this sector*”, they also noted: “[*t]he key barrier to entry is the lack of suitable wagons for hire*” and that, “[*t]he continuing market volatility reduces the risk of customer investment in an alternative coal wagon fleet*”. It further noted that a major weakness for Freightliner was the: “*lack of suitable wagons for coal*”. Similarly it is noted that DRS had: “[*n]o access to coal Wagons*”, and that Mendip Rail had hopper wagon familiarity: “*but no access to coal wagons*”. The conclusion within the plan is, therefore, that: “[*t]he scope for the impact of a non-EWS wagon fleet is limited during the plan horizon [2000-2003] and it has therefore been discounted [...]*”. However the potential threat of future investment: “*underlines the importance of negotiating new arrangements with [newer customers] as quickly as possible [...]*”. It raised, for example, the possibility of disaffected third parties and suppliers (e.g. ECSL) presenting a joint proposal to leasing groups to invest in suitable wagons and further noted that ECSL had: “*explored market potential for market supply*”.

235. EWS further noted the strategic significance of suitable wagons in an internal e-mail dated 15 May 2000<sup>289</sup>, under a sub-heading, “*Competition*”, it noted: “*Freightliner have met all key coal customers*” but: “[*i]n both Metals and Minerals, shortage of third party wagons is our strength [...]*”. A further internal business plan<sup>290</sup> noted: “*We have assumed that on-rail competition will not affect the Minerals*

---

<sup>286</sup> Provided by EWS at document 522 of volume 5 to its response to a section 26 notice of 19 March 2002.

<sup>287</sup> E-mail from David White dated 8 March 2001 provided by EWS at document 56 of supplemental documents in response to a section 26 notice dated 19 March 2002, following letters dated 25 September 2002 and 16 October 2002.

<sup>288</sup> Provided by EWS at document 342 of volume 3 to its response to a section 26 notice of 19 March 2002.

<sup>289</sup> E-mail from Nigel Jones to Allen Johnson provided by EWS at document 450 of volume 4 of its response to a section 26 notice of 19 March 2002.

<sup>290</sup> EWS Minerals Business Plan, “*Key Discussion Items*”, provided at document 724 of volume 6 of EWS’s response to a section 26 notice of 19 March 2002.

*portfolio over the plan period primarily because of the need for an alternative wagon fleet [...] it is unlikely another operator could make an impact before 2002/3 unless EWS was forced to divest wagons.”* Given that this was written in May 2000, it suggests that difficulty in obtaining wagons would result in new entry not occurring in a material sense for 2 years.

236. This view of coal wagons as wholly necessary for the haulage of coal by rail and also as difficult to secure access to, is supported by evidence from other rail freight companies.

237. FHH<sup>291</sup> has referred to the difficulty of placing orders for coal wagons with a UK supplier and has advised that Thrall UK and Greenbrier Europe (based in Poland) are the only suppliers of rail wagons. FHH has also advised that,

“Although Thrall were keen to offer Freightliner the same design as that available to EWS, a production run would not have been available until after all EWS commitments had been satisfied. The implicit lead-time was therefore unacceptable for a process whereby the opportunity to Freightliner was driven primarily by the glut of coal transportation tenders in issue towards the end of 2000.”

238. FHH also considered the possibility of leasing wagons, however, this agreement required the purchase of wagons to lease to FHH. The wagons leased by FHH were not available ‘off the shelf’, as no spare wagon capacity existed outside EWS. Thus, even entering into a lease deal, a new entrant would not be able to avoid the long lead times involved in wagon procurement.

239. FHH eventually placed an order with Greenbrier of Poland in July 2000 at a price of [...] per wagon<sup>292</sup> and financed this purchase with a lease back arrangement with a leasing company. It took delivery of the first tranche of 18 wagons [...] months later in December of that same year, but by September 2001 (14 months after the initial order) had only taken delivery of 127 units, with the order for a total of 350 wagons completed early in 2003<sup>293</sup>. Nevertheless, at paragraph 2.38 of its 16 May 2005 representations<sup>294</sup>, FHH has indicated that in respect of its first delivery of wagons:

“Freightliner obtained delivery of its wagons in [...] months from the date of order from Greenbrier. However, these wagons were not functioning correctly at the time and therefore there was a significant delay in such wagons becoming operational.”

---

<sup>291</sup> FHH response dated 29 April 2002 to a section 26 notice of 20 March 2002. [5/302/1.4]

<sup>292</sup> FHH response of 29 April 2002 to a section 26 notice of 20 March 2002. [5/302/28]

<sup>293</sup> FHH response dated 8 January 2003 to an ORR information request of 27 November 2002. [12/1063]

<sup>294</sup> FHH representations dated 16 May 2005 to a non-confidential version of the EWS Response. [27/228d.15]

240. EWS has pointed to such time scales as evidence that supply side entry could easily occur inside a year, given FHH took the first delivery of its wagons within 6 months. It further cited a number of documents at paragraph 3.98 of its Response, which record discussions a number of prospective entrants (including Rail Management services, Direct Rail Services (DRS)<sup>295</sup> and GBRf) have had with wagon manufacturers, which it submitted supports this conclusion.

241. However the date at which the first wagons are delivered is not what is central to assessing supply side entry. As EWS itself noted above, the relevant period is how long before the entrant can make an “*impact*”, that is, build up sufficient capacity to constrain the pricing of a hypothetical monopolist. The experience of FHH, in this regard, suggests that the time involved to build up capacity is likely to be significant.

242. In its 16 May 2005 representations (paragraph 2.38)<sup>296</sup>, FHH suggested that lead times are currently around [...] months and that it expects this position to deteriorate as a result of EWS’s recent acquisition of Probotec, a bogie manufacturer<sup>297</sup>.

243. As a result of the lead times in acquiring appropriate wagons for coal haulage by rail, in addition to incurring the associated sunk costs, an operator switching into coal haulage by rail is highly unlikely to develop sufficient capacity to constrain a hypothetical monopolist in that market. The capacity constraints faced by the only entrant during the relevant period is revealed in the following Table, based on FHH’s estimated maximum capacity for the haulage of coal by rail since its entry:<sup>298</sup>

---

<sup>295</sup> ORR describes the nature and size of GBRf’s and DRS’s activities in the discussion of potential competition in the *Assessment of Dominance* below.

<sup>296</sup> FHH representations dated 16 May 2005 to a non-confidential version of the EWS Response. [27/228D.15]

<sup>297</sup> At paragraph 2.34 of its 16 May 2005 representations<sup>297</sup>, FHH has identified EWS’s acquisition of Probotec as a further hindrance to supply-side substitution and entry. FHH has explained that the bogie system for the HHA wagon is produced by only one manufacturer, Probotec: “[...] which also owns the design rights to such bogie system. No other manufacturer is therefore in a position to manufacture the bogie system without obtaining a licence from Probotec.”

<sup>298</sup> March 2000 to May 2001 figures supplied in FHH response dated 7 September 2001, [22/2076.7] remaining data supplied in FHH response dated 8 January 2003 to an ORR information request of 22 November 2002. [12/1063]

**Table 7. FHH maximum capacity since entry in January 2001**

	<b>Monthly Capacity ('000 tonnes)</b>	<b>Annual Equivalent ('000tonnes)</b>	<b>Weekly Equivalent ('000tonnes)</b>	<b>Annual equivalent capacity relative to market annual tonnage**</b>
<b>March 2000 to December 2000*</b>	[...]	[...]	[...]	[...]
<b>January 2001*</b>	[...]	[...]	[...]	[...]
<b>February 2001*</b>	[...]	[...]	[...]	[...]
<b>March 2001*</b>	[...]	[...]	[...]	[...]
<b>April 2001*</b>	[...]	[...]	[...]	[...]
<b>May 2001*</b>	[...]	[...]	[...]	[...]
<b>June 2001</b>	[...]	[...]	[...]	[...]
<b>July 2001</b>	[...]	[...]	[...]	[...]
<b>August 2001</b>	[...]	[...]	[...]	[...]
<b>September 2001*</b>	[...]	[...]	[...]	[...]
<b>October 2001*</b>	[...]	[...]	[...]	[...]
<b>November 2001*</b>	[...]	[...]	[...]	[...]
<b>December 2001</b>	[...]	[...]	[...]	[...]
<b>January 2002</b>	[...]	[...]	[...]	[...]
<b>February 2002*</b>	[...]	[...]	[...]	[...]
<b>March 2002</b>	[...]	[...]	[...]	[...]
<b>April 2002</b>	[...]	[...]	[...]	[...]
<b>May 2002*</b>	[...]	[...]	[...]	[...]
<b>June 2002</b>	[...]	[...]	[...]	[...]
<b>July 2002</b>	[...]	[...]	[...]	[...]
<b>August 2002*</b>	[...]	[...]	[...]	[...]
<b>September 2002</b>	[...]	[...]	[...]	[...]
<b>October 2002*</b>	[...]	[...]	[...]	[...]

<b>November 2002*</b>	[...]	[...]	[...]	[...]
<b>December 2002</b>	[...]	[...]	[...]	[...]

\*Data provided by FHH. Weekly equivalents where no data provided calculated by linear interpolation by ORR.

\*\*Calculated by reference to SRA National Rail Trends total coal haulage by rail data.

244. From the end of December 2002 to December 2004, FHH's capacity evolved as follows:

**Table 8: FHH capacity from end December 2002**

	<b>Monthly Capacity ('000 tonnes)</b>	<b>Annual Equivalent ('000tonnes)</b>	<b>Weekly Equivalent ('000tonnes)</b>	<b>Annual equivalent capacity relative to market annual tonnage**</b>
<b>June 2003*</b>	[...]	[...]	[...]	[...]
<b>December 2003*</b>	[...]	[...]	[...]	[...]
<b>June 2004*</b>	[...]	[...]	[...]	[...]***
<b>December 2004*</b>	[...]	[...]	[...]	[...]***

\*Data provided by FHH in its response dated 16 May 2005 to an ORR information request dated 15 April 2005 [27/228(a).1].

\*\*Calculated by reference to SRA National Rail Trends total coal haulage by rail data.

\*\*\*Note: the reduction in FHH's capacity relative to total market haulage is due to the significant increase in coal haulage by rail in 2004/05.

245. TXU noted<sup>299</sup> that, in March 2001, FHH could not assist during a period of high cancellation by EWS: “[f]reezing weather is no longer a problem but EWS are still cancelling trains. EWS resources are so stretched that they have now declined some extra business next week. We offered [...] trains to Freightliner but unfortunately they do not have sufficient resources next week (availability will increase late April following delivery of more wagons)[...]”

246. The impact of FHH's capacity constraints on its ability to compete effectively in coal haulage by rail during the relevant period is also discussed in the analysis of bidding markets below.

<sup>299</sup> Fuel Trading weekly report w/e 16 March 2001 provided in the TXU response of 25 April 2002 to a section 26 notice of 20 March 2002. [385/172.2]

**(c) Barriers to supply-side switching – Risk associated with wagon purchase**

247. The wagons used to transport coal are specialised and cannot be used for alternative purposes. Combined with the fact that there already exists sufficient capacity to serve the entire market within EWS, this means that the opportunity for resale is likely to be limited, increasing the risk associated with their purchase.

248. An e-mail from Freightliner to Eastern Power and Trading (latterly TXU) of 12 January 2000<sup>300</sup> regarding an earlier approach by Freightliner to that company acknowledged the need for Freightliner to buy equipment upfront, indicating its willingness to speculatively purchase locomotives but highlighting the difficulty in taking the same approach with wagons:

“We have realised that entering the heavy haul market will be much easier for Freightliner if we can be seen to acquire some equipment etc ahead of full contractual commitment from customers. Our financiers have supported this in the case of locomotives, and we will soon be announcing the acquisition of further heavy haul capability; of course it will be possible to use the locos in mainstream business if the other prospects do not materialise. We would now like to try to do something similar with coal wagons, but we don’t have an existing use for them [...]”

249. In view of the risk associated with acquiring wagons (and indeed other inputs), FHH has sought to avoid ‘speculative purchase’ by ensuring that acquisition is on the basis of specific business. A 1999 paper prepared for it by [...] stated: “[...]”<sup>301</sup> FHH’s committed assets value proposition (‘COMAS’) is consistent with this in that it dedicates rolling stock, drivers, train crew, management and planning to each contract.

250. EWS cited at paragraph 3.98(b) of its Response the experience of Fastline in support of its contention that the procurement of wagons does not constitute a barrier to entry into the haulage of coal by rail. It also listed, at paragraph 3.99, a number of leasing firms which have built or converted wagons for the UK markets, and stated: “*there is an active market in wagon leasing, including large companies that will pursue profitable opportunities in wagon leasing*”.

251. However, Fastline referred<sup>302</sup> to the difficulty of procuring specialised wagons, which cannot be redeployed elsewhere within the business, without the risk sharing benefit of a long-term back-to-back contract, which shadows the leasing arrangement. [...]”<sup>303</sup> *undertaking from [confidential] to secure the full payments on a back-to-back basis.*” [...]

---

<sup>300</sup> Provided by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002. [385/192.1]

<sup>301</sup> [...]

<sup>302</sup> Paragraph 21 of minutes of meeting held on 12 June 2003. [20/1855a.5]

<sup>303</sup> Fastline response dated 19 June 2003 to a section 26 notice of 8 May 2003. [16/1538/4.7]

252. SCCL had similar concerns, in responding<sup>304</sup> to whether or not it would consider entering the market on its own account. It also referred to the need for supply contracts which underpin those initial entry costs. It noted:

“With the nature of the UK coal market having progressively changed since privatisation of the generators, from its historic multi-year index-linked contracts to what effectively comprises almost a spot market, it is very difficult to contemplate entering into high value, long term lease or purchase agreements for locomotives and rolling stock without the comfort of long term sales contracts.”

253. DRS also identified problems in securing access to rolling stock generally as a problem in entering into provision of coal haulage by rail. In 2000, DRS entered into discussions with ECSL about the creation of a joint venture. However, in its response, DRS stated that the commercial relationship with ECSL was not progressed partly because the term offered by ECSL did not, in its view, justify the significant investment required for the rolling stock necessary to resource this business<sup>305</sup>. The procurement of wagons was seen as a particular problem. In response to a joint expression of interest by ECSL and DRS, Engineering Link in a letter to ECSL dated 21 February 2000<sup>306</sup> provided a quote for the design, testing and associated costs of a new HAA wagon design to be of the order of approximately £[...], assuming a ten month build period. Engineering Link assumed, at that time, that the first wagon could be made available within 12 months.

254. EWS cited GBRailfreight (GBRf), at paragraph 3.90 of its Response, as supporting its contention that barriers to entry for an existing passenger operator would also be relatively low. It observed that GBRf<sup>307</sup> was founded in 1999 by a passenger operator wishing to expand into freight haulage and also observed it is now an established rail-freight operator. ORR describes the nature of GBRf's activities in the discussion of potential competition in the *Assessment of Dominance* below, where it also notes that GBRf's first freight operations did not commence until the spring of 2001. [...] <sup>308</sup>, availability of wagons is considered a particular barrier to entry<sup>309</sup>.

---

<sup>304</sup> The SCCL response dated 23 May 2003 to a section 26 notice of 30 April 2003. [1516/150]

<sup>305</sup> DRS response dated 25 April 2002 to a section 26 notice of 20 March 2002. [5/301/1.2]

<sup>306</sup> Letter provided in DRS response dated 25 April 2002 to a section 26 notice of 20 March 2002 [5/301/36.2]

<sup>307</sup> EWS also cited [at 3.92/p59] of its Response an e-mail from Anglia Railways to EME dated July 2000 [00415/9] estimating a start time of January 2001 for freight haulage and a further nine to ten months timescale for entering into coal haulage. GBRf became the sister company to Anglia Railways, which provides the freight services referred to in this exchange

<sup>308</sup> [...]

<sup>309</sup> FHH, in its response dated 5 June 2006, to a confidential version of the SO, advised that GBRf has recently secured a tranche of tonnage with Drax commencing operations in the first quarter of 2007 [see in particular footnote 10 of the FHH response]. [33/679B]

255. In support of a grant aid application to the Scottish Executive at that time being considered by SCCL, GBRf in a letter of 26 November 1999 provided an indicative purchase price of a Class 66 locomotive as £1.6 million and a 102 tonne gross laden weight bogie hopper wagon as £85,000. That weight suggests that the wagon being proposed is of the newer larger capacity variety such as the HHA or HTA. According to the EWS Frontier cost model<sup>310</sup> a train can consist of up to 19 HTA wagons, which together with the above price per wagon implies an outlay of £1,615,000 simply to acquire sufficient wagons for a single trainload. Adding in the above price per Class 66 locomotive gives a total outlay of £3,215,000 per coal train.

256. GBRf also gave details of a quote provided in May 2001 by GE Rail Services for the rental of new-build Coal Hopper equipment. The prices varied according to rental period and whether or not maintenance services were included, and are shown in Table 9 below<sup>311</sup>.

---

<sup>310</sup> Provided by EWS in electronic format in response to a section 26 notice of 27 November 2002.

<sup>311</sup> GBRf response dated 3 May 2002 to a section 26 notice of 20 March 2002 [5/309/35.2]

**Table 9. Rental charges for a new build 102 tonne coal hopper**

Term (years)	Maintenance inclusive price (£)*	Maintenance exclusive price (£)*
5	[...]	[...]
10	[...]	[...]
15	[...]	[...]

\*All prices are annual and per wagon and fall within the range £6-12k, with rental charges falling the longer the lease period.

257. GBRf also stated, however, that it has not “up to this point, been prepared to speculatively purchase wagons in order to enter the rail haulage market”. It has also suggested that only if some annual payment or tonnage commitment were made would it be prepared to make this investment<sup>312</sup>.

258. This further accords with the experience of Corus<sup>313</sup>, cited previously in the discussion of “Industry views as to the possibility of supply-side substitution” above. Corus has explained that at rail privatisation in 1994, it had explored the possibility of contracting with an alternative operator. The best potential fit for Corus was [...]. Discussions with [...] confirmed that not only would [...] require 15 months to get established and procure sufficient locomotives and rolling stock but would also require a contract term of at least 10 years.

259. FHH confirmed this view and has stated that the position set out in the Response in relation to wagon leasing firms is no longer accurate<sup>314</sup>:

“As the ORR recognises at paragraph 357 of the Notice, lending banks perceive that the market for wagons is now saturated and therefore wagon-leasing firms are not prepared to risk ordering new wagons; neither is it possible for new entrants to obtain viable operating leases on existing wagons. The risk associated with operating leasing of such wagons has resulted in leasing firms refusing to offer operating leases and operators are increasingly required to rely upon finance leasing arrangements for wagons. Finance leases are unattractive to new entrants as they are on “balance sheet” operations which would therefore require a new entrant to benefit from significant capital reserves in order for it not to be technically insolvent as a result.”

#### **(d) Barriers to supply-side switching – Access to infrastructure**

260. In addition to wagon procurement, another significant barrier to entry into provision of coal haulage by rail is procuring the necessary access to the track. EWS at paragraph 3.86(b) of its Response stated that “track access arrangements are negotiated with Network Rail and approved by the ORR and have clearly not

<sup>312</sup> See footnote 307 above

<sup>313</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO [33/677A]

<sup>314</sup> FHH representations dated 16 May 2005 to a non-confidential extract from the Response (paragraph 2.39) [27/228D.15]

*proven to be a significant constraint to Freightliner entry*'. At paragraphs 3.117-3.121 it discussed the role of the short-term access right in providing for Freightliner's initial establishment as a haulier of coal. It quoted in support of this Freightliner's response to a section 26 notice<sup>315</sup>:

"Despite its often laborious administration requirements and complete lack of any firm contractual rights the STAGA process has allowed Freightliner to establish itself within the coal transportation market by rail."

261. However, without firm contractual rights to run those trains, a train operator will not be able to bid for rights to be converted into timetable slots at the annual bidding cycle with any degree of assurance that its bids will be given any priority or that it will achieve a path which suits its own operational requirements and efficiencies.

262. Moreover, although freight operators may make a bid at any time in the planning cycle for a spot bid or short term planning (STP) bid under the terms of STAGA, (see Annex B *Becoming a rail freight operator within Great Britain*), such bids will only be accommodated within spare capacity. Thus, although an operator will bid for its preferred train slot, STP rights have low priority in the planning process and Network Rail has ultimate discretion and flexibility as to how such bids are slotted into the timetable. The train slot actually provided may not be optimum for the planning of the service. The notified slot, for example, may not allow the operator to plan his services in the most efficient way in terms of allocated rolling stock or train staff. It may also not be suitable for the end customer requirement, particularly if, for example, the slot does not tie in with the opening and closing times at the generator or disposal point.

263. ORR accepts that an existing rail freight operator will already have an access contract, which might confer upon him rights which he can use to offer coal haulage. FHH, for example, for a period 'piggybacked' on the access contract of its parent, Freightliner<sup>316</sup>. However, as explained in Annex B, access contracts generally establish the routes, times and numbers of trains that may be run under that contract. If this would not allow the train operator to fulfil its coal carriage agreement with its customer, the train operator will have to negotiate an entirely new contract or seek an amendment to its existing contract. The timescales for both processes are described also at Annex B.

---

<sup>315</sup> Letter from Freightliner dated 7 September 2001 in response to a section 26 notice dated 10 August 2001 [2/134.1 - 2/134.13]

<sup>316</sup> The Track Access Agreement between Railtrack PLC and Freightliner Limited approved, with modification, by the Rail Regulator on 21 December 2000 and entered into by the parties on 16 March 2001. The contract has an expiry date of March 2006. FHH entered into its own contract with Network Rail on 20 June 2003

264. Given this system, it is clear that an existing stock of firm contractual rights is a considerable advantage to any rail freight operator. It is precisely this advantage to which FHH referred in its general statement that<sup>317</sup>,

“The significant proportion of the coal business available for tender for short or long term opportunities varies in flow pattern and between haulier at very short notice and certainly out with the timescales and lead times established within the present track access regime.”

265. Furthermore, given the long timescales involved in the railway timetable planning process (described in detail in Annex B), EWS would have bid for and been allocated the slots necessary for it to deliver coal by rail during the summer and winter timetables of 2001, well in advance of entry by FHH (in 2001) into coal haulage by rail. Thus FHH, on entry and during its first year of operation, needed to rely on any residual capacity available under the short-term timetable planning process.

266. In addition to the difficulties experienced by any new entrant wishing to obtain access rights, a new entrant would also face difficulties in securing train paths. As already noted, a new entrant would not be able to secure firm contractual rights which conflicted with those rights already held by EWS. It is therefore likely that a new entrant would seek to use STP paths to service any new coal haulage business. However, where a STP path might conflict with the ability of a holder of firm contractual rights to exercise those rights, Network Rail must confirm that the holder of the firm contractual rights does not wish to exercise his rights with respect to the path before it can award that path to another operator. In this case, this means that a new entrant applying to Network Rail for a STP path for coal haulage cannot be awarded that path until EWS – which holds firm contractual rights on most coal related routes – confirms to Network Rail that it has no need of the path.

267. EWS submitted at paragraphs 3.103-3.105 of its Response that it has always “*sought to work with other rail freight companies in optimising the release of relevant excess capacity [...]*” [3.103] and explained at paragraph 3.112 the mechanisms it had agreed with Network Rail for doing so:

“EWS submits at paragraph 3.130(c) of its Response that the question of Freightliner not being able to use its preferred slots is largely a product of “*business structuring choice by Freightliner. Freightliner’s business model is to run specific trains at specific times, i.e. they would prefer to hold the equivalent of level one access rights for the haulage of coal*”<sup>318</sup>. In contrast EWS does not specifically allocate trains to slots a long time in advance and this yields more flexibility”.

---

<sup>317</sup> FHH response dated 8 January 2003 to an ORR information request of 27 November 2002 [12/1063/1.4]

<sup>318</sup> Level Two rights are those rights which are typically relevant to the carriage of coal by rail. Level 1 rights are firm rights in respect of quantum, origin, destination and timing: level 2 rights are firm in respect of quantum, origin and destination only, with Network Rail having freedom over the timing of the trains in question and the routes they must use.

268. FHH entered into its own track access contract with Network Rail in June 2003<sup>319</sup> (i.e. it no longer ‘piggy backs’ off the parent company’s contract) in which it has opted for a number of Level One rights, which guarantee it specific timings for its service. However this is not so much a business model choice as EWS suggests but a product of the limited size of FHH’s asset base and consequently the restrictions on its operational flexibility. In many senses this highlights the problems faced by an entrant attempting to efficiently utilise its resources with a limited customer base and at the same time trying to compete on the quality of its service.

269. EWS is by far the largest freight operator in the country with not only enough coal specific assets to service the entire industry but bases/depots all over the country out of which it can operate. As such, it runs what can be described as a ‘hub and spoke’ operation constantly moving its resources between depots to maximise resource utilisation and the efficiency of its diagrams as well as providing it with significant operational flexibility. On the other hand a smaller operator without the same resources will need to operate an ‘out and back’ type operation which simply does not afford the same degree of flexibility – see below for the difficulties identified by FHH in relation to access to stabling sites for wagons. Therefore, in order for a new entrant to utilise its resources as efficiently as possible and meet the performance requirements of customers a degree of certainty in the timings of its services is necessary. However, relying only on short-term rights, which must be accommodated around the firm contractual rights of others, particularly EWS, inevitably leads to the entrant facing a less efficient use of resources than it would hope for.

270. FHH has provided its view<sup>320</sup>:

“For Freightliner to run its business on spot rights alone represents a significant risk which is not generally commercially acceptable. For new entrants, which are not established in the market, this commercial risk is likely to prove unacceptable. As the ORR recognises, the majority of contracts are awarded for terms of 1 year or more. Even on the basis of EWS’s reasoning, whereby spot rights may be granted for up to six months, this is clearly not sufficient in order to enable Freightliner and potential new market entrants to plan efficiently their requirements and guarantee levels of service to their customers. In the absence of any guarantees of access to train paths, it is clear that potential entrants are discouraged from entering the market [...] EWS’ submissions in claiming that track access does not represent a material barrier to entry or expansion in coal freight do not therefore bear scrutiny.”

271. EWS has refuted the claim that it holds any material advantage over actual or potential competitors in regard to access contracts or the allocation of train paths, and as cited previously it stated “*it has always sought to work with other rail freight companies in optimising the release of relevant excess capacity*”. In support of this it

---

<sup>319</sup> Contract with Network Rail entered into on 20 June 2003

<sup>320</sup> FHH representations dated 16 May 2005 to a non-confidential extract of the EWS Response (paragraph 2.46) [27/228D.18]

cited at paragraph 3.104 of its Response an extract of a meeting note between itself, Network Rail and Freightliner:

“Since [Freightliner] started operating coal services 2 years ago EWS and [Freightliner] have worked together to agree appropriate utilisation of train paths on the Network Rail network and the allocation of loading/discharge slots at Collieries, Disposal Points and Power Stations. This has been achieved, often with compromise between the parties, and has enabled the overall requirements of the electricity supply industry to be met by the competing Freight Operating Companies.”<sup>321</sup>

272. Freight companies that have considered entry and other industry parties repeat the concerns identified by Freightliner over securing the necessary paths to service its traffic. In a meeting held between Network Rail and SCCL of 13 December 2001<sup>322</sup>, SCCL referred to the need to use the GS&W<sup>323</sup> line between Scotland and England. The meeting notes recorded that Network Rail advised that the current capacity for freight coal traffic on that line stood at 140 paths a week, but that this capacity was not being used effectively. [...]

273. Fastline also noted<sup>324</sup> that access to the appropriate train paths became a key consideration for entry. It stated:

“[...]”

274. GBRf, similarly noted<sup>325</sup> that a factor deterring entry into haulage of coal is access to the network, *“on an equitable basis as EW&S”*. GBRf noted that with the *“excessive access rights which EW&S currently have, they are able to operate in accordance with the flexibility demanded by this [coal haulage] market. This significant network capacity which can be utilised on one occasion, and on another occasion for a different customer. To compete with this GBRf would have to bid for a wide range of possible paths that it might use on the basis the customer may request coal to be delivered to a variety of destinations. There is insufficient network capacity for another operator to bid for the range of paths which EWS hold for this traffic”*.

---

<sup>321</sup> Fax received by W.Wishart (Scottish Coal) from M. Wilks (Freightliner) dated 28 March 2003 regarding information on train paths, notes from a meeting between EWS, Freightliner & Network Rail on 18 December 2002 [1516/108.1 – 1516/108.13].

<sup>322</sup> Notes of a meeting between Network Rail and SCCL held on 13 December 2001, provided by SCCL with its response of 23 May 2003 to a section 26 notice of 30 April 2003 [1516/10.1]

<sup>323</sup> Glasgow and South Western

<sup>324</sup> Fastline response of 19 June 2003 to a section 26 notice of 8 May 2003 [16/1538/4.13]

<sup>325</sup> GBRf response of 3 May 2002 to a section 26 notice of 20 March 2002 [5/309/2.2]

275. It appears that EWS was aware of this strategic potential. In an exchange of internal e-mails on 24 November 2000<sup>326</sup>, David White of EWS stated:

“I presume that all the resources, drivers, locos and wagons required for a 90/week Anglo-Scots plan are actually already deployed elsewhere on a week/week basis? I trust the WTT paths are still in the book? I believe Anglo-S traffic will pick up in January – and being the cautious soul I am would prefer us not to sacrifice any of the WTT slots. Could you also confirm that we have 10 trains per day from LBT to FF in the WTT – and 10 per day from Immingham to Aire Valley (over and above the IBT-CHP trains). This is important to protect us from Fliner [...]”

276. Further a hand written note of a coal team management meeting held on 14 May 2002<sup>327</sup>, referring to an “*Aire Valley Plan*”, records “*ensure that [an EWS employee] understands that FLHH must not “have free choice” on the paths*”, an indication that EWS continued to see the strategic importance of securing to itself, potentially to the detriment of the competition, optimum access to the track.

277. At paragraph 3.112 of its Response, EWS stated:

“Since 1 April 2002, if Network Rail receives a request for firm access rights from a third party that are substantially similar to those held by EWS, the track access agreement allows for Network Rail to request that EWS relinquish those rights so that Network Rail can offer them to the third party (indeed, the track access agreement has always obliged EWS to voluntarily and in good faith relinquish those access rights for which it no longer has a commercial need). Unless EWS can demonstrate a bona fide ongoing commercial need for those rights, they must be relinquished. Where Network Rail believes that EWS is being unreasonable it has the ability to refer the matter to the ORR for determination. This provision ensures that the access rights are ceded to whoever provides the haulage, thereby facilitating competition and allowing customers to move between haul[i]ers easily. To EWS’s knowledge, these provisions have only been invoked on one occasion.”

278. The Regulator consulted on the issues of transfer of access rights between freight operators in July 2003<sup>328</sup>. At paragraph 4.7 of his draft conclusions in December 2003<sup>329</sup>, the Regulator referred to the three main potential problems with existing mechanisms:

---

<sup>326</sup> Provided by EWS at document 50 to its supplemental documents produced in response to the section 26 notice dated 19 March 2002 following the letters dated 25 September and 16 October 2002

<sup>327</sup> Document 148 of volume 3 of documents provided by EWS on 16 September 2005 in response to a section 26 notice dated 17 June 2005. The index to which indicates that these meeting minutes were written by David Griffiths

<sup>328</sup> Model freight track access contract: A consultation document, 31 July 2003

<sup>329</sup> Model Freight track access contracts, A consultation document December 2003

- “(a) the long period of notice (60 days) that an applicant needs to give if it wishes to take over an incumbent’s access rights;
- (b) the difficulty for Network Rail in assessing whether an incumbent has made a case to retain the relevant rights against the criterion of having a reasonable on-going commercial need; and
- (c) the ability of an incumbent to retain the rights and paths in question whilst it disputes their proposed transfer, which could act as a disincentive for competitors considering triggering this mechanism.”

279. This reflects the views of the consultees. Freightliner at paragraph 4.26 of the draft conclusions argued “*that the process for transferring level 2 rights, which were largely synonymous with electricity supply industry coal rights*” in its view, “*has not been at all satisfactory*”. Network Rail advises at paragraph 4.27 of the draft conclusions that “*there had been more disputes about the transfer of level 2 rights than level 1 rights [...]*” and at paragraph 4.28, the Rail Freight Group suggests that “*the main area of concern for the transfer and extinguishment of rights was the electricity supply industry coal market*”. At paragraph 4.31 of the draft conclusions the Regulator summarised the consultees’ concerns with how rights are transferred between operators as: “*All respondents agreed that the existing rocker mechanism could be improved [...]*” apart from EWS which considered that “[...] *the need for change was fairly limited*”.

280. In his conclusions published in June 2004<sup>330</sup>, the Regulator at paragraph 5.5 noted that whilst there had been few problems with the transfer (and non-use) of level 1 rights there had been “*rather more concern about level 2 – more specifically, electricity supply industry coal – rights*”.

281. EWS stated at paragraph 3.112 of its Response that the Regulator, therefore, accepted the argument that in practice there had been few problems to date. The Regulator stated in summarising the situation relevant to both level 1 and level 2 rights:

“Whilst it was arguable that there had been relatively few problems in practice, this did not necessarily mean that the existing contractual arrangements for the transfer and surrender of rights would work successfully in the future [...]. Moreover, even if informal arrangements work satisfactorily between two operators, they are unlikely to work as well with three or more operators”.

He went on to state,

“Against this background, the Regulator considered that – in addition to developing the mechanisms described [...] below<sup>331</sup> – there was a good case

---

330 Changes to Access Rights: Final Conclusions (June 2004)

<sup>331</sup> Including rights review meetings between the operator and Network Rail, Use it or Lose it Provisions, and a review of the criteria and mechanisms by which rights are transferred between operators

in principle for greater use of short-term rights to slots for level 2 or electricity supply industry coal traffic, particularly on congested parts of the network [...] rather than certain operators holding long-term rights and slots in the timetable, with no requirement for them to release unused slots far enough ahead for other operators to use. This would also reduce the parties' reliance on transfer and UIOLI [Use It or Lose It] mechanisms, which are necessarily rather slow processes, in what is a particularly dynamic part of the rail freight market”.

282. Until April 2002, as EWS itself has noted, the only regulatory protection was the provision in its track access contract that if access rights were not used in part or in whole for a continuous period of 12 months such access rights were deemed automatically relinquished (Use it or Lose it provisions “UIOLI”). This clearly does not fit with the timescales required of a new entrant to satisfy a customer.

283. In relation to UIOLI, FHH commented that<sup>332</sup>:

“[...] as regards the "use it or lose it provisions", whereby if a train path is not used during the period of twelve months the access rights for such train paths are deemed relinquished, Freightliner has noted that, on a number of occasions, EWS will run a skeleton service on such train paths in order to maintain its track access rights. In this regard, the ORR will note from the letter attached at Annex 3<sup>333</sup> from Network Rail to Freightliner that Network Rail is unable to release train paths to Freightliner even where such paths are only occasionally used.

Where the "use it or lose it provisions" are invoked successfully, it is worth noting that this process can take up to nine months. In addition, Freightliner is aware of instances in which EWS has over-estimated its track access requirements in order to prove an on-going commercial need for track access rights where Freightliner has requested additional train paths for contracts it has won. As a result, Freightliner has lost business due to its inability to provide a service to its customers. These customers have subsequently been approached by EWS and offered services requiring the same train paths for which EWS had stated it already held a commercial requirement [...]"

284. What is clear is that the structure of access arrangements has presented a barrier to entry for would be entrants to the relevant market.

#### **(e) Barriers to supply-side switching – Charges for track access**

285. EWS has not only enjoyed a significant first mover advantage in terms of allocation of access rights but, until the implementation of the Regulator's freight

---

<sup>332</sup> FHH representations dated 16 May 2005 to non-confidential extracts of the EWS Response (paragraphs 2.44-2.45) [27/228D.17]

<sup>333</sup> Letter from Network Rail to Freightliner dated 16 May 2005 with the heading “*Application for Access Rights Glasgow and South Western*” provided by FHH in its representations dated 16 May 2005 to a non-confidential extract of the Response [27/228D.32-33]

charging review<sup>334</sup>, it has also enjoyed an advantage in its access charges. In its original contract with Network Rail, which commenced in 1997<sup>335</sup>, EWS negotiated an arrangement which allowed it to pay a substantial fixed charge to Network Rail (paid regardless of how many, or whether, trains were operated), in return for a low variable charge (expressed in £s per gross tonne mile for each train actually operated). Under this arrangement, EWS faced a variable track access charge of £[ ... ] per thousand gross tonne miles (kgtm)<sup>336</sup>.

286. The agreement entered into between Freightliner and Network Rail in March 1996 (and subsequently again in March 2001), contained a similar structure of charges in terms of a fixed and variable charge. However this agreement only allowed access to the infrastructure for Freightliner's existing business and did not include charges which could be applied to new traffic such as coal. As a consequence every new piece of business required a separate negotiation with Network Rail. Network Rail would also quote a charge for individual pieces of traffic which consisted of a fixed and variable element. As FHH was unable to spread the fixed element over a portfolio of business, it became an entirely incremental cost to FHH for operating individual traffic.

287. When bidding for traffic FHH, therefore, faced not only a higher track access charge than EWS, but also uncertainty surrounding that charge, significantly disadvantaging it in competing for business.

288. EWS, at paragraph 3.108 of its Response, stated that it "*does not accept that track access cha[r]ges represent a barrier to entry or expansion for its competitors*". FHH has advised, however, that the access charges it was quoted by Railtrack to run trains on a spot basis were well in excess of the variable rate which EWS, through its contract, was able to apply. FHH cited<sup>337</sup> a rate of £[...] per kgtm for flows from Scotland to England and a rate of £[...] per kgtm for short distance indigenous flows from Gascoigne Wood, Prince of Wales and Kellingley to the Aire Valley.

289. By September 2001, however, FHH had managed to achieve a simplified rate of £[...] per kgtm for all coal related traffic, although FHH further noted that<sup>338</sup>, "*[t]he Freightliner track access charge is also an entirely variable charge that therefore sits*

---

<sup>334</sup> The Regulator's Freight Charging Review conclusions of October 2001 provided that in future, until at least March 2007, all freight access rights would be quoted, by Railtrack, at a variable rate. This new structure would apply to any new agreement or amendment submitted to the Regulator post 1 April 2001. This had immediate effect on the EWS agreement approved by the Regulator in March 2001, due to a retrofit provision within that agreement. <http://www.rail-reg.gov.uk/upload/pdf/136-fchargfincon.pdf>

<sup>335</sup> And the successor agreement entered into in March 2001

<sup>336</sup> The successor agreement entered into in March 2001 had a variable charge of £[ ... ] per kgtm

<sup>337</sup> FHH response dated 7 September 2001 to a section 26 notice of 10 August 2001 [2/134.2]

<sup>338</sup> FHH response dated 7 September 2001 to a section 26 notice of 10 August 2001 [2/134.3]

*uncomfortably with the EWS fixed biased track access structure and the associated ability for EWS to cost flows using only the marginal Railtrack charge where competition is most likely*". Although EWS also incurred a fixed charge, the lower variable charge that it faced would have given it a significant advantage when competing for marginal volumes of coal haulage business. EWS would have faced a lower track access charge (per mile) than FHH for any additional coal haulage it undertook.

290. In 2000, DRS<sup>339</sup> had discussions with ECSL about a joint venture in which DRS would provide coal haulage by rail exclusively to ECSL. DRS has advised that this arrangement did not come to fruition in part because of the need for substantial investment in rolling stock, but also because of "*Railtrack pricing*."<sup>340</sup> As already noted, at this time EWS was facing much lower variable track access charges than other rail freight hauliers and it is clear that DRS – along with other rail hauliers – would have faced a significant cost disadvantage as a result. In DRS's new business evaluation for the Redcar-Eggborough flow<sup>341</sup>, for example, it is shown that a significant portion of the total cost of providing the service was represented by access charges, so that EWS's advantageous access charges would have placed DRS in an unfavourable position.

291. This charging arrangement came to an end following the implementation date of the ORR's freight charging review, which set out the principles by which ORR would approve new, or amendments to existing, freight track access agreements from 1 April 2001. Some agreements also had retrospective adjustment mechanisms in their agreements to automatically modify the charges to reflect the freight charging review conclusions. Thus after April 2001, the freight charging review meant that broadly, subject to specific contractual arrangements, the level and structure of track access charges paid by freight operators to Network Rail were the same for all operators. However, the previous charging review applied from 1997 until April 2001 and therefore for over one year of the relevant period, commencing March 2000. Furthermore, its impact seems likely to continue to be felt even after the implementation of the freight charging review since it constituted a considerable first mover advantage for EWS, affording it an advantageous position with respect to actual and potential competitors at a time when entry into coal haulage by rail was being contemplated.

292. Therefore, the difference between EWS's variable track access charge and Freightliner's was such that for a significant portion of the relevant period, EWS could price significantly in excess of costs without the risk of losing business to FHH (even if FHH were otherwise as efficient).

---

<sup>339</sup> DRS response dated 25 April 2002 to a section 26 notice of 20 March 2002 [Heads of Terms between DRS and ECSL at 5/301/8.2 and 5/301/8.3]

<sup>340</sup> DRS response of 25 April 2002 to a section 26 notice of 20 March 2002 [5/301/1.2]

<sup>341</sup> DRS response, dated 25 April 2002 to a section 26 notice of 20 March 2002 [5/301/45.1 – redacted in full for confidentiality]

**(f) Barriers to supply-side switching – Demand volatility**

293. In order to switch into the market for coal haulage by rail, a new entrant will be required to have at its disposal the capacity to haul the volume of coal demanded. This capacity comes in the form of the locomotives and wagons required physically to haul the coal, as well as the necessary number of drivers and train paths. All of these requirements come with a cost attached to them that will have to be financed by the new entrant. In order for entry to occur, it would have to be profitable. This requires the income streams from an investment to be greater than the cost of financing the investment.

294. A high level of demand volatility leads to the creation of a barrier to entry with two consequences: (a) riskier entry and (b) as a response, smaller scale entry. This can be demonstrated by considering the following two demand schedules; in the first, demand faced by the entrant remains constant at 10 units per period in each of four periods, while in the second demand fluctuates between 15 units per period and 5 units per period in a cycle over four periods (15,5,15,5). In both cases the total demand over the whole time period is 40.

295. The negative effect results from the differing capacity requirements experienced in the two examples. In the first case, the capacity requirement remains constant at 10, whilst in the second case it rises to 15 in order to meet the required demand in the periods of peak demand. A firm wishing to enter a market with volatile demand will therefore be required to make a greater initial investment in order to meet the changing demands of the market.

296. This higher level of initial investment, while spread across the same level of market demand, will mean that a new entrant faced with a market characterised by volatile demand will be unable to fully exploit its capacity in all periods. In the example with stable demand all ten units of capacity are fully utilised in each period. In the second example there are two periods where the full capacity is utilised and two periods where only a third of available capacity is utilised. Therefore, this creates a barrier to entry by (a) increasing the level of return required on each unit of sales to ensure that entry is profitable (i.e. a greater revenue must be generated on the same level of overall demand in order to cover the costs resulting from the extra capacity held to meet periods of high demand); or (b) if higher returns per unit of sales are not achievable, the period of time over which the investment can be recouped will be extended, thereby increasing the risk of entry.

297. Alternatively, with volatile demand, entry which might occur (i.e. abstracting from other barriers to entry) will be restricted in scale, so that even during periods of low demand, capacity is at, or close to, full utilisation.

298. The experience of FHH in entering the coal haulage by rail market offers clear empirical evidence that a new entrant's demand profile is likely to be highly volatile. Figure 1 below shows the actual volumes carried by FHH in the period January 2001 to December 2002 following its entry into the market, charted against the peak level of demand that it had experienced up to that point. The graph highlights the volatile nature of FHH's initial growth on entering the market.

## Figure 1 – FHH capacity utilisation – January 2001 to December 2002

[...]

299. Figure 1 above shows the growth trend experienced by FHH on entry into coal haulage by rail. Figure 2 below re-expresses this data to show the utilisation of resources as a percentage of previous peak demand. From this it can be seen that demand volatility meant that FHH's capacity utilisation fell as low as [...]% in August 2001. Overall, the demand volatility results in a total inefficiency of [...]%.<sup>342</sup>

---

<sup>342</sup> [...] represents the minimum possible inefficiency resulting from demand volatility. In reality this inefficiency will be much greater as FHH is likely to have had spare capacity at points of high demand, thus resulting in more unused capacity than is calculated here

## Figure 2 – FHH resource utilisation January 2001 to December 2002

[...]

300. The high level of demand volatility experienced by an entrant in the market can be partly explained by the fact that it will only be able to compete for that demand which is the residual of market demand, after allowing for long-term contracts held by the incumbent. As EWS held long-term exclusive contracts (see part II A, *Assessment of abuse of dominance – Exclusionary contracts*, below) with most of the major customers, expansion was supported through spot bidding. Spot bids represent the marginal demand requirements of generators and as such are highly volatile, reflecting fluctuations in demand for electricity generation. Therefore, any new entrant, without the certainty provided by contractual commitment, will experience a higher level of demand volatility than the incumbent.

301. EWS submitted at paragraphs 3.125 to 3.128 of the Response that demand volatility is only relevant as a barrier to entry to the extent that it results in a cost that must be borne by an entrant and not the incumbent. It stated that this is not the case with demand volatility, as the demand profile for any new haulage will be the same regardless if EWS or a new entrant carries the coal. It, therefore, sees no basis to suggest that EWS's incremental cost of meeting new business will be lower than its rivals.

302. Nevertheless, ORR maintains that an entrant contemplating entry into a market characterised by volatile demand will be both more exposed to and sensitive to that volatility than will a dominant incumbent. This is for the following reasons.

- Where, as here, a number of customers have take or pay provisions or volume incentives in their contracts with the incumbent, this should further diminish demand volatility borne by the incumbent.
- As a corollary to the preceding point, in an industry characterised by long-term contracts with purchase commitments, volume incentives or exclusive contracts (see part II A, *Assessment of abuse of dominance - Exclusionary contracts*, below), that additional demand which appears will, by its nature, be more volatile. It is only this non-contractually committed (and hence volatile) demand for which an entrant can expect to compete.

- Further, EWS's contractual base in supplying coal haulage to the electricity generators is diversified across a large number of customers. This means that the risk associated with fluctuating demand is spread across a number of contracts and it is not exposed to the fluctuations in the purchasing patterns of a single customer. Whilst EWS will of course be exposed to fluctuations in total market demand such demand is likely to be less volatile than that faced by an entrant with a single (or few) potential customers.

303. FHH has supported this view<sup>343</sup>:

“[...] the arguments of EWS ignore the ability of scale operators to divert resources in the event of fluctuations in demand. As EWS recognises, the ORR rightly states at paragraph 272 of the Notice that the volatility of demand affects new entrants to a greater extent than incumbents as a new entrant must maintain a critical mass of capacity which it cannot guarantee will be fully utilised. The ORR rightly states that in order for entry to occur, entry must be profitable, requiring income streams from an investment to be greater than the cost of financing the investment.

An incumbent operator such as EWS is not subject to such constraints and therefore, is able to price at lower levels, thereby discouraging entry. EWS' contention that all market operators are in the same position in respect of "new" business ignores the fact that the vast majority of such "new" business is already operated by EWS prior to re-tendering and that EWS holds a significant proportion of the market which is captive to it as a result of its contractual practices. Whilst EWS can switch its resources to other contracts, should it not be successful in any given tender, new entrants are not in such a position given the comparatively small volumes they are likely to be awarded. Freightliner therefore believes that demand volatility does indeed constitute a barrier to entry [...]"

304. Finally, EWS itself contemporaneously recognised fluctuating demand as a barrier to entry in the 2000 minerals business plan,<sup>344</sup> where it stated:

“The continuing market volatility reduces the risk of customer investment in an alternative coal wagon fleet.”

#### **(h) Barriers to supply-side switching – Stabling sites**

305. In its representations, FHH<sup>345</sup> identified a further barrier in the form of access to stabling sites for wagons – the majority of which are owned by EWS. FHH has advised:

---

<sup>343</sup> FHH representations dated 16 May 2005 to a non-confidential extract to the EWS Response (paragraphs 2.48-2.49) [27/228D.18-19]

<sup>344</sup> Provided by EWS at document 342 of volume 3 to its response to a section 26 notice of 19 March 2002

<sup>345</sup> FHH representations dated 16 May 2005 to a non-confidential extract of the EWS Response (paragraphs 2.51-2.52) [27/228D.19-20]

“Stabling sites are essential for any operator within the market as operators must have a location in which to store wagons when they are not in operation. The vast majority of these sites were granted to EWS upon privatisation and EWS does not grant access to other operators to use its stabling sites. Furthermore, there is no additional land available for the construction of new stabling sites. As a result, new entrants are dependant upon obtaining a lease for stabling sites from EWS or from other third parties. Freightliner itself is limited in its ability to grow its business as result of a lack of available stabling sites.

Even where stabling sites do become available, EWS seeks to prevent or impede entry or expansion. Freightliner has recently faced such a problem in relation to Gascoigne Wood. EWS owns all the current available stabling in North Yorkshire aside from Gascoigne Wood which is owned by UK Coal. UK Coal has indicated that it is seeking to lease the Gascoigne Wood stabling site and has invited tenders. Freightliner initially offered an amount of £[...] per year (inclusive of rates), a figure which UK Coal had indicated was acceptable to it. Upon EWS being made aware of Freightliner's interest in the Gascoigne Wood stabling site, Freightliner understands that EWS offered an amount in excess of £[...] per year, exclusive of rates. Freightliner considers this is a deliberate attempt by EWS to prevent Freightliner from expanding its operations in North Yorkshire. EWS has no commercial need for any additional stabling in the North Yorkshire area and therefore, Freightliner does not consider that there is any legitimate commercial rationale for EWS to submit a bid for the Gascoigne Wood stabling site.”

306. ORR considers that ownership by EWS of a significant proportion of a facility such as stabling sites is another factor which can contribute to entry barriers for new entrants in to the relevant market”.

### **Supply side analysis – conclusion**

307. The barriers identified above are sufficient to prevent even existing rail freight operators from entering swiftly (i.e. within less than one year), on a sufficient scale and without incurring substantial sunk costs in such a way as to constrain a hypothetical monopolist of coal haulage by rail. Further, there is no reason to expect that other possible entrants would not also face these barriers – and indeed would likely be greater. The relevant product market is therefore not expanded as a result of considering prospects for supply-side substitution into coal haulage by rail.

## **The geographical market**

### **Geographical market: overview**

308. EWS in its response of 20 December 2001 favoured a route by route geographical market definition and argued that,

“in defining the relevant market in this area, it is necessary to consider each individual route, comprising a single origin and a single destination between which goods are transported by rail. The next step is to consider whether

there are substitutes for rail freight services on this route that might constrain a hypothetical monopolist's ability to increase prices on that route".

309. At paragraph 3.129 of its Response, EWS agreed with ORR that on the supply-side the boundary of the geographic market is Great Britain, but argued that demand side factors would indicate separate destination based markets for the delivery of coal.

310. ORR considers that a route by route market definition is not supported by the evidence, and (as discussed below) given the relative ease of supply side substitution between destinations, does not consider there to be compelling evidence to indicate that the geographic market should be narrowed to separate destination based markets.

311. The geographical market analysis is structured as follows.

- First, ORR analyses the geographical market from the demand side, noting that generating companies are generally indifferent about the route used to deliver coal to a power station and, indeed, sometimes demand that rail haulage operators be flexible in relation to supply and destination points.
- Second, ORR considers the supply-side considerations, and the fact that an existing supplier of coal haulage by rail to one power station could switch quickly and easily into supplying coal haulage by rail to another power station.

Finally ORR considers EWS's contemporaneous view of a national market for the haulage of coal by rail

#### *Geographical market – demand side analysis*

#### *Route flexibility required by the generators*

312. The responses submitted by the electricity generating companies make clear that, although they require coal to be delivered to particular power stations, they are broadly indifferent about the source of supply and the route taken between supply point and destination. What characterises the responses from the generators to a section 26 notice of 20 March 2002 is that the key determinant for the source of supply is price. Price can be driven by a range of factors including the cost of the product, the cost of transport and the environmental cost resulting from the burn quality of the coal itself<sup>346</sup>. If the delivered price of coal from one supply point to a power station rises, the generating companies substitute coal from another supply point.

---

<sup>346</sup> Coal quality is assessed on a number of factors including the burn characteristics, calorific value, moisture and ash content. Environment Agency requirements as regards levels of sulphur emissions also have to be considered although low sulphur coal can result in higher dust emissions – also subject to Environment Agency constraints. Chlorine content, which leads to corrosion of boilers over time, is also a quality consideration. [Source: Meeting with TXU on 18 April 2002 – 17/1629.3]

313. The ability to make these substitutions is very important to the generating companies, and leads to a requirement for a flexible approach to transport supply and a need for rail haulage suppliers to switch between routes as occasion demands. Indeed in the earlier discussion of access rights as a barrier to entry, it is recorded that GBRf<sup>347</sup> expressly recognised the high levels of flexibility required in coal haulage by rail. It specifically referred to the fact that its large stock of access rights allowed EWS “to operate in accordance with the flexibility demanded by this market”.

314. E.ON at a meeting with the ORR on 11 April 2002<sup>348</sup> described its optimisation process. It is clear from this description that the efficiency of EON’s coal purchasing as a result of this process will depend on its having access to as large a number of source points and destinations as possible.

315. TXU described<sup>349</sup> an optimisation process, which generates a similar need for flexibility. Significantly TXU advised that this optimisation system relies heavily on contracts, which can be flexed to meet a broad range of supply and destination points, rather than nominated routes for nominated volumes.

316. These considerations were repeated in the range of responses from other generators:

- LEG<sup>350</sup>: *“Including the coal purchased on a delivered basis, London Electricity brought coal for Cottam from a wide variety of sources within the UK in 2001, while ensuring that the sulphur content of the coal was below 1.7 per cent, on average.”*
- Drax<sup>351</sup>: *“The main determinant of where we get our coal from (provided it meets the Drax quality requirements) is delivered price into the station.”*
- BE<sup>352353</sup>: *“Ultimately the requirements for rail transportation are derived from the generation forecast for the plant which in turn determines the volume of coal required. Sources of coal (and therefore rail haulage routes) are principally determined based upon the most advantageous “delivered to*

---

<sup>347</sup> GBRf response of 3 May 2002[5/309/2.2]

<sup>348</sup> Notes of a meeting with E.ON dated 11 April 2002 [5A/367.3]

<sup>349</sup> Notes of meeting with TXU dated 18 April 2002 [17/1629.3]

<sup>350</sup> LEG response dated 25 April 2002 to a section 26 notice of 20 March 2002 [23/2129.4]

<sup>351</sup> AES Drax response dated 25 April 2002 to paragraphs 10(c) and (d) of a section 26 notice of 20 March 2002 [5/317/1.4]

<sup>352</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/1.8]

<sup>353</sup> BE in its response dated 24 May 2006 to a non-confidential version of the SO has advised that, in its view, generating companies have now become much more involved in the sourcing of their coal requirements and the logistics of getting the coal to the station gate. In its view the indifference referred to in the Decision is likely to be historical rather than a reflection of future behaviour [33/676A]

power station” cost which can be achieved.” Further BE has stated<sup>354</sup> “[...] any available supply points within the UK provide potential substitutes [...] the total “delivered” cost of coal to Eggborough is the main determining factor”.

- RWE<sup>355</sup>: “[RWE’s] choice of supply point is determined by considerations such as any transport infrastructure constraints and the maximum road capability of each station. Price, quality and availability factors are also considered.”

317. Scottish Power<sup>356</sup> supplied a further relevant perspective: “It is essential that coal supplies are sourced from a number of supply points to ensure that the risk associated with the failure of any particular supply point and the subsequent impact on coal deliveries are managed.”

318. These views are borne out in the data collected on volumes hauled by rail which clearly shows large variations in movements for the same generator on different flows. Taking Ferrybridge as an example, from Immingham to Ferrybridge significant tonnages are moved after January 2001 increasing towards the end of the period, but prior to this date nothing is moved at all. Ferrybridge certainly required coal before January 2001, but this was supplied from a different source point. Similarly, while coal was moved from Butterwell to Ferrybridge in March 2000, none was moved thereafter, suggesting the use of some alternative source point. A similar picture is evident elsewhere. No coal was moved from Hatfield to Ferrybridge after August 2000, or from Mossend to Ferrybridge after June 2000. Haulage from Garleffan only began in November 2001, with levels increasing through Spring 2002, peaking in August. From Hull to Ferrybridge, coal was only hauled between September 2000 and May 2002, with flows peaking in January-April 2002. Similarly dramatic fluctuations in volumes from different source points are demonstrated in the figures for other power stations.

319. The evidence shows a high degree of substitutability between source points, with generating companies prepared to change source of supply depending on overall delivered price. Taken no further, this might suggest a market definition on a power station by power station basis. However, it is also necessary to consider the supply-side, and in particular whether there are barriers to entry that would prevent an existing supplier of coal haulage by rail to one power station switching quickly and easily into supplying coal haulage by rail to another power station.

---

<sup>354</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/1.17]

<sup>355</sup> RWE response dated 26 April 2002 to a section 26 notice of 20 March 2002 [5A/339/1]

<sup>356</sup> [Undated] Scottish Power response to paragraph 10(c) of a section 26 notice of 20 March 2002 [5A/370/11.1]

## *Geographical market – supply side analysis*

### *Rolling stock and locomotives*

320. Possible barriers to switching into provision of coal haulage by rail were discussed in relation to the product market definition. The most significant barrier to switching into provision of coal haulage by rail is procurement of rolling stock, in particular, procurement of wagons suitable for coal haulage.

321. However, existing suppliers of coal haulage to one power station would not face the same barriers to entry into provision of the same service to another power station. Crucially, a much lower level of investment would be required, as an existing provider of coal haulage would already possess suitable wagons and locomotives, which could quickly and easily be diverted from servicing one power station to servicing another.

### *Access rights*

322. The only input into the provision of coal haulage by rail to a given power station, which an existing supplier of coal haulage by rail to another power station would lack, would be the relevant access rights. An existing supplier of coal haulage by rail would likely already possess access rights from a range of supply points along routes to power stations already served, and will therefore not lack all the rights needed to switch into supply to another station. It is likely that it will require only rights relating to the final section of journey, and perhaps only the section leading to the new power station itself. The existing supplier of coal haulage by rail will also have an existing access contract with Network Rail. Thus, if it requires new access rights, he is eligible to use the STAGA process (described in Annex B, *Becoming a Railfreight Operator within Great Britain*) to apply for short term planning rights. Thus, a freight operator can bid for spare capacity on the network midway through a timetable period, allowing it to run trains prior to agreeing longer-term firm contractual rights with Network Rail.

323. The rail network suffers from a lack of spare capacity (at particular points and at particular times) and this could affect the rights awarded to a new entrant on any particular route. However, although freight traffic is not entirely time insensitive since trains must be planned around, for example, the opening and closing times of depots and facilities at either end, freight services can generally be accommodated and flexed around existing constraints.

324. The freight team at Network Rail confirmed at a meeting with the ORR held on 22 November 2002<sup>357</sup>, for example, that although a train operator may make a spot bid for a particular train path that cannot be accommodated as specified, it would be rare for Network Rail to reject the bid outright. In practice Network Rail will work with the bidder to adjust the specification of the bid so that it can be accepted. In response to a question as to whether FHH would have had to give up business within the last 18 months due to its bids not being accommodated, Network Rail

---

<sup>357</sup> [11/00901.4]

stated that, “[i]t is unlikely that FHH will have had to give up business due to lack of access rights, but that it is possible that FHH would not be able to run as efficiently as it would like because they cannot get their first choice rights”. See FHH’s representations recorded in the discussion of sub-section (d) of *Barriers to supply side switching* above, entitled *Access to infrastructure*.

#### *Gauging constraints*

325. The fact that coal haulage by rail is already being provided on particular routes to a particular power station is proof that coal can be hauled on those routes. There is therefore no reason to suspect that an existing supplier of coal haulage by rail on certain routes will not be able to enter provision of coal haulage by rail on other routes because of gauging constraints. There is therefore no reason to regard gauging issues as a significant barrier to entry for an existing provider of coal haulage by rail on one route into provision on another route.

#### *Driver route knowledge*

326. In order to operate a train on a particular route, the train operating company (freight or passenger) must ensure that the driver has sufficient route knowledge including route handling ability<sup>358</sup>.

327. In order to be an existing supplier of coal haulage by rail to a power station, a freight operator would already have trained drivers who might also have some relevant route knowledge. As explained, in Annex B – *Becoming a rail freight operator within Great Britain*, where a driver is already familiar with the relevant rolling stock, training a driver to haul coal on a new route could take as little as 2 months and is unlikely to take in excess of 6 months (a shorter period than is required when training a driver from ‘scratch’).

328. Even if an existing driver does not have the route knowledge to switch into driving on one of the routes in question, there are different means by which he might be trained. As discussed previously he could sit in the cab of a train operator driving the route or he could spend time in a driver simulator. The use of appropriate video, simulator training and classroom teaching may in some circumstances reduce the amount of time required within a cab. Sometimes, where the routes to be learned are only short stretches within sidings, drivers may learn the route by walking.

329. Because driver training is available relatively easily, and can be completed within 6 months, driver training does not appear to be a sufficient barrier to entry to prevent an existing provider of coal haulage by rail on some other route switching into the provision of coal haulage by rail on the routes of interest in the relevant period.

#### *EWS contemporaneous view of a national market for the haulage of coal by rail*

330. EWS, within its own internal documents, appears to consider there to be a national market for the haulage of coal by rail, rather than a market which is route,

---

<sup>358</sup> The ability to handle a train of the required characteristics on the new route

power station or generator specific. This would be consistent with its status as a national operator, with assets and expertise which enable it to provide a network of services throughout the UK. Its observations on market share (which are discussed later) tend to be either relating to coal moved throughout the UK or by customer portfolio, not by route. Further the organisational structure within the coal team relates not to management of routes but to customers or contracts. In its response of 10 May 2002, EWS provided information on the role of the Coal Marketing Managers within EWS's Coal Division. It advised, "*Coal Marketing Managers are the interface between EWS and its customers. Each manager is responsible for one or more customers or contracts.*" As noted above, each of those customers although destination specific, generally will be indifferent about the source of supply. Thus the Coal Market Managers could potentially be managing a national network of requirements from their individual customer portfolios.

331. This requirement for a national focus is borne out in internal strategy documents. In a Coal Business Commentary dated 5 February 2001<sup>359</sup>, in referring to the threat of entry by FHH into the coal haulage business, it stated that the, "*EWS opportunity is to exploit its ability to operate nationally*". Further, in the same document, reflecting the generators' agnostic approach to the origin of supply, (already described above), it stated, "*[...] as the coal market becomes increasingly complex then the approach to customer management will be matrix in approach. This can best be evidenced by PG now selling coal to AES [...] ships are often directed between ports as far apart as Avonmouth and Hunterston. This means that Market Managers need to understand each other's portfolios much more clearly than they may have done in the past. We now have one national market*".

332. This view was repeated 12 months later in the Coal Business Budget Commentary of 26 February 2002<sup>360</sup> where EWS once again stated, "*EWS's opportunity is to exploit its ability to operate nationally.*" Further it repeats almost identically the statement above, "*[a]s the coal market becomes increasingly complex then the approach to customer management will be matrix based in approach. This can best be evidenced by PG now selling coal to almost all power stations during 2001/02. Ships are often diverted between ports as far apart as Avonmouth and Hunterston, Market Managers need to understand each other's portfolio's much more clearly than they may have done in the past. We now have one national market*".

333. The view expressed on EWS's internal documentation, in favour of a national market definition, is consistent with a consideration of barriers to supply-side substitution.

---

<sup>359</sup> Provided by EWS at documents 43-65 of file 7 of the documents provided in response to a section 26 notice of 11 May 2001

<sup>360</sup> Provided by EWS at document 389 of volume 4 of documents provided in response to our notice of 19 March 2002 and our letter of 25 September 2002

### **Geographical market definition – conclusion**

334. For the reasons set out above, the geographical market should not be limited to individual flows on account of demand-side considerations, while supply-side considerations indicate that the market should not be defined on a power station by power station basis. The evidence supports a conclusion that the geographic definition of the product market, namely the haulage of coal by rail, should be Great Britain. (Note that there is no coal haulage by rail in Northern Ireland.)

### **Market Definition: conclusion**

335. The relevant market is therefore that for coal haulage by rail in Great Britain.

# Part I - Assessment of dominance

---

## The concept of dominance

336. As noted previously (in the *Introduction to the Legal and economic assessment*), the legal concept of dominance has been defined by the ECJ (in *United Brands*) as the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.

337. Dominance is related to the economic concept of market power, which as stated in the OFT Guideline *Assessment of Market Power*<sup>361</sup> “can be thought of as the ability profitably to sustain prices above competitive levels or restrict output or quality below competitive levels”. The guideline goes on to explain that “[a]n undertaking with market power might also have the ability and incentive to harm the process of competition in other ways; for example, by weakening existing competition, raising entry barriers or slowing innovation.” The guideline also states at paragraph 2.9: “The OFT considers that an undertaking will not be dominant unless it has **substantial market power**.”

338. While holding a dominant position is not contrary to the Act, it is unlawful to abuse that position. As the ECJ has stated, for example in *Michelin v Commission*<sup>362</sup>, a firm in a dominant position “has a special responsibility not to allow its conduct to impair undistorted competition on the common market.”

339. The case law also indicates that the degree of dominance is an important factor in assessing an undertaking’s conduct.

340. In *CMB*,<sup>363</sup> Advocate General Fennelly stated:

“[...] Article [82] cannot be interpreted as permitting monopolists or quasi-monopolists to exploit the very significant market power which their superdominance confers so as to preclude the emergence either of a new or additional competitor. Where an undertaking [...] enjoys a position of such overwhelming dominance verging on monopoly [...] it would not be consonant with the particularly onerous special obligation affecting such a dominant undertaking not to impair further the structure of the feeble existing competition for them to react, even to aggressive price competition from a new entrant, with a policy of targeted, selective price cuts designed to eliminate that competitor”.

---

<sup>361</sup> OFT Guideline ‘Assessment of Market Power’ (OFT 415), paragraph 1.4

<sup>362</sup> Case 322/81 [1983] ECR 3461, [1985] 1 CMLR 282, paragraph 57

<sup>363</sup> C-395/96P *Compagnie Maritime Belge v Commission* [2000] I 1365, Opinion of Advocate General Fennelly, paragraph 137

341. This approach has also been adopted in the UK. The Tribunal in *Napp*<sup>364</sup> stated as follows:

342. “We for our part accept and follow the opinion of Advocate General Fennelly in *Compagnie Maritime Belge* [...] that the special responsibility of a dominant undertaking is particularly onerous where it is the case of a quasi-monopolist enjoying ‘dominance approaching monopoly’, ‘superdominance’ or ‘overwhelming dominance approaching monopoly’[...].”

343. The OFT’s “*Guideline on Assessment of Conduct*<sup>365</sup>”, also refers to the concept that conduct must be assessed by reference to the degree of dominance, stating:

“Where an undertaking is in a position of ‘super-dominance’ (that is, it has a very high degree of market power, which may be inferred, typically, from a market share in the order of 90 percent), and it selectively cuts prices with the intent of eliminating a competitor, it may be abusing its dominant position even if the discounted prices charged are not loss making. (see cases C-395 and 396/96P *Compagnie Maritime Belge v Commission* [2000] ECR I-1365, including the opinion of Advocate General Fennelly; Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969; and *Napp* at paragraphs 337 to 339.)”

344. Further, ORR considers that the above authorities represent the application of the well established principle, articulated by the ECJ, that:<sup>366</sup> “the actual scope of the special responsibility imposed on a dominant undertaking must be considered in the light of the specific circumstances of each case which show a weakened competitive situation”.

345. As noted by Whish:<sup>367</sup>

“It follows that behaviour may be considered not to be abusive when carried out by some dominant firms but to be abusive when carried out by others [...] The idea that the obligations on dominant firms become more onerous depending on the special circumstances of the case (to use the language of the ECJ in *Tetra Pak*), finds expression in decisions and judgments that seem to have turned on the degree of market power that the dominant undertaking enjoys [citing *Tetra Pak*; *CMB*; *IMS Health* [2002] 4 CMLR 111 and *Deutsche Post AG* [2004] 4 CMLR 598].”

---

<sup>364</sup> Judgment of 15 January 2002 [2002] CAT 1, [2002] CompAR 13, [2002] ECC 177

<sup>365</sup> OFT414 – Previously entitled ‘*Assessment of individual agreements and conduct*’

<sup>366</sup> C-333/94P *Tetra Pak II* [1996] I 5951, paragraph 24; C-395P *CMB* [2000] I 1365, paragraph 114

<sup>367</sup> *Competition Law*, 5<sup>th</sup> edition, pages 189 to 190

346. ORR has therefore approached its assessment of dominance by reference to the guiding principle that the greater the market power of a dominant undertaking, the greater its special responsibility not further to impair competition.

#### Overview of dominance analysis

347. ORR's analysis of dominance is structured as follows:

- (a) Market Shares.
- (b) Existing competition, and in particular EWS's arguments in relation to bidding markets.
- (c) Potential competition.
- (d) Countervailing buyer power/vertical integration.
- (e) EWS's own analysis of its degree of dominance.

#### **(a) Market shares**

##### *ORR's assessment of market shares*

348. The OFT states at paragraph 2.12 of its *Guideline Assessment of market power*:

"The European Court has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50 per cent<sup>368</sup>. The OFT considers that it is unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent, although dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market and high entry barriers) provided strong evidence of dominance."

349. Ideally, market shares are calculated by value and by volume. Information was therefore sought from electricity generating companies in order to calculate EWS's share of the market for coal haulage in Britain both by value and by volume.

350. Looking first at EWS's share of coal haulage by rail for the ESI across the relevant period, the average monthly figure was 93% (on a volume basis). Figure 3 below shows EWS's share of ESI coal haulage by rail (monthly volumes) throughout the relevant period. More recent estimates of EWS's share of coal haulage by rail (for the entire relevant market – i.e. ESI and non-ESI) are presented under the next sub-heading.

---

<sup>368</sup> Case C62/86, *AKZO Chemie BV v Commission* [1993] 5 CMLR 215

**Figure 3 – Shares for ESI coal haulage by rail**

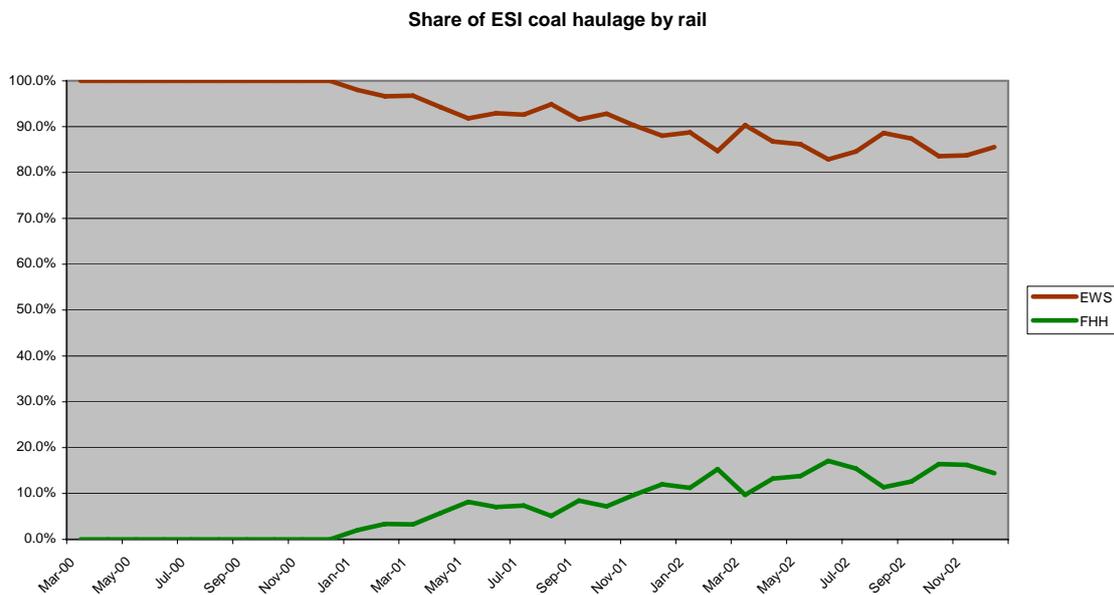


Table 10 below shows EWS’s share of coal haulage by rail to the ESI on a quarterly average basis between March 2000 and December 2002<sup>369</sup>.

<sup>369</sup> Data were collected on a month by month basis. However, quarterly data is used here because the monthly data fluctuates significantly depending on the day-to-day coal purchase decisions of particular generators, which might not genuinely reflect movements in market position. If, for example, E.ON, which solely uses EWS for rail haulage, were to reduce its overall demand in the same month as BE at Eggborough, which largely uses FHH through ECSL, increased its demand, the percentage market shares would fluctuate, but would not indicate any shift in market power

**Table 10. EWS's share of coal haulage by rail for the ESI on a calendar quarterly average basis**

Quarter	Tonnes carried	EWS share (%)	FHH share (%)
Quarter 2 2000	7780110	100	0
Quarter 3 2000	7375985	100	0
Quarter 4 2000	7989714	100	0
Quarter 1 2001	10387491	97.1	2.9
Quarter 2 2001	9859839	92.9	7.1
Quarter 3 2001	9187861	93	7
Quarter 4 2001	10060162	90.4	9.6
Quarter 1 2002	8183273	88	12
Quarter 2 2002	7932432	85.4	14.6
Quarter 3 2002	7157049	86.7	13.3
Quarter 4 2002	8682889	84.3	15.7

351. Although Table 10 and Figure 3 show only EWS's share of ESI coal haulage by rail, ORR considers that this gives a sufficiently accurate picture of EWS's overall share of the market for coal haulage to be used in the assessment of market power. As noted above, figures from Network Rail have suggested<sup>370</sup> that 36.1 million tonnes or 89% of coal haulage by rail is accounted for by the ESI, with non-ESI coal haulage accounting for just 4.6 million tonnes or 11% of coal haulage by rail in calendar year 2002. Since entry in 2001, FHH carried around [...] of non-ESI coal, this being for UK Coal - ultimately supplying Corus - from Maltby to Redcar<sup>371</sup>. This tonnage would have accounted for around 2% of all non-ESI coal hauled by rail in 2002 and around 0.2% of all coal haulage by rail. Thus, EWS's share of the relevant market (i.e. all coal haulage by rail) will have exceeded that outlined above in relation to ESI coal.

352. Further, both Table 10 and Figure 3 above, also under-estimate EWS's share of coal haulage by rail for the ESI for the period following the entry of FHH. This is because where a generating company identified volumes provided by ECSL prior to January 2001 (when FHH first began to haul coal), that volume was assumed as

<sup>370</sup> Network Rail e-mail of 20 October 2003 in response to an ORR e-mail information request of 13 October 2003 [21/1920.1]

<sup>371</sup> E-mail from FHH to the ORR dated 31 March 2003 [22/2074.1] in response to an e-mail information request of the same date, which confirmed that this is the only non-ESI coal moved by FHH and that the traffic commenced in April 2002, with tonnage to date of the FHH e-mail being approximately [...]kt]. Over the 9 months April-December 2002, simple pro-rating implies approximately [...] kt

having been hauled by EWS. After January 2001 it has been assumed that all ECSL provided coal was hauled by FHH. This was in fact not the case. Invoices provided by ECSL show that significant volumes were hauled for ECSL by EWS even after the entry of FHH. However, since complete information on this was not available, a minimum bound has been estimated by assuming that all post January 2001 ECSL coal was hauled by FHH.

353. The complicating effect of ECSL's activity in the coal market had a significant impact on the feasibility of obtaining market shares by value. In general, generating companies found the request for value data onerous. Those generators that used ECSL for coal provision found it impossible to provide an estimate of values for haulage because although they were aware of the volumes, they could not separate out the value of the haulage from the overall delivered price. Therefore, the data available from generators was not sufficient to complete a robust assessment of value based market shares.

#### *EWS's arguments*

##### *(i) Over-reliance on market shares*

354. EWS argued that ORR's assessment of dominance is at odds with the current legal thinking in this area and that it places too much reliance on market shares in circumstances where barriers to entry are low and buyer power is strong<sup>372</sup>.

355. ORR does not accept EWS's arguments in this respect as for the reasons explained below, barriers to entry are high and buyer power is relatively weak.

#### Updated market share estimates

356. EWS at paragraphs 4.10 et sequitur of its Response submitted that its market share has continued to decline in recent years in the face of competition from FHH. In support of this it provided market share figures in Table 4 of its Response based on its own data for the amount of coal it carried for the ESI and DTI data relating to ESI coal consumption. These figures suggest that EWS's market share declined over the relevant period and has continued to decline subsequently. ORR is not prepared to rely on these market share figures because by relating (a) the volume of coal hauled by EWS to (b) coal consumption, EWS has assumed a wider market definition than ORR by including all forms of haulage. Furthermore, figures based on ESI coal consumption will face additional distortions in that they will:

- capture ESI burn of stockpiled coal, thus inflating the denominator in the market share calculation; but
- fail to capture any coal hauled by FHH which is stored and not burnt.

357. At Table 5 of its Response EWS also provided its estimate of EWS coal haulage relative to industrial coal consumption (producing an EWS percentage share

---

<sup>372</sup> See paragraph 5.2(a) of EWS's Supplementary Response.

of the consumption of coal for industrial use which declines from 69% to 58% in the period from 1999/2000 to 2003/2004). As stated previously, ORR does not consider the market to comprise all modes of transport and again by using coal consumption rather than total coal haulage demand the computational issues noted above will also arise. ORR is not, therefore, prepared to rely on these figures.

358. In Table 11 below ORR has extended the period of analysis for market shares. On the basis of data from SRA National Rail Trends (2004-05 quarter two)<sup>373</sup> and FHH<sup>374</sup>, the difference between total coal tonnages lifted and FHH's coal tonnages lifted has been used to derive EWS's share for 2002/03 and 2003/04. Market shares for 2000/01 and 2001/02 were obtained using the SRA National Rail Trends figures for total coal tonnages lifted and the FHH tonnages lifted from generator submissions. Because FHH carried coal only for ESI customers in the period prior to April 2002<sup>375</sup>, it follows that for the years 2000/01 and 2001/02 the aggregated generator submissions for FHH's coal haulage can be used to derive FHH's share of the total market (i.e. comprising ESI and non-ESI coal haulage by rail). Given that only EWS and FHH have hauled coal by rail, the proportion of total coal haulage by rail not accounted for by FHH represents EWS's share of the relevant market (coal haulage by rail in Great Britain).

**Table 11. Updated market share estimates for coal haulage by rail (in tonnes)**

Year	Yr ending 31 Mar 2001	Yr ending 31 Mar 2002	Yr ending 31 Mar 2003	Yr ending 31 Mar 2004	Yr ending 31 Mar 2005
<b>Total coal haulage by rail (millions of tonnes)*</b>	45.7	46.1	40.7	42.0	51.7
<b>FHH market share (%)</b>	1	7	18	23	21
<b>EWS market share (%)</b>	99	93	82	77	79
<b>Percentage point change in EWS market share</b>		-6	-11	-5	+2

\*Source: SRA National Rail Trends 2004-05 quarter 2.

[http://www.sra.gov.uk/pubs2/performance\\_statistics/nat\\_rail\\_trends\\_mar\\_05/nat\\_rail\\_trends\\_March05\\_full\\_doc.pdf](http://www.sra.gov.uk/pubs2/performance_statistics/nat_rail_trends_mar_05/nat_rail_trends_March05_full_doc.pdf)

359. The above Table shows that although EWS's share of the relevant market has declined since FHH's entry in 2001, that decline has slowed and for the most recent

<sup>373</sup> [http://www.sra.gov.uk/pubs2/performance\\_statistics/nat\\_rail\\_trends\\_mar\\_05/nat\\_rail\\_trends\\_March05\\_full\\_doc.pdf](http://www.sra.gov.uk/pubs2/performance_statistics/nat_rail_trends_mar_05/nat_rail_trends_March05_full_doc.pdf)

<sup>374</sup> E-mail response from FHH dated 9 June 2005 to an ORR e-mail information request of 2 June 2005 [27/255(o)]

<sup>375</sup> E-mail from FHH to the ORR dated 31 March 2003 [16/1446] in response to an e-mail information request of the same date, which confirms that this is the only non-ESI coal moved by FHH and the traffic commenced in April 2002

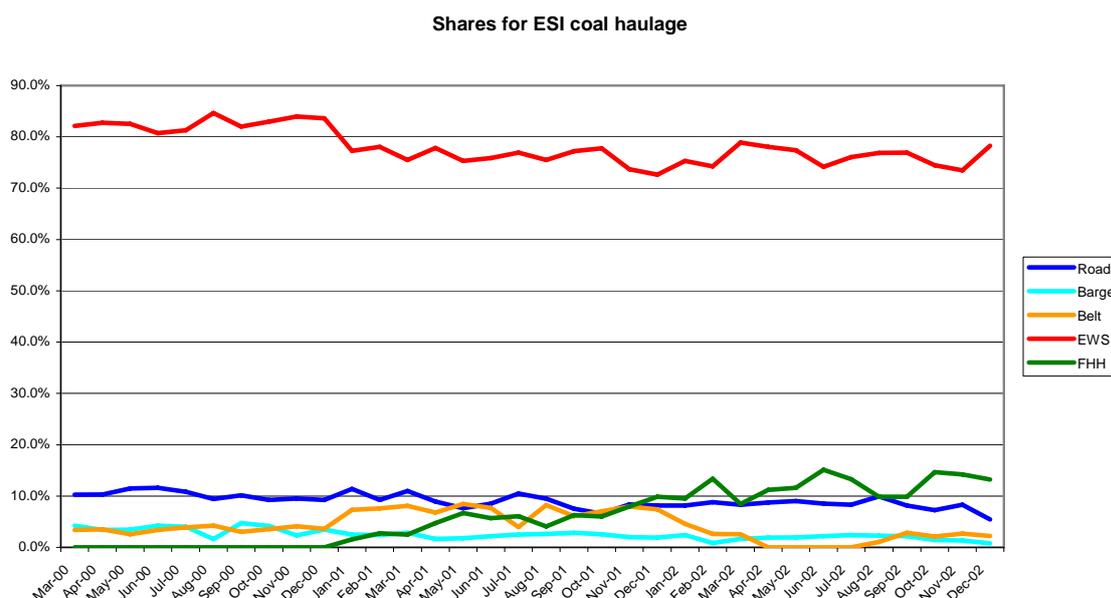
complete year (ending 31 Mar 2005) actually increased. Therefore, even since FHH's entry, EWS's share of the relevant market has not dipped below 77%.

*Shares on the basis of alternative market definitions*

360. The market in this case has been defined as that of coal haulage by rail in Great Britain, and it is clear that EWS's volume shares in that market strongly suggest a dominant position – indeed EWS was a monopolist up to December 2000. However, market shares estimated on the basis of alternative market definitions also give grounds for a presumption of dominance.

361. Even including all modes of transport in ESI coal haulage (i.e. rail, road, belt and canal)<sup>376</sup> would leave EWS with an average share since FHH's entry in 2001 of 78%, varying between 72% and 85% across the Period. Figure 4 below illustrates EWS's share of ESI coal haulage by all modes during that same period.

**Figure 4 – Shares of ESI coal haulage by all modes**



362. Data were also collected which allowed the calculation of volume shares both of coal haulage by rail and all coal haulage on a route by route basis for those routes of interest for this Decision. Volume data on a route by route basis show that volumes on particular routes fluctuate widely, which makes market shares calculated on this basis misleading. EWS's share of haulage on particular routes could fluctuate greatly, while its share of coal haulage by rail across the relevant market did not. For example, EWS's share of haulage on a particular origin-destination pair might fall from 90% in one month to 10% the next simply due to the generator substituting haulage by EWS on another route for haulage by EWS on the first route within the same contract and without going out to tender.

<sup>376</sup> As above this is based on data relating only to ESI coal movements

*EWS's contemporaneous view on market shares*

363. EWS periodically assessed its own market shares in internal documents. In these documents EWS is primarily concerned with its share of the national market for coal haulage by rail. It does not generally consider its position relative to non-rail hauliers. Nor does it perform route by route analysis, although it does consider its position in relation to the ESI industry and particular customers.

364. An internal e-mail dated 4 February 2000<sup>377</sup> assessed the value of a Joint Venture proposal made to EWS by ECSL. Nigel Jones observed to Philip Mengel and Allen Johnson, "*Enron know that EWS and its capacity provides the key to quick market share for themselves. We have 100% of the rail market share and 90%+ of the inland coal ESI market.*"

365. A review of coal haulage in February 2001<sup>378</sup> following the entry of Freightliner in January 2001 stated that the "*EWS market share of rail borne coal in 2001-2002 is budgeted to be 95%.*" It further broke this down into key accounts by share of the total General Mineral Sector income and by EWS share of the transport over all modes.

---

<sup>377</sup> Document 378 of volume 4 of documents provided by EWS in its response to a section 26 notice of 19 March 2002

<sup>378</sup> Coal Business Commentary 5 February 2001, provided by EWS at pages 43-65 of Volume 7 of documents produced in response to a section 26 notice of 11 May 2001

**Table 12. EWS contemporaneous view of market share**

	£mn	% of GM's income <sup>379</sup>	EWS share of transport in % [based on tonnes moved]
<b>Innogy</b>	[ ... ]	[ ... ]	95
<b>Powergen</b>	[ ... ]	[ ... ]	67*
<b>TXU</b>	[ ... ]	[ ... ]	100
<b>AES</b>	[ ... ]	[ ... ]	85
<b>SP</b>	[ ... ]	[ ... ]	80
<b>Edison</b>	[ ... ]	[ ... ]	95
<b>Enron</b>	[ ... ]	[ ... ]	60
<b>BE</b>	[ ... ]	[ ... ]	50
<b>Scottish Coal</b>	[ ... ]	[ ... ]	100

“\*1.5mtpa is moved by canal to Ferrybridge and 1mtpa is moved by road to 4 stations combined. We have no opportunity of winning any of the canal traffic or the 1/2mn.tonnes which goes by road to Ferrybridge;

These are the key accounts where we expect to lose to Freightliner in Year 1;

As a general rule most coal that we do not carry moves by road from non-rail connected supply points.”

Source: EWS Coal Business Budget Commentary dated 5 February 2001<sup>380</sup>

366. A similar review in February 2002<sup>381</sup> reported on 2001/2002 financial year activity. It referred to a power station outturn usage for the financial year 2001/2002 of 50 million tonnes, with an EWS forecast outturn of 35 million tonnes. This provided EWS with a 70% share of movements of all ESI coal.

367. It also stated within this document that, “*Freightliner will exceed a volume of 4 million tonnes in their first year of operation [January 2001-January 2002] within the coal market.*” The market for coal haulage by rail, then, in the year from January 2001 to January 2002, would be of the order of 39 million tonnes in total. On this basis, EWS’s 35 million tonnes suggests that it had around 90% of the market for coal haulage by rail within that year. (This approximation based on EWS’s own figures is very close to ORR’s calculation for 2001, derived from the quarterly data shown in Table 10, which yields a weighted average market share for EWS of approximately 93%.)

368. Further, EWS forecast the key accounts for 2002-3 to be as follows:

<sup>379</sup> GM refers to General Minerals, the Sales and Marketing Division of EWS which includes the management of electricity generating coal within its portfolio

<sup>380</sup> Provided by EWS at documents 43-65 of file 7 of documents provided in response to a section 26 notice of 11 May 2001

<sup>381</sup> Coal Business Budget Commentary dated 26 February 2002 provided by EWS at document 389 of volume 4 of documents received in response to a section 26 notice of 19 March 2002 and letter of 25 September 2002

**Table 13. EWS own contemporaneous view of the key accounts for 2002/2003**

	£mn	% of GMs Income	EWS share of Transport % [Based on tonnes moved]
TXU	[ ... ]	[ ... ]	75
Powergen	[ ... ]	[ ... ]	100*
Innogy	[ ... ]	[ ... ]	100
AES	[ ... ]	[ ... ]	95
AEP	[ ... ]	[ ... ]	100
Scottish Power	[ ... ]	[ ... ]	100
London Power	[ ... ]	[ ... ]	75

“\*2mtpa is moved by canal to Ferrybridge and 1mtpa is moved by road to 4 stations combined. We have no opportunity of winning any of the canal traffic or the ½ mn tonnes which goes by road to Ferrybridge.

As a general rule most coal that we do not carry moves by road from non-rail connected supply points or is delivered direct from deep-sea shipping.”

Source: EWS Coal Business Budget Commentary dated 26 February 2002<sup>382</sup>

369. In an e-mail dated 29 July 2002,<sup>383</sup> David White referred to a market share of 80%, which roughly corresponds to ORR’s calculation of EWS’s share of coal haulage by rail in June 2002 of 83%. Although in a response to a section 26 notice of 27 November 2002<sup>384</sup>, EWS stated that, “[t]he figure was derived, to the best of David’s recollection, by asking EWS’s train planning department how many trains were planned for EWS in the previous week and how many for Freightliner.” There is nothing within the rest of the document that would suggest such a limited and temporal view of the market. Indeed within the e-mail, David White considered this share to be strategically significant, since it might lead to a consideration of dominance or super-dominance and stated that that was “[t]he key factor influencing our decision making process[...]”. It is significant that when asked by ORR officials

<sup>382</sup> Provided by EWS at document 389 of volume 4 to documents received in response to a section 26 notice of 19 March 2002 and letter of 25 September 2002

<sup>383</sup> Document 14 of the documents provided by EWS at the site visit on 22 October 2002

<sup>384</sup> EWS letter to the ORR dated 19 December 2002

at the site visit to what market he had been referring when he made this statement, David White replied that this was, *“the market for the movement of coal by rail to power stations in the UK, measured in metric tonnes.”*

370. This view of market share is repeated in a further document provided at the site visit<sup>385</sup> where in handwritten notes of a strategy meeting of 31 July 2002<sup>386</sup> a reference is made to a Freightliner share of 17-20%.

371. A Board report from November 2001<sup>387</sup>, which contained market share calculations, is presented in Table 14 below. These appear to be calculated for all coal haulage by different modes, and show EWS with a 72% share of weekly tonnage transported to power stations.

---

<sup>385</sup> Document 21 of the documents provided by EWS at the site visit

<sup>386</sup> It is confirmed in EWS's response dated 19 December 2002 to a section 26 notice of 27 November 2002 that these notes were taken by Neil Cawood. It is also noted that, *“Neil Cawood cannot recall who, if anyone, mentioned these figures and is unable to indicate the basis on which they were derived.”*

<sup>387</sup> Provided at document 329 of Volume 4 of supplemental documents provided by EWS in response to a section 26 notice of 19 March 2002, following letter dated 25 September 2002

**Table 14. EWS estimate of shares of weekly coal haulage by different modes, November 2001**

Company/Method of haulage	Coal hauled (tonnes)	Share (%)
EWS	[...]	72
FHH	[...]	11
Seafed	[...]	11
Road	[...]	4
Canal	[...]	2

*Source: EWS Board Report, November 2001*

### **Conclusion on market shares**

372. From March to December 2000, before the entry of FHH, EWS was a monopolist. EWS's share of the market fell from the entry of FHH, in 2001, but remained significantly in excess of 80% even in the last quarter of 2002. Since then, EWS's market share has declined a little further but at the end of 2003/04 remained at over three-quarters of the relevant market.

373. EWS has therefore enjoyed a very high share of the market for coal haulage by rail in Great Britain, throughout the relevant period. This constitutes very strong evidence of EWS's dominance and, indeed, gives rise to a presumption of dominance in the absence of evidence to the contrary.

374. Further, the fact that, even at the end of 2005, EWS's only competitor accounted for less than 25% of the relevant market and that no other entry has been observed, supports ORR's findings in respect of barriers to entry and expansion, discussed below.

### **(b) Existing competition**

#### *Introduction*

375. EWS's only existing competitor in the market for coal haulage by rail in Great Britain is FHH. As already noted above, FHH entered the business of coal haulage in January 2001. This Decision focuses on various periods from March 2000. EWS faced no existing competition for the first 10 months.

#### *EWS's bidding markets argument*

376. EWS submitted at paragraph 3.2 of its Response that ORR's analysis of market shares and its assessment of the competitive constraints faced by EWS is fundamentally flawed. In its view ORR's characterisation of the market is misconceived as it has failed to appreciate that since January 2001 and the entry of Freightliner it has been subject to full and effective competition through a series of bidding markets.

377. EWS, at paragraph 3.5 et sequitur of its Response, submitted that in an effective bidding market, where firms compete not for sales (competition in the market), but for the right to be selected as a producer or provider of a service (competition for the market) a successful bidder will still be required to price at the competitive level. At paragraph 3.8 it provided a number of conditions necessary for a competitive bidding market to hold, namely:

- At least two firms need to be capable of making credible bids;
- No flaws in information – All potential bidders must receive the formal (or informal) invitation to tenders;
- Bidding costs are not sufficiently large to deter firms from bidding – bidders can participate in the bidding process with only negligible costs;
- No capacity constraints – firms should not be capacity constrained, otherwise their decision to participate would depend on their available spare capacity.

378. EWS submitted that, under such conditions, an assessment of market shares based on the volume of coal hauled by each participant, will provide little insight into the competitive constraints faced by an individual firm as it fails to account for competition at the time the contract was let. As an alternative and in its view more accurate indicator of competitive interaction, EWS provided a table<sup>388</sup> showing the number of contracts won and lost by itself and FHH between 2001 and 2003 (this is replicated at Table 15 below) and stated at paragraph 3.17:

“There is variation over time in the number of contracts that EWS wins and loses and this is typical of a bidding market. In no year, however has EWS won more than 65% of contracts. It can, therefore, be concluded that EWS does not have a particular advantage over Freightliner when tendering for new business. As regards coal haulage to power stations, both EWS and Freightliner are able to submit credible bids on any route.”

---

<sup>388</sup> Table 2 to section 2 of the Response (page 35)

**Table 15. Business won and lost by EWS and Freightliner**

	2001	2002	2003	2001 to 2003 %
Business won by Freightliner	15	18	6	34%
Business shared	2	15	5	19%
Business won by EWS	7	30	18	47%
Total number of contracts	24	63	29	100%

Source: *The Response (Table 2 to section 2)*

### *Overview of bidding markets analysis*

379. First, EWS implicitly concedes that no effective bidding market could have been active before 2000 and the participation of Freightliner in the tenders held by BE, EME and AES Drax.

380. Second, ORR rejects EWS's assertions that during the relevant period the market for the haulage of coal by rail could reasonably be characterised as a series of bidding markets in which EWS was exposed to effective competition. This is for the following reasons, elaborated on in the paragraphs below.

- The volume of coal hauled outside of EWS's legacy contracts was limited. Whilst a number of spot contracts were issued these rarely represented more than a generator's marginal requirements and were certainly insufficient to support additional new entry.
- Capacity constraints limited FHH's ability to provide an effective alternative to EWS for the small number of major contracts actually tendered for during the period.
- For a new entrant unable to recover fixed costs elsewhere (i.e. because it does not have an installed customer base with legacy contracts), the entrant might be unable to provide effective competition for specific contracts.
- FHH's ability to access the rail network, given EWS's track access rights. Since track capacity is finite, EWS's earlier acquisition of a significant quantity of access rights gives it a competitive advantage over other operators since it leaves fewer rights available to (actual and potential) competitors.

### *EWS's legacy contracts*

381. In Table 15 above EWS suggests that 87 contracts were put out to tender between 2001 and 2002. To simply look at the absolute number of contracts however, vastly misrepresents the extent of competitive interaction over the period and competitive pressures actually faced by EWS.

382. That a significant proportion of the market was not open to tender has been identified by FHH in its representations dated 16 May 2005<sup>389</sup> where it stated in response to EWS’s analysis of bidding markets that it is:

“[...] highly misleading for EWS to suggest that it is only necessary to take into account new business in the assessment of EWS' market power, given that a large proportion of the market is not put out to tender.”

383. As can be seen from Table 16 below, a handful of long-term contracts signed prior to FHH’s entry and often with exclusivity provisions and other provisions with exclusive effect (see *Assessment of abuse of dominance below*) covered a significant proportion of the relevant market. Because these ‘legacy contracts’ were agreed prior to any competitive alternative to EWS in the supply of haulage of coal by rail, they were immune from the pressures of competitive tender.

**Table 16. Coal haulage by rail accounted for by legacy contracts (signed prior to 2000)**

	Estimated percentage of market covered by contract in calendar year		
	2000*	2001	2002
E.ON	[ ... ]	[ ... ]	[ ... ]
RWE	[ ... ]	[ ... ]	[ ... ]
Corus	[ ... ]	[ ... ]	[ ... ]
TXU	[ ... ]	[ ... ]	[ ... ]
Total 'legacy contracts'	79%	64%	49%

\*Based on Mar-Dec 2000

384. Three sizeable contracts were put out to tender during the year 2000 and these are considered next. However, the vast majority of the 87 contracts cited by EWS were likely to be spot contracts for relatively small tonnages. While they may have accounted for a large number of the ‘transactions’ in the relevant market, in terms of volume they were not.

#### *FHH Capacity Constraints*

385. The sole change in market structure since 2001, which could lead EWS to argue that an effective bidding market now exists, is the entry of FHH. According to EWS, if, after January 2001, it failed to offer its lowest available price to a particular customer, it risked losing the entirety of the contract to FHH. This is, however, dependent on FHH having the available capacity to provide the full amount of haulage required under the contract from the inception date.

<sup>389</sup> FHH representations dated 16 May 2005 to a non-confidential extract of the EWS Response (paragraph 2.13) [27/228d.7]

386. EWS itself noted the importance of capacity in ensuring the effective operation of a bidding market, but at paragraph 3.9(c) of the Response it stated, “*there are in general no significant capacity constraints on any individual routes.*” However, what this fails to recognise is that outright capacity constraints were relevant as were weaker constraints. In particular, certain flows can only be served by EWS because of either rolling stock restrictions (including Wilton and Longannet) and, more generally, FHH simply did not have the residual capacity to bid for all a customer’s requirements under contracts put out to tender. Weaker constraints also exist as a result of EWS’s first mover advantage with respect to access rights and because an entrant would need to use STP path applications, which are only accommodated where they do not conflict with the rights of holders of existing contracts. (See sub-section (d) above in *Barriers to supply-side switching, Access to infrastructure* for further details on access issues.)

387. The transfer of generating assets in the late 1990’s (see Annex D, *History of coal power station ownership*) led to a number of generators seeking rail haulage contracts in the summer and autumn of 2000 (see Annex E, *A brief summary and chronology of the next generation of coal carriage contracts*), as divestment coal supply contracts for the supply of coal from the original owners came to a close. It was these coal haulage contracts that prompted the decision by FHH to enter the market for the supply of coal haulage by rail.

388. FHH entered into an agreement with ECSL to provide coal haulage by rail in July 2000<sup>390</sup>. The contract covered Immingham, Redcar and Hull to the Aire valley and [...].

389. FHH placed an order for coal wagons in July 2000, taking delivery of its first tranche of 18 wagons in time for it to begin coal haulage in January 2001. However as already noted in Table 7 above (see sub-section (b) in *Barriers to supply-side switching, Existing capacity, wagon build costs and lead times* above) it took a considerable period of time for FHH to build up capacity, particularly in relation to coal wagons. From that Table it can be seen that FHH’s total capacity during its first calendar year was significantly less than 15% - only by December 2001 was it in a position to supply up to 15% of the total market. However, as noted below and in the *Assessment of dominance – exclusionary contracts*, a significant proportion of the market was not contestable. Indeed, the very fact that a significant proportion of the relevant market was not contestable forms the basis of ORR’s objections discussed in the section: *Assessment of dominance – exclusionary contracts*. In any case, FHH’s ability to compete for any given tonnage put out to tender would be contingent on its non-contractually committed capacity. In considering FHH’s ability to compete in any given tender and hence provide a full and effective competitive constraint on EWS, it is therefore necessary to consider to what extent it had residual (i.e. net of existing contractual obligations) capacity to compete for the full amount of tonnage put out to tender.

---

<sup>390</sup> FHH response dated 29 Apr 2002 to a section 26 notice of 20 March 2002 [5/302/1.12]

390. Looking at the three significant tenders during 2000, it can be seen that because of FHH's capacity constraints, its ability to constrain EWS was significantly limited.

### **Edison Mission Energy**

In July 1999, on acquisition of Fiddlers Ferry and Ferrrybridge from E.ON (then Powergen) EME invited tenders for the supply of coal. It opted for a one year E2E deal with ECSL. With no alternative rail haulier, ECSL sought a coal carriage contract with EWS and signed a seven-month "best-endeavours" contract in December 1999.

EME issued an ITT on 26 June 2000 for its long-term coal haulage requirements to its power stations, following expiry of the previous E2E deal with ECSL. The contract was for haulage to EME's two power stations at Fiddler's Ferry and Ferrybridge for a four-year period with a commencement date of 1 January 2001. ECSL (on an E2E basis), FHH and EWS all bid for the contract. FHH submitted its detailed response in July 2000<sup>391</sup> and made a revised offer at the end of September 2000<sup>392</sup>. EWS was awarded the contract with discussion of 'Heads of Terms' commencing on 3 October 2000<sup>393</sup>.

However, during the period of bidding and negotiation FHH was contractually committed to supply ECSL (having signed with ECSL on 30 June 2000 for delivery commencing January 2001), and subsequently committed to Drax (with FHH confirming this by e-mail at the end of September 2000<sup>394</sup>). However, haulage was not required for Drax until April 2001 – so for the first three months of the year FHH was only effectively committed to ECSL (in the sense that failure to haul for ECSL earlier in the year would make it more difficult for FHH to achieve its annual tonnage commitment under the ECSL contract).

On the assumption that FHH's only contractual commitments (for haulage the following year) up to the period of close of the EME tender were the ECSL minimum supply of 1.1 million tonnes p.a. and the Drax tonnage (as actually hauled under that contract), then not until **November 2001** could FHH have hauled all EME's requirements.

Therefore, because FHH was not able to haul all the customer's volumes at contract inception and would not have been able to do so up to 10 months after contract

---

<sup>391</sup> July response to tender document provided by FHH in its response dated 29 April 2002 to a section 26 notice of 20 March 2002 [5/302/8.1-11]

<sup>392</sup> Value of revised offer to Freightliner provided by FHH in its response dated 29 April 2002 to a section 26 notice of 20 March 2002 [5/302/10.1-7]

<sup>393</sup> Doc 159 of file 2 of documents provided by EWS in response to a s26 notice of 11 May 2001

<sup>394</sup> E-mail from Roger Petit, FHH, to Paul Cook, Drax, dated 1 October 2000: "Following our exchange of e-mails at the end of last week where you formally offered certain tonnages and I accepted them on behalf of Freightliner [...]" Provided by FHH in a response dated 29 April 2002 to a section 26 notice of 20 March 2002. [5/302/13.1]

inception, ORR does not consider that it was appropriate to characterise the EME tender as a bidding market in which EWS was fully and effectively constrained to price at the competitive level. That is, the customer was reliant on EWS for haulage, at least partially, for a significant period of the contract (i.e. more than 20% of the contract duration).

### **Drax**

Drax issued an ITT in July 2000 for the haulage of domestic coal, which it intended to purchase on a direct basis (i.e. not E2E). The contract was for a four-year period with delivery commencing in April 2001.

Both FHH and EWS bid for the contract and ORR's understanding is that FHH was committed to Drax with effect from late September 2000<sup>395</sup>. Finally, the contract was split between EWS and FHH on a tonnage basis which amounted to a proportionate split of 84%/16%.

ORR's understanding is that at the time FHH was awarded the contract it was not contractually committed to anyone other than ECSL and so effectively its capacity net of the 1.1 million tonnes p.a. committed to ECSL was available to bid in the Drax tender. On this basis, it appears that FHH would not have been able to haul all Drax's requirements until **April 2002**. Drax did not award FHH more than 16% of the tonnage put out to tender and, from ORR's calculations, this is the maximum that FHH could have delivered at the time that haulage under the contract was due to commence (April 2001).

ORR does not therefore consider that it was appropriate to characterise the Drax tender as a bidding market in which EWS was fully and effectively constrained to price at the competitive level because the customer would have been reliant on EWS, at least partially, for a full year into the contract (i.e. 25% of the contract duration).

---

<sup>395</sup> Ibid

## British Energy

In November 1999 BE invited tenders for a one year deal following its acquisition of Eggborough from RWE (at that time trading as National Power). This contract was awarded to ECSL, which started supplying coal (on an E2E basis) from March 2000. Although EWS and ECSL competed for this contract, ECSL could not be regarded as constraining the prices charged by EWS, as ECSL was still entirely reliant on EWS for haulage. In any case, EWS argued at paragraphs 7.37 and 7.252-7.268 of its Response that ECSL was not in fact a competitor to EWS, even in circumstances in which EWS was quoting a haulage price to a power station to which ECSL was also tendering for business on an E2E basis.

BE issued a second ITT on 5 October 2000 for its residual coal requirements not supplied under the National Power (now RWE) divestment agreement. The contract was awarded to ECSL for a [...] <sup>396</sup> and ECSL subsequently placed haulage with both EWS and FHH.

Although FHH responded to BE's 5 October 2000 ITT, by that stage it was already committed to ECSL and Drax (see above). Based on the contractual minimum with ECSL (1.1 million tonnes p.a.) and the actual haulage under the Drax contract, FHH's residual capacity would not have allowed it to haul all BE's required tonnage until **June 2001** under the BE 'low usage' scenario or until **August 2001** under the BE 'high usage' scenario.

Therefore, FHH was not able to fully meet the customer's demand between 2-4 months from contract inception. ORR does not consider that it was appropriate to characterise the BE tender as a bidding market in which EWS was fully and effectively constrained to price at the competitive level because the customer would have been reliant on EWS, at least partially, (for up to 11% of the contract duration). Indeed, although the contract was awarded to ECSL, ECSL remained reliant on EWS. Excluding haulage under the RWE divestment contract – for which haulage was effectively entirely provided by EWS <sup>397</sup> anyway – 14% of haulage to BE under the ECSL contract from inception to December 2002 (the latest period for which ORR has data) was provided by EWS.

391. The inability for FHH to place a full and effective competitive constraint on EWS when bidding for specific coal haulage contracts is revealed not only by the fact

---

<sup>396</sup> Source: BE/ECSL contract dated 17 September 2001, provided by BE in its 1 May 2002 response to a section 26 notice of 20 March 2002 [5A/329/44.2-44.17]

<sup>397</sup> FHH was used once by RWE in December 2001 for just over [...]kt on a 'spot' basis. The BE/RWE contract was used for a full year after inception of the second BE contract put out to tender (the first BE contract was also won by ECSL on an E2E basis) and a total of 986kt was supplied under the BE/RWE contract. Aside from the aforementioned [...]kt, the remainder was entirely hauled by EWS.

that FHH was never awarded a contract to supply the entirety of a customer's requirements (EME, Drax or BE) but also by the following evidence:

- A note prepared by Mel Thorley of TXU on 4 April 2002<sup>398</sup> in respect of FHH's proposed contract for the provision of rail freight services stated, "[c]learly we will have to continue to use EWS as Freightliner could not move all our volume [...]"
- As noted above, in BE's Coal Strategy Paper for 2001/2002<sup>399</sup>, it stated under the heading "Market Dominance", "[i]f EWS changed its strategy and decided to raise prices, there is little BE could do in the short run as any new competitor would need to order new rolling stock."
- Drax has also stated, "[u]ntil Freightliner or other market entrants develop the capability to take over the large volumes of coal movements currently handled by EWS then EWS will be an indispensable trading partner for Drax."<sup>400</sup>

392. Further, RWE noted in a meeting with ORR<sup>401</sup> that, even on the date of the meeting, 5 October 2004, it still considered EWS to be [...]. RWE also noted, "when going out to tender for rail haulage contract [sic] RWE has limited options due to the short timeframes within which it must operate. EWS is [...] able to respond to their tender within the requisite timescale". RWE added "EWS was also [...] able to offer sufficient guarantees regarding its ability and capacity to run the service. Such guarantees are essential to operations such as those of RWE."

393. Accordingly, capacity constraints limited FHH's ability to provide an effective alternative to EWS for the small number of major contracts actually tendered for during the period in question.

#### *Economies of scale enjoyed by EWS*

394. Coal haulage by rail is a business characterised by significant fixed costs and especially in the case of wagons, sunk investments.

395. Given the secure volumes from EWS's legacy contracts, EWS is able to recover fixed costs across a larger volume of business than a new entrant. This allows it advantages through economies of scale, and even the possibility to price down towards variable costs on strategically important flows without facing cash-flow difficulties. Such asymmetry may lead to situations where a new entrant cannot compete effectively against EWS.

---

<sup>398</sup> Provided by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002, in section entitled "Recent documents prepared for Middle Office on Freightliner as an alternative to EWS" [385/197.2]

<sup>399</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/3.4]

<sup>400</sup> Drax response dated 25 April 2002 to paragraph 9(b)(iii) of a section 26 notice of 20 March 2002 [5/317/1.3]

<sup>401</sup> Notes of a meeting between ORR and RWE dated 5 October 2004 [25/79.2-25/79.3]

### *Disadvantage over access rights and train paths*

396. In the discussion of barriers to supply-side switching above, reference was made to EWS's advantage in relation to access rights and to the associated rail network access issues raised for a new entrant such as FHH if it wishes to expand.

397. As the incumbent, EWS enjoys an advantageous position in terms of access and pathing in relation to coal flows, in part simply because the system for obtaining rights and paths is itself complex and time consuming (see Annex B, *Becoming a rail freight operator within Great Britain*, for details on the acquisition of an access agreement and the subsequent acquisition of the relevant train path).

398. The track access agreement entered into by EWS in 1997 and its successor agreements entered into in March 2001 and May 2002 provide EWS with a substantial quantity of access rights. First, since track capacity is finite, the mere fact that EWS has these rights gives it a competitive advantage over other operators since it leaves fewer rights available to (actual and potential) competitors. (Network Rail cannot give access rights to those other operators which might impinge on EWS's ability to exercise its rights.) Second, such a quantity of rights is particularly advantageous in respect of coal, where the demand-side is highly complex, with generators seeking a high degree of flexibility from their hauliers to allow them to take coal from a variety of source points and at various times, depending on demand for electricity and the characteristics of the coal required.

399. In his Conclusions on *Changes to access rights* published in June 2004<sup>402</sup>, the Regulator at paragraph 5.5 noted that concerns had been expressed by consultees about the transfer of rights connected to electricity supply industry coal. He continued that even though incidences of dispute may have been infrequent "[...] *this did not necessarily mean that the existing contractual arrangements for the transfer and surrender of rights would work successfully in the future [...]. Moreover, even if informal arrangements work satisfactorily between two operators, they are unlikely to work as well with three or more operators*". At paragraph 5.6 he concluded that the existing contractual mechanisms "[...] *are necessarily rather slow processes, in what is a particularly dynamic part of the rail freight market.*"

400. ORR considers that during the relevant period, EWS, as the incumbent coal haulage operator, with an approved right to access paths on the national network for the haulage of coal, was afforded considerable control over an essential input of its competitors. It has the ability to delay and block the granting of paths. It also has the ability to influence which paths are granted and thereby to affect the efficiency of competitors' diagrams<sup>403</sup>. This is confirmed by Network Rail in a meeting with ORR<sup>404</sup>, also noted at paragraph 3.105 of the Response:

---

<sup>402</sup> Changes to Access Rights: Final Conclusions (June 2004)

<sup>403</sup> An operational plan of working which includes the utilisation of the train sets and drivers

<sup>404</sup> Meeting between Network Rail and ORR dated November 2002 [11/00901.5]

“AE [ORR] then asked whether potentially in the past 18 months it is unlikely that Freightliner will have had to give up business due to lack of access and BB [Network Rail] responded it was unlikely that Freightliner have actually not been able to take business because of lack of access rights but that it is possible that **Freightliner would not be able to run as efficiently as it would like because they cannot get their first choice rights.**” [Emphasis added.]

401. FHH has complained to ORR that following its successes in winning new contracts it has been unable to secure the paths necessary to service its customers. In fact, it cited<sup>405</sup> a meeting between Network Rail, EWS and itself<sup>406</sup> as an example of where EWS had used its stock of access rights and its understanding of the nexus between FHH’s loading slots at power stations and its required paths to intentionally block its trains, damaging FHH’s relationship with its customers and the efficiency of its train plans: “*Once again they have played their cards, they knew what we wanted from the meeting last Wednesday*”.

402. In an e-mail to ORR following this up<sup>407</sup> Adam Cunliffe (Managing Director, FHH) commented:

“Freightliner has won traffic from EWS however EWS are refusing to release paths and we are cancelling trains (we have had to cancel trains with a revenue value of [...]this week alone). EWS have openly acknowledged that there are enough paths to run all customer required traffic out of Scotland but because they want absolute flexibility with the paths they own they are refusing to give up paths to Freightliner.”

403. A further e-mail<sup>408</sup> copied to ORR noted:

“update on the loading slots offered by EWS this lunchtime. EWS say they MAY have more to offer tomorrow (I do not know why it may change??) [...] We will see if we can make any of these work & will have to see what changes tomorrow. Any resultant train plan will not be as robust as we would have wished & there will be corresponding risk attached to the plan”.

404. Regardless of whether or not there is any merit to the accusation that EWS was deliberately withholding paths on this occasion, what this series of e-mails highlight, at the very least, is the first mover advantage EWS holds in relation to train paths – a key input of its competitors. It seems clear that such priority rights, which over the life time of the track access contracts take on the characteristics of property rights, have materially disadvantaged FHH (the only entrant to date) by making

---

<sup>405</sup> An e-mail from Terry Lenton of FHH dated 24 December 2002 to Martin Wilks which FHH copied to ORR and Network Rail [27/223h]

<sup>406</sup> See Footnote 316 above

<sup>407</sup> E-mail dated 6 January 2003 from Adam Cunliffe of FHH to ORR [12/1046]

<sup>408</sup> E-mail from Martin Wilks of FHH to SCCL dated 30 December 2002 copied to ORR and Network Rail [27/223e]

effective planning and the efficient utilisation of its resources more difficult: either because it has not been able to secure its choice of path or simply through the delay and uncertainty involved in the planning process.

### ***Conclusion in relation to existing competition and bidding markets***

405. For all these reasons, ORR rejects EWS's argument that it is not dominant on the basis that it was subject to full and effective competition through a series of bidding markets.

### **(c) Potential competition**

#### *Introduction and overview*

406. It is also necessary to examine whether a dominant party is constrained by potential as well as existing competition.

407. As the OFT notes in its guideline on the *Assessment of market power*<sup>409</sup>:

“The lower the entry barriers, the more likely it is that potential competition will prevent undertakings already within a market from profitably sustaining prices above competitive levels.”

408. The OFT guidelines (paragraph 5.6, page 15) go on to identify a list of potential entry barriers which could affect market entry, these include:

- Sunk costs,
- Poor access to key inputs and distribution outlets,
- Regulation,
- Economies of scale,
- Network effects, and
- Exclusionary behaviour.

409. ORR's analysis of potential competition is structured as follows.

- i. Barriers to entry.
- ii. Potential entry by rail hauliers.
- iii. Potential entry by generating companies.
- iv. Potential entry by other undertakings.

---

<sup>409</sup> Assessment market power, OFT415, December 2004 (5.2, page 15)

v. EWS's contemporaneous view of the feasibility and likelihood of entry.

**(i) Barriers to entry**

410. In discussing barriers to supply side substitution a number of impediments were identified. These remain relevant barriers that would need to be overcome by any prospective entrant intending to supply coal haulage by rail. The following paragraphs discuss some of those barriers to entry.

*Sunk costs – coal wagons*

411. In the discussion on supply side substitution it was noted that wagons were considered a barrier to entry for two reasons. First, wagons are difficult to procure and the older HAA type wagons, which are still the only wagons permitted on certain parts of the network, are no longer in production and there is a time lag involved in procuring new wagons. Second, given the perception that there already exists sufficient wagon capacity to service the relevant market, potential entrants have expressed a reluctance to take on the residual value risk unless it can be supported by guaranteed contractual commitments with secure volumes.

412. EWS's acquisition of the UK stock of versatile HAA wagons represents a significant first mover advantage in two respects. First, EWS acquired a stock of coal wagons sufficient to provide for all Britain's needs of coal haulage by rail, giving it a considerable advantage in terms of capacity. Secondly, given the difficulties (notably the time lags) involved in procuring new wagons, EWS's ownership of the available stock of second hand wagons provides it with a significant means of influencing the absolute capacity (and therefore costs) of actual and potential competitors.

413. At section 4 of its Minerals Business Plan 2000<sup>410</sup>, EWS undertook a competitive analysis of the coal and other minerals sector which reflects the above contentions. Whilst noting that, "[t]here is currently no on-rail competition in this sector", it also noted that, "[t]he key barrier to entry is the lack of suitable wagons for hire" and that, "[t]he continuing market volatility reduces the risk of customer investment in an alternative coal wagon fleet." It further noted that a major weakness for Freightliner was the "lack of suitable wagons for coal." Similarly it noted that DRS had, "[n]o access to coal Wagons", and that Mendip Rail had hopper wagon familiarity "but no access to coal wagons." The conclusion within the plan was therefore that, "[t]he scope for the impact of a non-EWS wagon fleet is limited during the plan horizon [2000-2003] and it has therefore been discounted [...]"

*Sunk costs – declining market*

414. Demand for coal haulage by rail is derived from demand for coal and the declining market for ESI coal demand (see Annex H) will, given that it is the dominant source of coal consumption, inevitably lead to a declining market for coal

---

<sup>410</sup> Provided by EWS at document 342 of volume 3 to its response to a section 26 notice of 19 March 2002

haulage. Since coal haulage by rail involves specialised investment – in particular in coal wagons – the residual value risk will be higher than for a market where investments are not sunk (i.e. can be redeployed elsewhere). If the market itself is declining, exit is more likely, and the chance that any new entrant will actually face this residual value risk rises. This in itself makes entry less likely.

415. TXU commented<sup>411</sup> that, in its view, the future of coal haulage in rail would depend on coal market size. Significantly it referred to the amount of coal already in stock at power stations and at ports referring to some existing 20% excess coal-generating capacity leading to retiring and mothballing plants.

#### *Sunk costs - demand volatility*

416. Also mentioned in the discussion on supply side entry is the demand volatility in coal haulage by rail. Associated with this is the need for a higher volume of committed assets than would otherwise be the case, and accordingly a higher level of return is expected from each unit of output. For a potential entrant therefore this increases the risk associated with entry by reducing the likelihood that entry will be profitable and increasing the probability of an aggressive response by an incumbent. As noted above, EWS's 2000 Minerals Business Plan 2000 stated<sup>412</sup>, "[t]he continued market volatility reduces the risk of customer investment in an alternative wagon fleet."

#### *Length and size of incumbent contracts*

417. As previously discussed, a significant proportion of the relevant market was already contractually committed to EWS during the relevant period – indeed, a number of these contracts remain in place to this day. Although customers have put business out to tender, the majority of such business is for marginal tonnage which would be insufficient in itself to induce new entry, particularly given the sunk costs of entry.

418. Only three substantial contracts (i.e. covering all or the majority of a given generator's demand (comprising one or two power stations)) were put out to tender during the relevant period at a time when FHH was capacity constrained. These tenders, and ECSL's involvement in bidding for them on an E2E basis, created FHH's route to market. This situation has not been repeated since.

419. Entry into coal haulage by rail involves significant fixed and sunk investment and accordingly any entrant must be confident that it will be able to secure sufficient business to recover both these fixed costs as well as its variable costs. [...] <sup>413</sup> [...]

420. The importance of large, long-term contracts for the generators and their reluctance to move coal on a spot basis is illustrated in comments made to ORR.

---

<sup>411</sup> Meeting with TXU on 18 April 2002 [17/1629.7]

<sup>412</sup> Provided by EWS at document 342 of volume 3 to its response to a section 26 notice of 19 March 2002

<sup>413</sup> [...]

For example a response by RWE<sup>414</sup> noted that “*generally speaking [RWE] would always prefer to move coal under a fully termed written haulage contract and would thus only elect to move coal on a “spot” basis on an ad hoc basis when operational circumstances so require.*”

421. RWE repeated this view in a later letter to ORR<sup>415</sup>:

“In view of the importance to us of being able to have coal delivered to our coal fired power station in large quantities on a regular basis you will appreciate that having a secure term agreement in place to do this is of paramount importance to us. Due to the nature of this business, it is not possible for us to rely upon purchasing rail freight services on a spot basis.”

422. It also noted:

“We consider that a fully termed written contract provides greater security of supply to our flexible coal plant, and ultimately the country by allowing us to respond with some certainty to movements in the electricity market.”

423. As noted previously (and in more detail in the *Assessment of abuse of dominance* below), EWS had in place a large number of exclusive or effectively exclusive legacy contracts. Therefore, even where exclusivity clauses were not present, the legacy contracts had the effect of the customers rarely, if ever, using another haulier.

424. Contemporaneous evidence demonstrates that EWS recognised the strategic significance of entering into such contracts in future. A paper from a mineral marketing team meeting entitled “ESI Business Strategy” held on 20 January 2000 noted<sup>416</sup> that Freightliner had established a ‘Heavy Haul Division’ and stated:

“We are particularly vulnerable where customers have own wagon fleets. Freightliner could ‘cherry pick’ key power stations. We must act very promptly with customers who are not contracted.”

425. At paragraphs 5.5 and 5.6(a) of its Response EWS criticised ORR for using this quote in the context of discussions surrounding exclusionary contracts. EWS submitted that it was simply stressing the desirability of contracting with customers in the “*new competitive environment*” “*after January 2000*”. However, given that FHH had not formally committed to entry at this stage and if EWS’s assertion that this statement had nothing to do with any unlawful impediment to competition is accepted, then at the very least EWS is implicitly recognising here the effect

---

<sup>414</sup> RWE response dated 26 February 2003 to an ORR information request of 20 December 2002 [12/1020/1.5]

<sup>415</sup> RWE representations (page 2) dated 2 November 2004 to a non-confidential version of the Notice. [25/81.3]

<sup>416</sup> Document 362 of Volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002

contractual relations had in effectively tying customers to EWS for the duration of the contract.

### *Customer inertia*

426. EWS submitted at paragraph 4.46 of its Response that one of the ways the generators could assist entry and gain leverage in negotiations with EWS would simply be if a generator lagged the period between agreeing a contract with an entrant and when it commenced haulage under that contract, thus circumventing the problem of capacity constraints. However, one of the key obstacles for any new entrant is how to establish an initial relationship with customers and persuade them to provide the support required to make entry viable.

427. FHH benefited in this respect from its relationship with an intermediary in the form of ECSL. This provided FHH with the opportunity to ‘piggy back’ off ECSL’s contracts, bypassing the need for a direct contractual relationship with the generators itself. This meant that as FHH’s capacity built up, ECSL could migrate traffic from EWS to FHH.

428. Establishing relationships with coal haulage customers is necessary, clearly, in order to enter the market, particularly where financiers are unsupportive of speculative purchase (see discussion on *Barriers to supply side switching – existing capacity, wagon build costs and lead times* and *Barriers to supply-side switching – Risk associated with wagon purchase*, above). Therefore, an established intermediary such as ECSL can facilitate entry. Evidence provided by the generators has revealed a reluctance to provide any direct financial assistance or investment risk sharing. TXU, for example, has explained<sup>417</sup> that early discussions with Freightliner in late 1999 were not favourable to TXU [...]. FHH’s relationship with ECSL and the similar route to market attempted by Fastline with a coal supplier, is discussed in more detail in the *Assessment of abuse of dominance* (under the heading *Exclusionary price discrimination*).

429. One of the reasons for customer inertia to switch may arise from security of supply concerns. Moreover, as explained previously, the key driver for the generators appears to be the delivered coal price. Therefore, whilst generators will be concerned with minimising transport costs, the potential savings from supporting entry or re-tendering contracts might not outweigh the risk of contracting with an untested haulage supplier, or indeed the cost of managing more than one haulier. In relation to certain exclusive provisions within the CCA which it has with EWS, E.ON has stated<sup>418</sup>:

“[...]. “

“[...].”

---

<sup>417</sup> Meeting with TXU on 18 April 2002 [17/1629.5]

<sup>418</sup> E.ON representations dated 2 November 2004 to a non-confidential extract of the Notice [25/80.4]

430. RWE has stated, similarly in relation to effectively exclusive terms within its CCA<sup>419</sup>:

“We value our relationship with EWS who have experience, capability and capacity to move our coal from supply points to coal fired power stations in accordance with the terms of the CCA. We consider that a fully termed written contract provides greater security of supply to our flexible coal plant, and ultimately the country by allowing us to respond with some certainty to movements in the electricity market [...]”

“Any direction by your office that might jeopardise the existence or enforceability of the CCA would have significant adverse impact upon our business both in terms of operational risk and increasing our costs and those of our customers.”

431. The satisfaction with current arrangements is further demonstrated by RWE in a response to ORR<sup>420</sup> where it stated:

“[...] the Agreement has in the past satisfied substantially all of [RWE’s] requirements for the transportation of coal by rail in the UK. For the most part EWS has, when requested, had the capability to move [RWE]’s coal from Supply Points to Power Stations under the Agreement at competitive rates. Accordingly during the period in question [RWE] has had no reason to carry out any formal tender exercises.”

432. Corus has confirmed<sup>421</sup> that although rigorous at outset in researching the best supplier for its rail transport requirements, once a term deal had been concluded on mutually accepted prices and conditions there was then “[...] *little incentive to make further changes*”. Corus has explained that this is in part due to the fact that: “*Main line railway operations are not a core skill and capability of Corus. Limited capital resources means that steel making plant and equipment takes priority*”.

#### *Access to key inputs*

433. As noted in the analysis of barriers to supply-side substitution, FHH has also identified access to stabling sites for wagons – the majority of which are owned by EWS – as a barrier to entry and expansion.

#### *Regulatory barriers – licensing, access rights and train paths*

434. In addition to the problems associated with obtaining the appropriate train paths for operation within the coal haulage market (which would act as a barrier to

---

<sup>419</sup> RWE representations dated 2 November 2004 to a non-confidential copy of the Notice [25/81.2]

<sup>420</sup> RWE response of 26 February 2003 to an ORR information request of 20 December 2002 [12/1020/1.4]

<sup>421</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO [33/677A.3]

supply-side switching for existing train operators active in other markets<sup>422</sup>) an entrant not yet operating as a freight haulier would also need to obtain a licence to operate, a safety case and agree an access contract with Network Rail. While not insurmountable, this regulatory process is likely to take over a year and add to the other, significant barriers, discussed within this Decision.

### *Driver availability*

435. Although existing rail operators will already have a stock of drivers, to the extent that entry into provision of coal haulage would necessitate the acquisition of new drivers, this would constitute an additional barrier to entry. There has been a significant shortage of train drivers for some time, and the process of recruiting and training can be both lengthy and costly.

436. A paper from Nick Newton (SRA) to the DTI (dated 31 January 2003) in response to a consultation on the working time directive (it refers to both freight and passenger) set out the problem:

“[s]ince privatisation there has been an increase of approximately 20% in rail traffic even taking account of the recently announced cutbacks in some areas. Overall, traffic continues to increase. The industry has struggled to cope with this increase whilst also improving the level of service and safety and controlling costs [...] One aspect of this situation has been an ongoing shortage of staff in certain grades, particularly drivers, who typically require extensive training for 2 years<sup>423</sup> before they become fully productive [...] The Authority understands there is a shortage of over 500 drivers – around 5% of the total – who would have to be recruited and trained to eliminate dependence on long working hours to maintain services [...] Since 1998 TOCs have been working hard to increase the number of drivers entering the industry. Currently there are over 1000 new recruits undergoing driver training; however, most of these are required to replace drivers leaving the industry and so will not make an immediate impact upon the shortfall. For example, it takes over a year to train a driver on the mechanics of his role. It then takes a further year to learn the relevant routes and to become fully productive. Subject to training constraints, the current shortfall in drivers would cost £60,000 per driver to train [...]”.

437. FHH has also referred explicitly to problems in securing drivers, and has advised<sup>424</sup>, “*FHH has experienced difficulty in recruiting appropriate driver resource.*”

---

<sup>422</sup> This is discussed in more detail in the section on Market Definition, above, under the heading *Barriers to supply-side switching – Access to infrastructure*

<sup>423</sup> Internal ORR experts have questioned whether training is typically for more than 2 years, suggesting that 14 months might be more usual

<sup>424</sup> FHH response dated 8 January 2003 to an ORR information request dated 22 November 2002 [22/2075.7]

### *Exclusionary behaviour*

438. A reputation for responding aggressively to entry (whether abusively or not) can act as a barrier to entry, particularly in markets characterised by significant fixed and sunk costs – as in coal haulage by rail.

439. Both DRS and Mendip Rail (MRL)<sup>425</sup> were concerned about how EWS might react to any decision to enter into the supply of coal haulage by rail. These operators have relationships with EWS elsewhere in rail-freight haulage and appeared concerned that an attempt to enter into competition with EWS on an important part of its business would lead to ‘reprisals’ elsewhere, at the least in the form of a worsening relationship with the company.

- MRL, for example, in a discussion paper dated June 2000<sup>426</sup> on the decision for MRL to become a train operator [...]
- Further an [undated] note from DRS to its Group Executive<sup>427</sup> discussed, “[p]otential new business opportunity for rail services.”. It discussed the potential joint venture with ECSL and under the heading “*Risks and Safeguards*” discussed the “[a]ffect [sic] on DRS relationship with EWS. DRS’ dependency on EWS is now at a minimal level allowing the company to continue to provide its core services without the requirement for additional assistance. As added assurance, the Rail Regulator is empowered by the Railways Act to prevent any anti competitive behaviour.”
- In the [...] Report commissioned by Freightliner in 1999<sup>428</sup>, in a discussion on *Competitive dynamics* following potential entry, it stated:  
  
    {...}.
- Fastline has also reported<sup>429</sup> from its early discussions with a potential trading partner [...]

440. ORR considers that the [...] Report cited above is particularly prescient since it anticipates precisely the approach EWS has taken since FHH’s entry. As explained in part II B *Assessment of abuse of dominance, Discrimination*, EWS first targeted ECSL’s attempts to enter/facilitate entry and then deliberately pursued more aggressive predatory and selected price reductions at FHH’s key customer at the time, LEG.

---

<sup>425</sup> The history and status of MRL is discussed further below

<sup>426</sup> MRL response of 22 April 2002 to a section 26 notice of 20 March 2002 [5/313/3.2]

<sup>427</sup> DRS response of 25 April 2002 to a section 26 notice of 20 March 2002 [5/301/41.1]

<sup>428</sup> “[...]” – *A paper prepared by [...]*. Provided by FHH in its response dated 29 April 2002 to a section 26 notice of 20 March 2002 [5/302/2.12]

<sup>429</sup> Fastline response dated 19 June 2003 to a section 26 notice of 8 May 2003 [16/1538/4.2]

### *Economies of scale*

441. Coal haulage by rail is characterised by significant economies of scale. In particular, the greater an undertaking's operation the more efficiently it is able to diagram trains – i.e. optimise journey times; distances travelled and therefore resources employed. Moreover, given the significant fixed investments involved (in locomotives and wagons) even for a fixed level of capacity, the more those assets are used the lower the unit costs of supply.

442. Given its first mover advantage and having acquired at privatisation sufficient assets to serve the entire market for coal haulage by rail, EWS therefore has a significant cost advantage over any potential entrant.

### **(c) Potential entry**

#### *Potential entry by rail freight hauliers*

443. The following Table lists (by comparative size in 2003) those rail freight hauliers that might, in principle, represent potential entrants into coal haulage by rail. Also included in the Table are the current undertakings in the relevant market – EWS and FHH – for comparison.

**Table 17. Comparative sizes of freight train operators as at October 2003**

Undertaking	Number of locomotives	Rolling stock	Coal Wagons	Current activity measured in daily services	Turnover for financial year 2002/2003 (2001/2002)(2000/2001) £m
EWS	>600	>15,000	>5,000	>1,000	494.6 (517.5) (498.1)
Freightliner	>100	<2000	0	<200	185.9 (167.6) (144.1)
FHH		<500	<500	<200	56.85 (37.72)
GBRf	<20	<100	0	<20	10.6 (10.5 <sup>430</sup> )
DRS	<50	0 <sup>431</sup>	0	Information not available	19.8 <sup>432</sup> (15.2) (13.7)

#### *GBRf*

444. GBRf was established in 1999<sup>432</sup>, with its operating licence awarded in April 2000. It is a subsidiary of GB Railways Group which, until recently, also operated the Anglia Railways passenger franchise and the open access passenger operator, Hull Trains. GBRf's initial operations commenced in March 2001 with the award of an eight year contract for the carriage for Network Rail of materials to engineering work sites.

<sup>430</sup> Commenced trading on 31 March 2001

<sup>431</sup> All wagons hauled by DRS are owned by its customers

<sup>432</sup> [www.gbrailfreight.com](http://www.gbrailfreight.com), ("*Track Record*", October 2003) [23/2174]

445. GBRf currently owns 17 Class 66 locomotives, with the delivery of 5 new locomotives which took place on 22 May 2003. It leases over 100 flat bed container wagons and took possession of a further 50 flat wagons which were manufactured by Thrall in Romania in September 2003<sup>433</sup>. It possesses no wagons suitable for the haulage of coal.

446. GBRf has confirmed that it has made proposals to a number of customers, consumers and producers of coal for rail haulage<sup>434</sup>. However, it has also noted that a condition for entry would be appropriate commercial terms including some form of commitment in terms of an annual minimum payment or a commitment to move a minimum number of tonnes<sup>435</sup>. More specifically, it has noted the lack of access to suitable wagons as a factor deterring entry and stated that, *"GBRf has not, up to this point, been prepared to speculatively purchase wagons in order to enter the rail haulage market."*

447. However, in an internal e-mail dated 16 November 2000<sup>436</sup>, EWS noted that GBRf with its base in the Anglia area might be a competitive threat for the TXU contracts, *"[o]ne other little thought has occurred to me. When is this contract due to start? If its effective date is March next year then we might be as well keeping an eye on GB Railfreight (If we're not already). East Coast ports towards the Anglia area...Perfect fit for them."*

448. At paragraph 3.92 of its Response, EWS identified comments from Anglia Railways that it might take nine to ten months to enter coal haulage by rail. Anglia Railways was a subsidiary of the then GB Railways Group, ultimately owned by FirstGroup. Anglia Railways never entered coal haulage by rail – and remained, until April 2004<sup>437</sup>, a passenger train operator. Its sister company GBRf was (and remains) the specialist freight haulier within what was the GB Railways Group. However, as stated above, GBRf during the relevant period was not prepared to incur the sunk costs of entering coal haulage by rail and has not to date entered that relevant market.

## DRS

449. DRS is owned by the Nuclear Decommissioning Authority (NDA), previously, British Nuclear Fuels plc (BNFL). Based in the North West of England, it was established to provide BNFL with a rail transport service following the privatisation of

---

<sup>433</sup> E-mail from GBRf dated 16 June 2003 [23/2134] in response to an e-mail request from the ORR of 4 June 2003 [17/1645A]

<sup>434</sup> GBRf response dated 3 May 2002 to a section 26 notice of 20 March 2002 [5/309/2.1]

<sup>435</sup> FHH's response dated 5 June 2006 to a non-confidential version of the SO indicates (at footnote 10) that GBRf has been awarded a contract to supply Drax, commencing in 2007 [33/679B]

<sup>436</sup> Provided at document 23 of file 5 in the documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>437</sup> Until the franchise operated by Anglia Railways was awarded to National Express Group PLC operating under the name 'One'

the British Railways. DRS received a licence to operate non-passenger trains on 12 December 1995. Its rail operations, to date, primarily involve the transport of spent nuclear fuel, low-level nuclear waste and the transport of bulk chemicals<sup>438</sup>. It owns approximately 50 mainline diesel locomotives including 10 Class 66 locomotives which were delivered at the end of 2003. The [...] strong fleet of nuclear flask wagons used by DRS is owned by Magnox Electric plc and BE. Malcolm Warehousing leases to DRS [...] wagons in support of the Malcolm traffic<sup>439</sup>.

450. DRS<sup>440</sup> has had only one actual involvement in the haulage of coal by rail (despite three attempts):

- In early 2000 EWS requested that DRS assist in the delivery of coal from Falkland yard in Ayr to Carlisle. The twice-daily service continued through until the end of December 2000. This “hook and haul contract” involved the provision of train crew and motive power to EWS;
- Discussions with ECSL during 2000 regarding a joint venture contract with DRS “to provide exclusive marketing of all non-nuclear rail services provided by DRS.” This proposal did not progress to a successful conclusion (see below); and
- An enquiry received by DRS from SCCL during March 2002 which DRS chose not to progress.

451. DRS has advised that the commercial relationship with ECSL was not progressed due to the cost of access to the track together with the term offered by ECSL which in the view of DRS did not justify the significant investment required for the rolling stock necessary to resource this business. A report to the Board Sub Committee of BE<sup>441</sup> reporting on a 2000 tender process for haulage to Eggborough Power Station stated, “[p]roposals have been received from Freightliner and EWS. DRS appear to have decided not to enter the market and declined to quote – they were concerned that they would be unable to sustain standards of service to their current customers [...]”.

452. DRS has not entered into provision of coal haulage by rail. As noted above, DRS has cited Railtrack pricing, the availability of wagons, and the investment required in both wagons and locomotives as particular barriers to entry. Although DRS<sup>442</sup> has not ruled out entry at some future point, given the appropriate financial incentive, it has concluded within its response that, “[d]ue to the present business commitments with our current customers, DRS has no immediate plans to re-enter the coal market.”

---

<sup>438</sup> [www.directrailservices.com](http://www.directrailservices.com) (“A brief history of Direct Rail Services (DRS)”, October 1993) [23/2175]

<sup>439</sup> Information on wagons provided by DRS in an e-mail dated 6 June 2003[17/1611] in response to an e-mail request for information of 14 April 2003 [16/1471]

<sup>440</sup> DRS response dated 25 April 2002 to a section 26 notice of 20 March 2002 [5/301/1.1]

<sup>441</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/5.5]

<sup>442</sup> DRS response dated 25 April 2002 to a section 26 notice of 20 March 2002 [5/301/1.2]

453. Its own internal documents show that EWS periodically reviewed the activities of DRS. In a draft paper submitted to Allen Johnson on 23 June 2000<sup>443</sup> regarding road and on-rail competition, a recommendation was made that, “[w]here possible we should minimise the risks from certain operators by encouraging them to concentrate in certain areas (e.g. DRS who focus on nuclear flask traffic are keen to act as our local sub-contractor in Cumbria). In this way we can soak up their spare resource capacity and discourage aggressive deployment.”

#### MRL

454. MRL is a joint venture between Foster Yeoman Limited and Hanson plc<sup>444</sup> established in October 1993 as a joint locomotive and rolling stock management company for those two companies<sup>445</sup>. It currently manages 8 General Motors Class 59 locomotives and over 400 items of rolling stock used in the transportation of limestone from the Mendips and aggregate from South Wales, Leicestershire, the Isle of Grain and Essex. The trains are operated by EWS, for MRL, when on the national network. MRL received its own non-passenger train operator licence but this was revoked by agreement with the Regulator on 26 November 2003.

455. Although the primary purpose behind the decision to apply for an operating licence was to move aggregates for its parent companies, MRL has advised<sup>446</sup> that because of company links with shipping companies and docks, approaches were made to it by the Port of Bristol, Drax, EME, Cumbria and SCCL regarding MRL’s ability to move coal by rail.

456. Although the Port of Bristol did not pursue its initial enquiry in September 1999, Drax and EME sent tender documents to MRL on 26 and 28 June 2000 respectively. On 5 July 2000, MRL wrote to both companies formally withdrawing its interest. In those responses<sup>447</sup>, MRL stated that it was not yet ready to enter into competition for rail haulage services due to a lack of rolling stock and suitably trained staff, which it considered would not be achievable within the timescales available. An earlier approach by Cumbria and SCCL in November 1999 was not pursued for similar reasons. An internal discussion paper (“Action Plan”) dated 29 June 2000<sup>448</sup> stated, “[c]urrently the MRL Board is not in favour of developing any [...] I am about to reject requests to quote for Power Station coal from AES Drax [...] and Edison Mission Energy.”

---

<sup>443</sup> Document 519 of volume 5 of documents provided by EWS in response to a section 26 notice of 19 March 2002

<sup>444</sup> [www.foster-yeoman.co.uk](http://www.foster-yeoman.co.uk) (“Logistics, Rail” – October 2003)

<sup>445</sup> [www.foster-yeoman.co.uk/index.cfm?fuseaction=web.history](http://www.foster-yeoman.co.uk/index.cfm?fuseaction=web.history) (“Company History” – October 2003)

<sup>446</sup> MRL response dated 22 April 2002 to a section 26 notice of 20 March 2002 [5/313/1.2]

<sup>447</sup> MRL response of 22 April 2002 to a section 26 notice of 20 March 2002 [5/313/17 and 5/313/20]

<sup>448</sup> MRL response of 22 April 2002 to a section 26 notice of 20 March 2002 [5/313/3.13]

457. At paragraphs 3.87 and 3.91 of its Response, EWS attempts to characterise MRL as an undertaking which could credibly enter the market for the haulage of coal. However, in a briefing memorandum<sup>449</sup> to Philip Mengel from Allen Johnson, dated 3 September 2000, regarding the Drax tender, Mr Mengel stated, “[o]n a slightly lighter note, they [Drax] told us that Mendip Rail had expressed some interest in bidding but have evidently found this level a little above them.”

458. MRL’s decision to withdraw from interest in the provision of own account haulage services was primarily due to a lack of resolution on a mutually acceptable performance penalty regime with Railtrack. On 13 February 2001, MRL wrote to the Regulator formally confirming that it “is not able to continue to pursue its Freight Train Operating Status.”<sup>450</sup>

#### *Jarvis plc - Fastline*

459. Jarvis plc is the largest infrastructure renewals company in the UK, with 6,000 employees and at the time of the Notice in May 2004 had a turnover in excess of £400 million per annum<sup>451</sup>. Jarvis Fastline Limited (which became known as Fastline Limited (Fastline) in November 2004) has an operating licence which permits the operation of the Jarvis fleet of On-Track Maintenance Machines (OTMs) and is currently the name under which Jarvis carries out its rail related business. Fastline currently owns no traction or rolling stock other than OTMs. It has, however, over 200 operatives who “drive” OTMs, resulting in a driver resource with an extensive track knowledge. It also has a train operations division based in York and 17 depots with workshops for the maintenance of the OTMs.

460. The operating licence held by Fastline does not restrict operations to current rail maintenance activities. ORR understands that Fastline did enter into discussion with the HSE with reference to the requirement for a revised safety case and with its insurers with reference to any additional premium necessary for its proposed expanded activities. It also entered into discussions with a rolling stock leasing company for the lease of the Class 66 locomotive<sup>452</sup> [...].

461. Fastline did not, however, ultimately enter the market and has advised it is unlikely to enter coal haulage by rail for the foreseeable future. This is because [its partner in that venture, *confidential*] suspended talks due to uncertainty over Jarvis’s financial position. Fastline confirmed in a letter dated 23 June 2005<sup>453</sup>: “[...] *The heads of terms with [...] has now expired.*”

---

<sup>449</sup> Provided at document 231 of file 5 to the EWS response to the section 26 notice of 11 May 2001

<sup>450</sup> MRL response of 22 April 2002 to a section 26 notice of 20 March 2002 [5/313/29.1]

<sup>451</sup> [www.jarvisplant.com/uk\\_htm\\_files/about\\_jarvis\\_rail.htm](http://www.jarvisplant.com/uk_htm_files/about_jarvis_rail.htm) (“About Jarvis Rail”, October 2003)

<sup>452</sup> Note of telecon with John Prothero of Fastline dated 24 November 2003 [21/1997]

<sup>453</sup> Fastline representations dated 23 June 2005 to a non-confidential extract of the EWS Response [27/266.1]

462. Although Fastline stated in the same letter that it “[...] believes that there remains a possibility for it to enter into the coal haul business in the future [...]” it does not “[...] envisage considering this option for at least 2 years from the commencement of its freight haul business [itself not anticipated until April 2006].” It is currently exploring other opportunities for entry into rail haulage, which will not require the purchase of new locomotives or bespoke wagons. Therefore there is no prospect of Fastline contemplating entering the relevant market and providing a future competitive threat for some time to come.

#### *RMS*

463. At paragraph 3.93 of the Response EWS mentioned Rail Management Services (RMS). However, as the document cited by EWS itself makes clear<sup>454</sup>,

“The new entrant proposal was not developed further as the climate did not appear favourable and, crucially, surplus wagons were not offered to us for sale by HM Government.”

464. This statement again reveals the importance of wagons as a barrier to entry. Moreover, FHH has commented in respect of RMS that:

“Rail Management Services is not a realistic competitor to EWS. Rail Management Services is a locomotive and track maintenance operator which has supplied locomotives for marshalling of trains within the Cottam rail site.”<sup>455</sup>

#### *Conclusion on entry by other rail freight hauliers*

465. Even if GBRf or DRS were to enter into provision of coal haulage by rail, they would face the same obstacles to becoming an effective competitor to EWS as FHH. Becoming a sufficiently large operator to challenge a significant proportion of EWS’s business would take considerable investment in sunk assets (in particular wagons) and other major capital assets (i.e. locomotives); require access to infrastructure, drivers and groundstaff; as well as considerable time and the risk of EWS responding aggressively or strategically to entry (whether exploiting its first mover advantage in access rights or exploiting economies of scale).

466. Similar barriers would confront Fastline, which expressed an interest in entering the market for the haulage of coal by rail as early as spring 2002, but to date has not yet hauled a coal train and by its own account is unlikely to even contemplate doing so until at least 2008<sup>456</sup>.

---

<sup>454</sup> E.ON response dated 3 May 2002 to a section 26 notice dated 20 March 2002 [351/1.18] (2/49)]

<sup>455</sup> FHH representations dated 16 May 2005, to a non-confidential version of the EWS Response (paragraph 2.59) [27/228D.22]

<sup>456</sup> FHH’s response dated 5 June 2006 to a non-confidential version of the SO indicates that GBRf is likely to enter the market for the carriage of coal by rail for Drax but that entry is unlikely to occur until 2007 [33/679B – in particular footnote 10 of the response]

### *Potential entry by generating companies*

467. As purchasers of coal haulage by rail, it is conceivable that generating companies might seek to expand upstream into self-provision of rail haulage.

468. First, it is important to note that in entering the market for coal haulage by rail, the generators would face all those barriers to entry already discussed in relation to potential entry from existing rail freight hauliers. In addition, they would also face the need to acquire a non-passenger train operator's licence, a railway safety case<sup>457</sup>, a track access contract and railway insurance, as well as the need to develop expertise in running freight trains.

469. Indeed, there has only been one example of vertical integration into coal haulage by rail. RWE (then National Power) entered into provision of its own coal haulage by rail in November 1995 hauling approximately 8 million tonnes of coal each year to its power stations at Drax and Eggborough<sup>458</sup> with a rail unit consisting of 6 locomotives and 5 sets of coal wagons. The minutes of an EWS Minerals Market Budget Control Group dated 30 July 1997<sup>459</sup> reported that agreement had been reached with RWE to carry all its rail borne coal traffic beyond 31 March 1998 and that this agreement included the acquisition of the National Power Rail Unit.

470. However, the introduction of competition into the electricity supply industry has led to an increased fragmentation in power generation (see Table 18 below), making it less likely, other things equal, that a generating company, even guaranteeing its own rail haulage operation for all its coal needs, would have sufficient business to justify expending the start up costs involved in rail haulage. The point has been made directly by RWE<sup>460</sup>

“[RWE] does not anticipate entering into the provision of haulage of coal by rail. Following the demerger from National Power and the divestment of significant coal fired generation plant, we do not require the volumes of coal that would make such an operation economically viable. [RWE] would not consider the provision of rail haulage services to be our core business and would not expect to be able to do it more cheaply than existing providers.”

---

<sup>457</sup> This continued to be the case during the relevant period. However, the railway safety case regime has, with effect from 10 April 2006, been aligned with European requirements. Mainline freight undertakings will in future require a safety management system and safety certificate, rather than a safety case

<sup>458</sup> Source EWS Coal Business Budget Commentary dated 5 February 2001 provided at documents 43-65 of file 7 of response to section 26 notice of 11 May 2001

<sup>459</sup> Source EWS Minerals Marketing Budget Control Group minutes dated 30 July 1997 provided at document 61 of volume 1 of response to section 26 notice of 19 March 2002 following letter dated 25 September 2002

<sup>460</sup> RWE response of 26 April 2002 to a section 26 notice of 20 March 2002 [5A/339/2.6]

**Table 18. Generating Companies' Share of Electricity Generation 1990/1 and 2001/2\***

Generating company	Share 1990/1 (%)	Share 2001/2 (%)
National Power/Innogy/RWE	47	13
Powergen/E.ON	30	12
Nuclear Electric/BE	14	14
Interconnectors	5	5
Others**	4	9
Independent Power Producers		21
TXU		10
EME		9
AES		5

\*Calculated by volume of actual generation (all figures provided to ORR by Ofgem directly). Figures may not sum to 100 due to rounding

\*\*NB 'others' might include different groups of generating companies in the two periods

471. Scottish Power also referred<sup>461</sup> to costs and uncertainty over coal volumes deterring entry into the rail haulage market for coal. It has stated, “[t]he volume of coal to be transported will vary from year to year and is determined by a number of factors which may mean that locomotives and wagons dedicated to our own requirements are not used efficiently” and thus the “[c]apital cost of purchasing or leasing locomotives and wagons and overheads of operating a rail haulage business for the transportation of coal is not felt to be economically justified.”

472. In its Minerals Business Plan 2000<sup>462</sup> EWS has also assessed future potential own account operation or “Customer Involvement”. The potential is reported with repeated references to “lack of critical mass.”

---

<sup>461</sup> Undated Scottish Power Response to paragraph 10 ((i) of a section 26 notice of 20 March 2002 [5A/370/11.2]

<sup>462</sup> EWS Minerals Business Plan 2000 provided by EWS at document 342 of volume 3 to its response to a section 26 notice of 19 March 2002

**Table 19. EWS’s own contemporaneous view (2000) of potential entry by generating companies into the market for coal haulage by rail**

National Power	Sold rail unit to EWS. Now lack critical mass to be other than purchaser of services. Contract until 2003/8 with EWS.
Powergen	Considered own account operation 5 years ago and rejected it. Now lack critical mass to be other than purchaser of services. Contract until 2005 with EWS.
TXU	Currently disposing of assets. Lack critical mass to be other than purchaser of services but would welcome competition. Contract until 2002 with EWS.
Scottish Power	No interest shown in own account or open access operation.
AES	No interest shown hitherto in own account or other operators (eg Fifoots Pt contract with EWS until 2014).

473. EWS was more concerned with someone kick-starting a new entrant. The “English Welsh and Scottish Railway Business Plan 2000”<sup>463</sup>, stated under “Competitive Analysis – Coal and Other Minerals”, *“[t]he continuing market volatility reduces the risk of customer investment in an alternative wagon fleet. The key risk comes from disaffected third parties (eg Ports) and suppliers (eg Enron) seeking to increase their market power vis-à-vis EWS by combining to persuade a third party leasing group such as G.E. Capital to invest in (eg) 500 or 1000 wagons. It is possible that some of the newer customers – eg AES, Edison Mission, British Energy will give sufficient encouragement to such an approach [...]”*

474. The generators have said generally that they are not interested in own account operation. BE has responded<sup>464</sup> that, *“British Energy has never considered entering the market for the rail haulage of coal.”* It listed the following factors as deterring such entry:

- “Lack of relevant in-house expertise, experience;
- Non-core business activity/competency for British Energy;
- Requirement for major capital investment;

<sup>463</sup> Provided at document 342 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002

<sup>464</sup> BE response dated 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/1.21-1.22]

- British Energy's own requirements for rail haulage services unlikely to justify this investment and business case and would therefore rely on third party sales to achieve payback;
- Uncertainty over realisation of benefits (payback, cost reduction, improved service levels);
- Strength of other rail hauliers (experience, capacity, capability and resources) would make it difficult to compete and it is likely that British Energy would remain reliant on other rail hauliers in order to maintain the required route and source flexibility."

475. Other generators also identified various of these factors as barriers to entry for them into the provision of coal haulage by rail. A paper on "*Powergen Rail Strategy*"<sup>465</sup>, presented at a Management Team Meeting on 11 March 1996 discussed the benefits and disbenefits of terminating the then Powergen Coal Carriage Agreement with the British Railways Board in the light of the acquisition of all three trainload freight companies by one preferred bidder, Wisconsin Central (to become the major shareholder in the newly formed EWS). Although the disbenefits of contracting with Wisconsin, in the absence of any other on-rail competition are discussed, the possibility of becoming an own account operator is dismissed on the basis of the high set up costs and lead times. The RWE (then National Power) experience was also noted, "*[i]n indeed, National Power's decision to invest in locomotives and wagons is generally considered to have been expensive in capital and management resource.*"

476. E.ON also advised<sup>466</sup> that during the run up to rail privatisation, a substantial amount of work was carried out on transport options including a detailed proposal to establish an own account operation. E.ON, however, decided not to proceed with this option on the basis that, "*rail operations were outside its area of core expertise and that there were no significant synergies with power station operation.*" Further during this same period a review of a joint venture with an aspiring new entrant operator was not developed "*as the climate did not appear favourable and, crucially, surplus wagons were not offered to us for sale by HM Government.*" Further E.ON has stated that it "*[...] has undertaken no further analysis of the option of setting up as an own account operation and remains committed to the principle of contracting with an experienced rail operator.*"

477. AEP<sup>467</sup> responded that it, "*has never considered entering the freight market [...] AEP would consider that the combination of the large capital requirements, the risk involved, and the potential rewards make any new entrants into the coal rail freight market very unlikely.*"

---

<sup>465</sup> E.ON response of 10 May 2002 to a section 26 notice of 20 March 2002 [351/54.1-4]

<sup>466</sup> E.ON response dated 3 May 2002 to a section 26 notice of 20 March 2002 [351/1.18]

<sup>467</sup> AEP response dated 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002 [414/1.7]

478. LEG<sup>468</sup> stated that, “[w]e have not, thus far, considered the possibility of entering into the provision of haulage by rail or otherwise”, further it has stated, “[b]ecause a large proportion of our expected coal requirement is already contracted on a long-term delivered basis, we have not regarded coal delivery as being of strategic importance to our business, and have therefore not, at the current time, carried out any analysis of alternative transport methods.”

479. Drax drew attention to likely problems in securing finance for a foray into coal haulage by rail and stated<sup>469</sup>, “AES Drax Power Limited is a power generating company. We are in the business of running power stations and have never, even remotely, considered the option of getting into the rail haul business ourselves.” It went on to say, “[g]iven the covenants and restrictions imposed by our finance and project documents such action would be unlikely to be approved by the banks and bondholders anyway.”

480. An EME report dated February 2000<sup>470</sup> reviewed an own account operation for a dedicated service line between LBT and Fiddlers Ferry. It was observed within this report there was a need for potential “over investment” in rolling stock to allow for breakdown and maintenance and the costs of introducing new rolling stock onto the network. It is noted, “[a] shuttle service on this route is possible with a minimum of four trains operated on a round route basis, however spare capacity will be essential to maintain uninterrupted supply to the station.” EME also discussed the alternative preferred possibility of leasing stating that the “EME preferred option would be to minimise capital expenditure. Leasing companies provide new or refurbished wagons for varying periods of time, from spot hire to long term contract leases. Leasing rolling stock to be operated by a third party may provide adequate hardware.” It nonetheless further observed that even by using this approach “the capital costs may be prohibitive”, particularly given that the costs of engineering acceptance would also need to be taken into account.

#### *Conclusion on entry by generators*

481. ORR’s conclusion, therefore, is that in the relevant period EWS faced (and continues to face) no likely competitive constraint from future entry into the rail coal haulage market by power generators.

#### *Potential entry by other undertakings*

482. Other potential entrants will face at a minimum all the barriers discussed above in relation to existing rail freight operators and generating companies.

---

<sup>468</sup> LEG response dated 25 April 2002 to a section 26 notice of 20 March 2002 [5A/344a]

<sup>469</sup> Drax response dated 25 April 2002 to paragraph 10(h) and (i) of a section 26 notice of 20 March 2002 [5/317/1.4]

<sup>470</sup> Provided by AEP in its response dated 3 May 2002 to a section 26 notice dated 20 March 2002, reissued on 4 April 2002 [415/4.9-4.10]

483. SCCL<sup>471</sup>, a coal supplier, views its entry into coal haulage by rail as an unlikely proposition, primarily due to the fact that currently the greatest part of UK coal production is sold to the generators on a 'Free on Rail' basis, with the rail haulage operators having direct contractual arrangements with the generators. SCCL has observed that, "[...] *it is by no means certain that the generators would be prepared to relinquish this element of 'control over the coal supply chain [...]*". Further SCCL has referred to the likely resistance from other coal suppliers, "[...] *there is a risk that other coal producing competitors wishing to transport coal by rail may be uncomfortable doing business with that company as a consequence of it possibly gaining additional information regarding competitor trading activities than would normally be available in the public domain, and may consequently choose not to use their services. This could lead to a company such as SCCL, should they enter the rail haulage market, being effectively restricted to haulage and delivery of their own coal.*"

484. In response to ORR's question as to whether there were any circumstances in which UK Coal would consider entering into the provision of coal haulage by rail, UK Coal stated<sup>472</sup>, "[t]here are no obvious circumstances in which it would".

485. ECSL, entering into E2E provision of coal for the electricity supply industry, also considered entering into coal haulage by rail – apparently mostly out of frustration with existing rail haulage. A framework paper<sup>473</sup> prepared by ECSL for early discussions with TXU on terms for [...] coal supply agreement, reported on ECSL's policy for inland transportation. It stated, "[t]he nature of the UK rail network makes it possibly the weakest link in any power station's supply chain suffering from inefficiency, poor performance, little customer service and very high rates."

486. A report by Promeco Technical Services Limited prepared in April 1999<sup>474</sup> which assessed the "*Feasibility, Procedures and Costs*" of establishing an independent railway operation between Liverpool Bulk Terminal and Fiddlers Ferry Power Station concluded that the time frame for so doing would be dictated by the one-year ordering time for the Class 66 locomotive.

487. A further undated paper prepared by ECSL<sup>475</sup> examined, "*The factors involved in the fuel supply strategies of Fiddler's Ferry and Ferrybridge Plants, UK*" and reviewed strategic tactics in relation to ensuring future rail security. One option proposed by the paper was to construct an "in-house" freight haulier "*through the purchase of coal cars and locomotives*". However, as already noted (in the analysis

---

<sup>471</sup> SCCL response of 23 May 2003 to a section 26 notice of 30 April 2003 [1516/150]

<sup>472</sup> UK Coal response dated 24 April 2002 to a section 26 notice of 20 March 2002 [5/294/1.4]

<sup>473</sup> TXU response of 2 May 2002 to a section 26 notice of 20 March 2002 [385/521.2]

<sup>474</sup> A report prepared for Enron International for Promeco Technical Services Limited and provided with the AEP response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002 [414/14.35]

<sup>475</sup> AEP response of 26 April 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002 [414/41.7]

of *Barriers to supply-side switching*), it specifically identified availability of wagons and EWS's ownership of the existing stock as a significant barrier to entry.

488. ECSL did not enter into coal haulage by rail but chose as an alternative to contract with FHH for rail haulage services.

*EWS's contemporaneous view of the feasibility and likelihood of entry*

*Entry by other rail freight hauliers*

489. As noted in the discussion of barriers to entry above, EWS's Minerals Business Plan 2000<sup>476</sup> assessed potential entrants in turn. As can be seen from the following Table, this document reveals in particular the relevance of wagon access as a barrier to entry:

---

<sup>476</sup> Provided by EWS at document 342 of volume 3 of documents produced in response to a section 26 notice dated 19 March 2002

**Table 20. EWS’s contemporaneous view of potential entrants (2000)**

Freightliner	<p>Known to have visited key customers and suppliers, exp TXU, Enron, Edison Mission, Corus</p> <p>Believed to have engaged Roger Pettit</p> <p>Geographical synergy at certain ports – Redcar, Liverpool</p> <p>Fleet of Class 66s suitable for coal trains</p> <p>Major weakness is lack of suitable wagons for coal</p>
DRS	<p>Believed to be close to Corus regarding Shap Lime and Rails, exploiting Cumbria links</p> <p>Loco fleet currently available and suitable</p> <p>No access to coal wagons – Shap wagons are owned by Corus</p>
GB Rail	<p>Exploited Scottish links of John Ellis</p> <p>Class 66 loco fleet</p> <p>No access to coal wagons</p>
MendipRail	<p>Historic links to nPower</p> <p>Recent links to nPower’s successor at Drax, AES. Known to have visited Drax recently</p> <p>Class 59 fleet</p> <p>Hopper wagon familiarity, but no access to coal wagons</p> <p>Recent investment proposal for additional locos rejected</p>

490. The conclusion within the plan was therefore that, “[t]he scope for the impact of a non-EWS wagon fleet is limited during the plan horizon [2000-2003] and it has therefore been discounted [...]”.

*Entry by ECSL*

491. However, ECSL was seen by EWS as a potential competitive threat. In an internal e-mail from Nigel Jones dated 1 July 1999<sup>477</sup>, Mr Jones discussed the potential relationship with ECSL and any future negotiating stance on prices. He referred in this e-mail to the tough negotiating stance that ECSL was taking and advised that ECSL would contract but only if the price was right. He warned that if agreement was not achieved, ECSL might “[...] do something radical like buying wagons themselves.”

<sup>477</sup> Provided by EWS at document 229 of volume 3 of documents produced in response to a section 26 notice dated 19 March 2002

492. In its Minerals Business Plan 2000<sup>478</sup> EWS reviewed ECSL as a potential rail operator and referred to ECSL's interest in acquiring an operating licence and its ownership of shunting locomotives and observed that ECSL had explored market potential for wagon supply. Further it observed that *“there is currently no on-rail competition in this sector [coal and other minerals].”*

493. Relevant at this juncture is the transcript of a telephone conversation held on 15 March 2000 between Mr Kearney of Enron and Mr Jones of EWS.<sup>479</sup> This transcript is also discussed in the *Assessment of abuse of dominance – exclusionary pricing* and is presented in full at Annex F. The transcript clearly reveals that EWS was interested in establishing whether ECSL intended to enter coal haulage by rail and, by implication from the dialogue, was only prepared to offer a more favourable deal if ECSL did not intend entering.

494. ECSL was, therefore, seen by EWS to pose some form of threat. There is no evidence that this threat was sufficient to place effective competitive constraint on EWS.

#### *Conclusion on potential competition*

495. For the reasons discussed above, in particular the sunk costs of coal wagon purchase, the advantages already enjoyed by the EWS including economies of scale and access to the necessary track capacity, together with the potential for an aggressive response to competitive entry, ORR concludes that EWS did not face effective competition from potential entry into the carriage of coal by rail by existing railfreight operators. ORR also concludes that for all of the reasons above, entirely new entry is unlikely to occur, including from the owners of the generating companies themselves. ORR, therefore, concludes that EWS does not face effective competition from potential entry to the market for the supply of coal haulage by rail.

#### **(d) Countervailing buyer power/vertical integration**

496. Buyer power exists where buyers have sufficient leverage over sellers to extract advantageous conditions from those sellers, which would not otherwise have been forthcoming. The leverage usually consists of a credible threat on the part of the buyer to take its business elsewhere, including self-supply. If the buyer represents a significant proportion of the supplier's business then the buyer could influence the supplier's position.

497. As EWS submitted at paragraph 4.47 of its Response

“[a]t no point since the Summer of 2000, [...] could EWS assume that it did not have direct on-rail competition for each tender or contract process in which it was involved, as is evidenced by Enron's participation in each of the

---

<sup>478</sup> Provided by EWS at document 342 of volume 3 of documents produced by EWS in response to a section 26 notice dated 19 March 2002

<sup>479</sup> Provided by ECSL in the original complaint dated 1 February 2001 [1/12/01 to 1/12/07]

EME, BE and Drax tenders. As each of the generators had a potential alternative haulier to EWS, they were therefore (and remain) able to play EWS and Freightliner against each other in order to secure the best possible haulage price. This ability on the part of generators effectively constrains any market power that EWS would otherwise have.”

498. However, as discussed in ORR’s evaluation of the bidding markets hypothesis advanced by EWS, such a proposition only holds where the alternative supplier can act as a viable alternative to the incumbent. From 2000 until January 2001, EWS was the only provider of coal haulage by rail and for a significant period thereafter FHH was capacity constrained. For example, ORR’s analysis above of the three tenders cited by EWS clearly reveals that FHH was capacity constrained such that for various periods from contract inception (depending on the contract and assumptions made about FHH’s other commitments), the customer would have been reliant on EWS for at least some of its haulage requirements.

499. Furthermore, the mere presence of ECSL did not provide generators with a credible alternative to EWS as ECSL was only an E2E supplier – i.e. a reseller of haulage. This point has been acknowledged by EWS in its Response regarding price discrimination and competitive disadvantage. At paragraph 7.37 of its Response EWS argued:

“Enron was not in fact acting as a competitor to EWS, even in circumstances in which EWS was quoting a haulage rate to a power station to which Enron was also tendering for business on an E2E basis (which in turn, required Enron to obtain a quote from EWS for the haulage element of its proposal). Enron was, on the contrary, a customer of EWS. Enron was not therefore, in competition with EWS [...]”

500. That the generators could not exercise a credible threat to switch meant that EWS did not face countervailing buyer power during the relevant period.

501. This notwithstanding, EWS also argued that there were specific examples where its behaviour was constrained by countervailing buyer power. In its response to ORR of 20 December 2001 (annex 1) EWS stated:

“EWS entered into contracts with Powergen, National Power (now RWE and International Power) and Eastern (now TXU) between 1996 and 1998. At this time, the UK coal market was in a period of long-term decline, exacerbated by the coming on line of a substantial number of gas-fired power stations and the “dash for gas” as it subsequently became known.

“Mr Roger Pettit, who was formerly the General Manager, Coal at EWS, who is now at Freightliner as General Manager, negotiated these contracts for EWS. The terms and conditions of these contracts including price reflect the prevailing economic circumstances of the mid 1990s. For EWS’ part, there was the need to obtain a return on its substantial capital tied up in this part of its business. At the same time, Powergen, National Power and TXU each exercised substantial countervailing power to ensure that they obtained the best rates possible. This countervailing power recognised the degree to

which EWS was depend[er]nt upon these three generators in relation to a key part of its business, while at the same time they were diversifying their power station fuel sources to reduce their requirements for coal and particularly indigenous coal.”

502. Indeed, certain terms in the coal haulage contracts, onerous for EWS, can be seen as indicative of buyer power. An example of such a term would be the Network Rail track access pass-through clause which is present at [...] of [...] coal carriage agreement. However, this clause works both ways and allows EWS to alter the Price Variation mechanism existing in the contract in the event that track access prices rise. The clause states:

[...]

[...]

503. Furthermore, although the clause, as written, should require EWS to pass on the benefits of any reduction in access charges, there is evidence that the lack of transparency in EWS’s costs allows it, at the very least, to avoid doing this. EWS’s behaviour following the ORR review of freight track access charges is a case in point. The review resulted in track access charges for freight being almost halved – EWS’s charge fell from £[...] to £[...]. In an e-mail dated 8 February 2002<sup>480</sup>, David White of EWS considered the [...] [...]. This hardly appears to reflect the behaviour of a firm faced with effective countervailing buyer power.

504. An internal EWS e-mail from William Sunnucks to Nigel Jones of 18 January 2000<sup>481</sup> provides insight into EWS’s contemporaneous view of its position in the market for coal haulage by rail. The e-mail referred to the fixed track access charge within its contract with Railtrack and stated, “[t]he £[...] m annual fixed charge paid [by us] to Railtrack is really their share of coal monopoly profit [...]”. This suggests that EWS not only believed itself to be a monopoly provider of coal haulage by rail but also that it possessed the ability to extract a monopoly profit from that market. This would simply not have been possible in the face of effective buyer power.

505. Significantly, the generators themselves do not consider that they are in any position of power in their dealings with EWS. The comments and documents provided by the generators variously quoted above reveal the opposite to be the case.

506. EME<sup>482</sup> in February 2000 considered, “EWS’s monopolistic position as the UK’s rail freight provider”, and discussed possible entry. However, it concluded, “[t]o

---

<sup>480</sup> Document 362 of volume 4 of supplemental documents provided by EWS in response to a section 26 notice of 19 March 2002 and a letter dated 25 September 2002

<sup>481</sup> Document 392 of volume 4 of documents provided by EWS in its response to a section 26 notice of 19 March 2002

<sup>482</sup> Rail Freight Study Report dated February 2000 provided by AEP with its response of 3 May 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002 [415/4.4 and 415/4.6]

*summarise, unlike other service industries, there are limited alternatives for hauling large volumes of coal. Much of the current system, infrastructure and working practices, have been inherited from British Rail. Change is evident, albeit at a pace unable to cope with the rapid changes that we see in the UK generation industry [...] Freightliner has stated that it would require a minimum of nine months to one year lead time before any rail plans can be finalised. Other new entrants would require similar planning periods.*<sup>483</sup>

507. As noted above, BE in its Business Plan for the year 2000/2001<sup>484</sup> considered that EWS was a monopoly provider that did not have to offer competitive prices and further in its Coal Strategy Paper for 2001/2002<sup>485</sup>, in the absence of other rail hauliers with sufficient capacity, it considered itself powerless in the short term should EWS decide to raise prices.

508. The generators' behaviour supports this. The Coal Carriage Contract dated 29 August 1997 with Eastern Power and Energy Trading Limited (which became TXU) has no defined performance regime within it, giving TXU no recourse should it not receive the required standard of service. Poor performance was indeed experienced. In an internal e-mail dated 21 October 1998<sup>486</sup>, concerns were expressed about EWS performance. Referring to a letter to EWS dated 16 September 1998<sup>487</sup> in which Eastern listed recent failures including cancellations and derailments, it asked, "[...] *do we have records of all the times they failed? [...] Secondly, do we have records of any occasions when we may have failed them [...] If we really get pushed [internally] into taking this further we may have to look at penalties for non-performance but I can't see that working unilaterally.*" This seems hardly the approach of a purchaser with significant purchasing power. A further facsimile message to EWS of 30 October 1998<sup>488</sup> referred to the level of train cancellations from Avonmouth to Rugeley and remarked, "[w]e cannot continue to survive with this poor level of service. We are subject to additional costs if the coal is not moved out by a certain time, and perhaps even more importantly, we need to burn it before it starts to heat up in the stockyard."

509. Performance did not improve. The Fuel and Weather Trading reports for the week ending 1 June 2001 reported, "[s]everal meetings have been held with EWS in

---

<sup>483</sup> E-mail from Anglia Railways to EME dated 19 July 2000, "[a]lso, as I explained on the telephone we will not be ready to start in January 2001. Our most realistic timescales are nine/ten months from contract signature. This is because of our need to recruit staff, obtain locomotives and wagons and establish an operational presence in Scotland of Northern England." Provided by AEP in its response of 3 May 2002 to a section 26 notice of 20 March 2002, reissued on 4 April 2002 [00415/9]

<sup>484</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/2.6]

<sup>485</sup> BE response of 1 May 2002 to a section 26 notice of 20 March 2002 [5A/329/3,4]

<sup>486</sup> TXU response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/353]

<sup>487</sup> Letter dated 16 September 1998 provided by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/353]

<sup>488</sup> TXU response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/358.1]

*the last couple of weeks to try to gain improvements in the service they are providing.”* In September 2001 the Fuel and Weather Trading reports noted<sup>489</sup>, “[o]n Monday 3 September we hosted a meeting with EWS and the three major port companies, to discuss ways and means of improving the combined logistics service offered to TXU [...]” In December 2001 TXU noted<sup>490</sup>, “[l]ong distance rail movements continue to fail due to EWS problems.” In an internal e-mail dated 12 December 2001<sup>491</sup>, which discussed the benefits of contracting with FHH, TXU observed, “[w]e are currently discussing with Freightliner the possibility of a rail haulage contract. We have been using them for some spot business but we are talking about a [...] commitment. The background is that we have struggled to move all our required volume with the existing rail provider – EWS [...] EWS have also been guilty of poor resource planning and controls. The industry has long considered that a competitor would stimulate better performance.”

510. In a meeting with EWS to discuss train performance held on 10 November 1997<sup>492</sup>, E.ON noted, “[g]iven EWS’s position as the dominant supplier of rail freight services, [E.ON] itself had little recourse in the event of continuing poor performance.” In spite of performance penalties existing within E.ON’s coal carriage contract with EWS, there is no evidence that these performance penalties were ever invoked even where such performance resulted in additional costs. In the letter of 4 November 1997, for example, E.ON stated, “[i]n particular, the train arrival performances at Fiddlers Ferry in the last 8 weeks has been only [...] % compared with the EWS target of [...] %. Late train arrivals result in the double handling of coal which costs the station about [...] per train.”

511. At paragraph 4.48 of its Response EWS argued that there was a “credible threat” of generators self-supplying. However, for the reasons presented above (under the heading *Potential competition – limited prospects of entry by vertical integration*), this was not in fact a credible threat. Only one example of vertical integration can be cited (National Power) and that operation ceased prior to 2000, with the associated assets being acquired by EWS. Moreover, particularly with increasing fragmentation within the ESI, evidence from the generators themselves reveals that vertical integration was never likely to be pursued. Indeed, as EWS’s own contemporaneous review noted, even the larger customers (then National Power, Powergen and TXU) lacked sufficient “critical mass” to integrate vertically.

512. Furthermore, even if generators would be able to self-supply coal haulage by rail (or sponsor entry), the scope for this to act as a constraint on EWS is severely

---

<sup>489</sup> Fuel and Weather Trading reports week ending 7 September 2001, provided with TXU response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/180.2]

<sup>490</sup> Fuel and Weather Trading report for week ending 14 December 2001, provided with TXU response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/183.2]

<sup>491</sup> Contained within TXU’s response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/196.1]

<sup>492</sup> Notes of a meeting with EWS to discuss train performance held on 10 November 1997 provided by E.ON in its response of 10 May 2002 to a section 26 notice of 20 March 2002 [351/151]

limited by the time lags involved. Apart from the brief period before National Power sold its rail haulage operation to EWS, the generators lacked suitable wagons. As discussed in the sections above on supply-side substitutability, the procurement of wagons would involve a lead-time of many months. Therefore at or around the time of re-negotiating contracts with EWS, if a generator were prepared to bear the risks of wagon purchase, it would still face an interim period where it would be dependent on EWS for coal haulage by rail. In addition, since a generator would be aware of its likely reliance on EWS during any such interim period, it might be particularly disinclined to take steps to self-supply (or sponsor entry) because of the risks that this would jeopardise its commercial relationship with EWS before it had achieved the ability to operate independently of EWS.

513. At paragraph 4.49 of its Response EWS argued that EWS's ESI coal haulage operations were far from excessively profitable (and presents Figures 1 and 2 of its Response in support). It argued that this contradicted the suggestion that: "[...] *EWS was able to maintain prices that were above competitive levels, and shows that any market power that EWS would otherwise have possessed was effectively constrained by the countervailing negotiating power of the generators throughout the relevant period.*"

514. ORR does not consider this aspect of the Response persuasive.

- First, the internal e-mail cited previously from William Sunnucks to Nigel Jones of 18 January 2000<sup>493</sup> reveals that EWS not only considered itself a monopolist but was also able to earn monopoly profits: "[t]he £[ ... ] *annual fixed charge paid [by us] to Railtrack is really their share of coal monopoly profit [...]*"
- Second, in a market in which there are allegations of predatory pricing and certainly evidence of specific instances of pricing below average total cost (see *Predation on flows to Cottam and West Burton* and *Pricing on flows from Hunterston*), profitability analysis is likely to be a poor indicator of market power.
- Third, a monopolist in a market with high barriers to entry will not be incentivised to be as cost efficient as it would in a competitive market. Therefore, if costs are higher than they would be in a competitive market, this could lead to reported profits being lower than otherwise.
- Fourth, a number of EWS's reported profitability problems appear to derive from cost and traffic-related shocks, not from the exercise of buyer power. For example, just prior to the beginning of the relevant period (1997/98-1998/99), increased haulage on loss-making Anglo-Scottish flows, a driver pay deal, and restructuring costs for ground staff and engineers (paragraph 2.64(b) of the Response), all reduced profitability. The loss-making situation is then reversed largely due to compensating gains on the supply-side: i.e. the

---

<sup>493</sup> Document 392 of volume 4 of documents provided by EWS in its response to a section 26 notice of 19 March 2002

introduction of HTA wagons improves efficiency as does the impact of the new track access regime (paragraph 2.75 of the Response).

- Fifth, as a more general proposition, profitability analysis needs to be interpreted with care in particular to avoid accounting distortions. For example, earnings are affected by the choice of depreciation schedule and also by accruals (i.e. transactions for which cash payment has yet to be made). Capital employed is affected by the choice of depreciation schedule and asset valuation methodology. Figure 2 of the Response reports that in 2002/03, EWS earned a ROCE of around (-[ ... ]%). However, Figure 2 shows that in 2002/03, EWS reported a profit (EBITDAL) of £[ ... ]m. The Frontier Cost model as it stood in 2002 had an annual depreciation charge of £[ ... ]m for all coal business assets and an average net asset value of £[ ... ]m. Combining these results implies a ROCE of £[ ... ]m excluding working capital. In order to achieve a ROCE of (-[ ... ]%), working capital would need to be of the order of £[ ... ]m. From inspection of the English Welsh & Scottish Railway Holdings accounts, the total working capital for FY ending 31 March 2003 was almost £120m. This would imply that EWS's coal business accounted for around [ ... ]% of the Holding company's working capital, which seems disproportionately large. Notwithstanding the fact that the above inference mixes the Frontier Model asset values with the Holding company's audited accounts, it nevertheless emphasises the need for caution in interpreting accounting based measures of profitability.
- In any case, in light of the customer responses regarding their negotiating position vis-à-vis EWS and the limited outside options for supply (e.g. the only competing rail haulier, FHH, emerged only a third of the way into the relevant period and was significantly capacity constrained in the early stages of entry), it is not credible to argue that EWS was confronted with effective buyer power.

515. In summary, ORR believes that the principal factor which would have allowed the generators to enjoy countervailing buyer power in relation to EWS, namely their ability to credibly threaten to switch away from EWS, was absent during the relevant period. Although EWS argued that generating companies constrained its behaviour, contemporaneous documentation provided by the generating companies shows that they did not consider themselves in a strong negotiating position with respect to EWS. Overall, ORR does not accept the argument that EWS's power as a seller in the market for coal haulage by rail in Britain was significantly constrained by countervailing buyer power.

#### **(e) EWS's own analysis of its degree of dominance**

516. The high degree of dominance held by EWS had also been recognised internally, and was considered to be relevant to how it conducted itself in the market. For example, in an e-mail from David White (EWS Business Manager – Coal)<sup>494</sup> dated 29 July 2002 he stated:

---

<sup>494</sup> Document 14 of documents provided at the site visit

“Because we have an 80% market share and because we are Regulated [sic] we are not like any other company. So far as coal is concerned, specifically, our concern is that we may be found to be Dominant or Super-Dominant (both in a legal sense). The consequence of which is that we are more like British Telecom or British Gas or Scottish Power in the provision of a utility supply to the masses. So we are not necessarily our own masters with it comes to the way we earn a commercial return from our several different assets. We can't favour one client over another – the decision to devote a set of assets to one client and then reduce prices to below average costs (I think that's right Jim?) may well be discriminatory because somebody else must be paying more to offset their above average costs. If we were able to quote a reduced price to party A and then quote a higher price to the next party B that comes along we are likely to be in difficulty.

We may also be predatory pricing too.

You are right to say that we can deploy the HTAs how we wish – but what we simply can't do is go then go [sic] the next stage and reduce prices to below average costs on that flow accordingly simply because we have introduced the HTAs on that flow to that one client.

The key factor influencing our decision making process is our market share – 80%.”

### **Conclusions as to dominance**

517. For the reasons set out above, and in particular those detailed below, EWS held a dominant position on the market for coal haulage by rail:

- (a) Only one company, FHH, competed against EWS in the relevant market. FHH did not haul coal until January 2001, and remained capacity constrained at least until the end of 2002. Generally, EWS remained an inevitable trading partner for at least part of each generator's coal haulage requirements.
- (b) Very large market shares, of over 50%, are considered in themselves, and but for exceptional circumstances, evidence of the existence of a dominant position<sup>495</sup>. Market shares between 70% and 80% have been held to warrant a presumption of dominance<sup>496</sup>. Here, EWS had a market share of 100% in the period before 2001. Between January 2001 and December 2002, EWS's quarterly market share never fell below 84%. More recently, in the financial years ending March 2004 and March 2005, EWS's market share is calculated to have been 77% and 79% respectively. Furthermore, even if the scope of the relevant market were expanded to include coal haulage by other modes of transport (in particular road and canal), EWS's market shares would still be found to be very high, and to continue to provide strong evidence of a dominant position.

---

<sup>495</sup> C-62/86 *AKZO v Commission* [1991] ECR I 3359, paragraphs 60

<sup>496</sup> T-30/89 *Hilti v Commission* [1991] ECR II 1439, paragraph 89

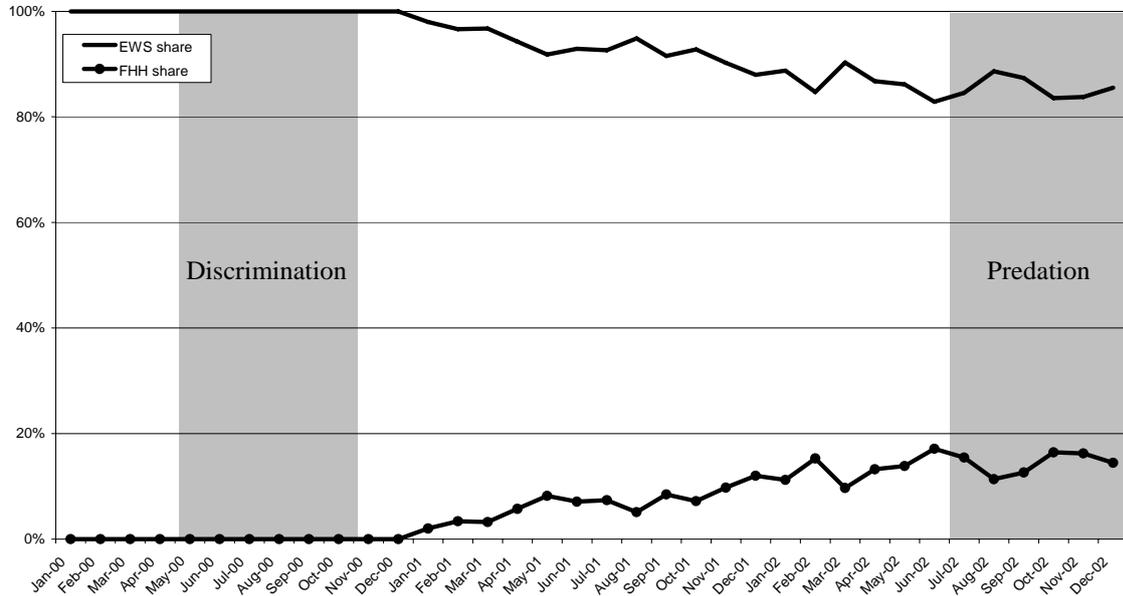
- (c) The relevant market is characterised by significant barriers to entry. EWS enjoyed numerous advantages as a result of its position as the leading (and, for a long period, only) haulier of coal by rail. These included: its exclusive contracts covering a large proportion of the market; its access to large numbers of coal wagons (and in particular the old, hopper wagons) and stabling sites; its stock of access rights, allowing it considerable flexibility and the possibility of using its resources efficiently; and other economies of scale resulting from its large size.
- (d) Buyer power has been limited.

518. As indicated in the diagram below, EWS was a monopolist in the relevant market until the end of 2000, and the conduct discussed in parts IIA and IIB relating to exclusionary contracts and discrimination all took place during a period when EWS had a market share over 90%. Even when its market share fell below 90% in 2002, EWS only faced one competitor in the relevant market and it was this competitor that EWS targeted with aggressive and selective price cuts (part II C of this SO, *Assessment of abuse of dominance, Predatory pricing on flows to Cottam and West Burton*). Even at the end of 2002, EWS had a quarterly market share in excess of 84%<sup>497</sup>. Table 5 below shows, within the period January 2000 to December 2002, the approximate timing of the discriminatory and predatory abuses (three out of the four exclusionary contracts applied right across this period) and the (monthly) market shares that EWS held at those times

---

<sup>497</sup> EWS's share of coal haulage by rail for the ESI was 84.3% in the last quarter of the calendar year 2002. FHH's share of non-ESI coal haulage was less than its share of ESI coal haulage by rail and so EWS's market share was greater than 84.3%

**Figure 5. Timeline of market share and abusive conduct**



519. ORR considers that the factors set out above indicate that EWS had a very high degree of market power, and, consistent with the case law of the ECJ, these form part of the circumstances that must be taken into account when determining the precise scope of EWS's special responsibility not to impair competition further.

# Part II: Introduction

---

## Assessment of abuse of dominance: Overview of ORR's objections

1. This Decision concerns three allegations of abusive behaviour by EWS that ORR has concluded infringe Article 82 and the Chapter II prohibition in the light of all the prevailing circumstances:

- (a) Exclusionary contracts with industrial users of coal;
- (b) Discrimination against ECSL; and
- (c) Predatory behaviour directed towards FHH.

2. The effects of such behaviour have to be seen in the context of the prevailing conditions of competition in the relevant market at the material time. Of particular significance during the investigatory period is that EWS, from 1996 to January 2001, was in a position of monopoly. Between 1996 and 1999, EWS entered into a series of long-term exclusionary coal haulage contracts with the generating companies, limiting the amount of coal haulage available to prospective entrants. (See part II A for further details of exclusionary contracts.) Further, between May 2000 and November 2000, EWS engaged in discriminatory pricing by setting ECSL higher prices whilst offering significant reductions direct to ECSL's customers, Edison Mission Energy (EME) and British Energy (BE). This conduct had the actual or potential effect of making it more difficult for ECSL to negotiate E2E and intermediary deals with those generating companies and was also intended to deter ECSL from sponsoring the entry of an alternative freight train operator. (See part II B for further details of discriminatory conduct adopted by EWS.)

3. Following the market entry of FHH in January 2001 and up to August 2002, EWS's market share in the relevant market fell from 100% to around 84%. EWS responded to the direct competitive threat posed by FHH by engaging in predatory pricing in order to protect its market share. (See part II C for further details on predation by EWS on the West Burton and Cottam Flows.)

**Table 1. EWS abusive conduct in terms of time and market share**

Abuse	Time period	EWS's market share
Exclusive contracts	1996 to 2005	100% – 84%
Discrimination	May 2000 to October 2000	100%
Predation	July 2002 to December 2003	85 – 86%

4. EWS's operation of exclusionary contracts and its discriminatory and predatory pricing practices had the aim of limiting actual or potential competition, by foreclosing new entrants from the market and/or by reducing the opportunities for new entrants to compete with EWS. This behaviour is inconsistent with the obligations of a dominant company not to hinder the maintenance of the degree of competition still existing in the market or the growth of that competition.

5. As stated above, ORR's finding is that all three types of infringing conduct

set out in Parts A-C below form part of a continuing strategy to seek to exclude or restrict EWS's potential competitors' participation in the market for coal haulage by rail. ORR has not found it necessary to make a finding as to the precise level from which that strategy emanated. In particular, ORR has not found evidence of endorsement at Board level in relation to any of the infringing conduct and consequently ORR also finds that the EWS Board played no part in any strategy comprised of the various pieces of infringing conduct. As will be seen below, this has been taken into account in setting an appropriate penalty.<sup>1</sup>

### **Application of Article 82 of the EC Treaty**

6. EWS submitted at paragraphs 1.30 and 10.24-10.26 of its Response that ORR had not complied with its obligations under Regulation 1/2003/EC (the Modernisation Regulation) to consider the application of Article 82. It submitted that the Modernisation Regulation came into force on 1 May 2004, and as the Notice was issued to EWS on 6 May 2004, it was incumbent on ORR to consider the potential application of Article 82 EC to the case, under Article 3 of that Regulation. It further submitted that it is likely, on the case as framed in the Notice, that there may be a potential effect on trade between EU Member States.

7. ORR has considered EWS's representations as to ORR's obligations as a National Competition Authority (NCA) under the Modernisation Regulation and has undertaken its own assessment of whether EWS's conduct, as framed in the SO, had or had the potential to affect trade between Member States. ORR has concluded that EWS's exclusionary agreements and practices may have affected trade between Member States actually or potentially, directly or indirectly. (See ORR's full assessment immediately below.) ORR has acted in accordance with the principles for allocation set out in Article 11 of the Modernisation Regulation and has informed the European Competition Network (ECN) of the case.

#### *The effect on trade concept*

8. The effect on trade concept is a jurisdictional criterion. Its purpose is to distinguish those agreements and practices which are capable of having cross-border effects, so as to warrant an examination under the Community competition rules, from those agreements and practices which do not. Articles 81 and 82 of the Treaty are applicable to horizontal and vertical agreements and practices on the part of undertakings, which 'may affect trade between Member States'. The European Commission (EC) Notice<sup>2</sup> *Guidelines on the effect on trade concept* provides guidance, based on the principles developed by the Community Courts, as to how this is to be interpreted by NCAs within Member States.

9. The EC Notice states<sup>3</sup> that: "*The effect on trade criterion confines the scope of application of Articles 81 and 82 to agreements and practices that are capable of*

---

<sup>1</sup> See Footnote 14 in Part I above.

<sup>2</sup> OJ/2004/C 101/07. 27 April 2004.

<sup>3</sup> Paragraph 13, Ibid.

*having a minimum level of cross-border effects within the Community*”, and the ability of the agreement or practice to affect trade between Member States must be ‘appreciable’<sup>4</sup>. It is not required that the agreement or practice will actually have or have had an effect on trade between Member States. It is sufficient that the agreement or practice is ‘capable’ of having such an effect<sup>5</sup>.

10. The concept of ‘trade’ is not limited to an exchange of goods and services across borders but is a wider concept, covering all cross-border activity, including the free movement of services, persons, capital and freedom of establishment<sup>6</sup>. It is not confined to actual exchanges but also applies to the potential for goods and services to be traded across the borders of Member States. Therefore an agreement or conduct may be physically limited to the UK or a part of it, but still affect trade between Member States due to a blocking or deterrent (exclusionary) effect. Additionally, the concept of ‘trade’ encompasses cases where agreements or practices affect the *competitive structure* of the market. Thus, for example, practices that threaten to eliminate a competitor operating within the Community may be subject to the Community competition rules<sup>7</sup>.

11. Paragraph 41 of the Notice discusses potential effects on trade between Member States, and identifies them as being effects that may occur in the future with a sufficient degree of probability, hence ensuring that foreseeable market developments are taken into account, even if trade is not capable of being affected, at the time the agreement or practice is being implemented. The EC Notice goes on to explain that in this respect, it is also relevant to consider the impact of liberalisation measures adopted by the Community or by the Member State in question.

12. The influence of an agreement or practice on the pattern of trade may be direct or indirect<sup>8</sup>. Direct effects occur in relation to the products or services covered by the agreement or practice. Indirect effects occur to related products or services, whose supply is dependent on the products or services covered by the agreement<sup>9</sup>.

13. The effect on trade must be appreciable. Under the EC Notice, agreements are deemed incapable of appreciably affecting trade between Member States where the following cumulative conditions are met:

- (a) A turnover threshold. In the case of vertical agreements, the aggregate annual Community turnover of the supplier in the products covered by the agreement does not exceed €40 million.

---

<sup>4</sup> Case 22/71, *Béguelin*, [1971] ECR p.949, paragraph 16.

<sup>5</sup> Case T-228/97, *Irish Sugar*, [1999] ECR II-2969, paragraph 170, and Case 19/77, *Miller*, [1978] ECR 131, paragraph 15.

<sup>6</sup> Paragraph 19 *ibid.*

<sup>7</sup> Paragraph 20 *ibid.*

<sup>8</sup> Paragraph 36 *ibid.*

<sup>9</sup> Paragraph 38 *ibid.*

- (b) A market share threshold. The aggregate market share of the parties on any relevant market within the Community affected by the agreement does not exceed 5%:

14. As demonstrated in part I – *Market definition and Assessment of dominance*, both the turnover and market share thresholds are satisfied in this case. At the relevant time EWS's turnover was between €472 and €517 million and its share of the relevant market was between 85 and 100%.

15. Vertical agreements, covering the whole of a Member State, may be capable of affecting patterns of trade between Member States when they make it more difficult for undertakings from other Member States to penetrate national markets<sup>10</sup>. Similarly where a railway undertaking, or a supplier of railway services which holds a dominant position covering the whole of the UK (in this case GB), engages in exclusionary abuses, trade between Member States is normally capable of being affected, where it makes it more difficult for competitors from other Member States to enter the market, whether by exports or establishment<sup>11</sup>. If there exists a pattern of such behaviour, an effect on trade may arise from the reputational impact of the abuse among other potential competitors.

16. Abusive conduct that forms part of an overall strategy pursued by a dominant company must be assessed in terms of its overall impact rather than each element of behaviour being assessed in isolation. Where a dominant company pursues various practices in pursuit of the same aim, it is sufficient that at least one of these practices is capable of affecting trade between Member States<sup>12</sup>.

17. Objections as to the long-term exclusionary contracts between EWS and its customers (industrial users of coal) are set out in part II A below (*Exclusionary contracts*). It is also explained why the contracts may foreclose (or may be capable of foreclosing) entry to the relevant market. In addition, parts II B and C, (*Discrimination and Predatory pricing on flows to Cottam and West Burton*) both demonstrate a pattern of exclusionary behaviour by EWS. There is evidence to suggest that such conduct built on a previous pattern of behaviour whereby EWS may have acquired a reputation for adopting exclusionary practices toward potential competitors and/or their customers<sup>13</sup>.

#### *Finding on effect on trade*

18. EWS's exclusionary agreements and practices may have affected trade between Member States, actually or potentially, directly or indirectly, in the following ways:

---

<sup>10</sup> Paragraph 86 *ibid.*

<sup>11</sup> Paragraph 93 *ibid.*

<sup>12</sup> Paragraph 17 *ibid.*

<sup>13</sup> See also the discussion of *Exclusionary behaviour* in part I, *Assessment of dominance*, subsection (c)(i), *Potential Competition, Barriers to entry*. In an internal e-mail dated 12 January 2000 provided by [...] in its response of 25 April 2002 to a section 26 notice of 20 March 2002 [385/192.1], Jonathan Moser of Eastern Power & Energy said “[...]” [Emphasis added]

- (a) **Effect on the pattern of coal imports from EU Member States.** ORR notes at paragraph 6 of Annex C to this Decision that in 2002 approximately 28.7m tonnes of coal were imported into the UK of which 20m tonnes were used in electricity production<sup>14</sup>. The following Member States have exported coal to the UK between 1999 and 2005<sup>15</sup>: Germany, Spain, France, Irish Republic, Belgium, Luxembourg, Netherlands, Portugal and, since its accession, Poland<sup>16</sup>. Coal imports are delivered through ports including, amongst others, Immingham, Bristol, Liverpool, Hunterston, Port Talbot and Redcar<sup>17</sup>. E.ON has also confirmed that, from 1997 to date, it sourced approximately 6.5 million tonnes of coal from suppliers or traders based in EU Member states such as England, Ireland, Germany and France, for its Kingsnorth power station, which was transported through continental ports<sup>18</sup>.

Had competition in the market for coal freight by rail not been impeded by EWS's exclusionary agreements and behaviour, the power generators or intermediaries (notably, ECSL) could have had a greater choice of providers of haulage services and could have contracted for the purchase of coal, including from other Member States, differently. For example, the practice of discriminatory pricing by EWS was directed against ECSL and was the subject of ECSL's original complaint. That practice had or at least was capable of having an adverse impact on ECSL's cross-border economic activities comprising the arrangement of intermediary including so called 'End to End' (E2E) coal delivery services for power generators and other customers in the UK<sup>19</sup>, because ECSL relied wholly or at least in part on the coal haulage services provided by EWS in order to win business.

Likewise, EWS's predatory pricing behaviour, which was directed against the new entrant FHH, threatened to eliminate or at least substantially to weaken FHH as the only competitor in the national market for the haulage of coal by rail. The effect of that, in turn, could have been to influence the balance between purchases of domestic coal and purchases of imported coal from other Member States, as well as the incidence and pattern of deliveries of coal from other Member States. For instance, if lower haulage rates were available for the same

---

<sup>14</sup> Source: [www.dti.gov.uk/energy/inform/dukes](http://www.dti.gov.uk/energy/inform/dukes) (Chapter 2, Solid fuel and derived gases – Main Text).

<sup>15</sup> Source – DTI DUKES publication table 1999-2004 G.5 imports and exports of solid fuel in annex H [http://www.dti.gov.uk/energy/inform/energy\\_stats/foreign\\_trade/index.shtml](http://www.dti.gov.uk/energy/inform/energy_stats/foreign_trade/index.shtml).

<sup>16</sup> Member State of EU from 1 May 2004.

<sup>17</sup> See Table 3 in Annex C.

<sup>18</sup> E-mail dated 14 February 2005 from Stephen Taylor at E.ON in response to an ORR information request of 3 February 2005 [31/588].

<sup>19</sup> See paragraph 38 of the Commission's Notice on effect on trade. See also paragraph 94, stating that "*trade between Member States is capable of being affected where the targeted undertaking exports to or imports from other Member States and where it also operates in other Member States.*"

end destination through different ports (e.g. from Bristol to Ironbridge rather than from Hunterston) and/or from domestic pits as a result of greater competition in the haulage service, the power companies might have selected a different haulier operating from a different source point to haul their coal requirements. In such circumstances, the pattern of imports from other Member States could have been different.

- (b) **Effect on the competitive structure of the market and on the establishment of European freight companies in Great Britain.** EWS's exclusionary agreements and its discriminatory and predatory pricing behaviour were aimed at and/or had the effect of limiting the development of competition in the haulage of coal by rail in Great Britain. In particular, EWS's behaviour threatened to eliminate FHH as a direct competitor in the coal haulage market, as well as ECSL as a facilitator of competition in the coal haulage market. As a result, EWS's pricing behaviour affected the competitive structure inside the Community<sup>20</sup>.

Moreover, during the relevant period, there were train operators established in other Member States which were in a position to establish freight operations in Great Britain, or an international grouping pursuant to EC Directive 91/440<sup>21</sup> for the purpose of providing an international combined transport (freight) service or else investing in Great British freight operations through joint ventures or other shareholdings. In this connexion, it is striking and relevant to compare

---

<sup>20</sup> See paragraph 20 of the Commission's Effect on Trade notice.

<sup>21</sup> Under the Railways Act 1993, any undertaking is permitted to establish a freight operation within GB (see Annex B, *Becoming a Rail Freight Operator within Great Britain*) provided it gains appropriate regulatory clearance (including a licence issued by ORR) and negotiates the appropriate train paths with the Infrastructure Manager.

In addition to domestic railway legislation the European Union introduced a number of Directives that had the aim of liberalising the railway sector across Member States. One of the first, Council Directive 91/440EC *On the development of the Community's railways* (transposed into UK legislation by way of S.I. 1998/1340 which came into force on 27 June 1998), established by way of Article 10 that **international groupings** (defined within the Directive as any association of at least two railway undertakings established in different Member States for the purpose of providing international combined transport (freight) services between Member States) should be granted access and transit rights in the Member States of establishment of their constituent railway undertakings, as well as transit rights in other Member States. An international freight service in a GB context is a service, which transits through the Channel Tunnel.

Further EU railway liberalisation measures followed, Directives 2001/12/EC (which amended 91/440), 2001/13/EC (which amended 95/18), and 2001/14/EC, (known together as the 'First Package') and later Directives 2004/49/EC, 2004/50 (amending Directives 96/48 and 2001/16) and 2004/51/EC (which further revised 91/440) and Regulation 881/2004 (known together as the 'Second Package'). The First Package Directives together with a number of measures in the Second Package were implemented into UK legislation by way of The Railway (Licensing of Railway Undertakings) Regulations 2005 (SI 2005/3050) and the Railways Infrastructure (Access and Management) Regulations 2005 (SI 2005/3049). The implementation regulations provide that a train operator licensed in another Member State may from November 2005 access the GB network for the purposes of running a freight service.

the absence of new entry from operators based in other Member States in the market for coal haulage by rail with developments in the market for passenger rail services. In the market for passenger rail services, French and Dutch operators (SNCG and NEDRAILWAYS) have set up joint ventures and/or invested capital in subsidiary companies to run the Transpennine Express, Thameslink, South Central, Kent and Northern Rail franchises. In short, there is good reason to suppose that EWS's exclusionary conduct and agreements have had the effect of, or at least were capable of, dissuading new entrants based in other Member States from entering the market for the haulage of coal by rail in Great Britain.

19. Furthermore EWS's conduct runs counter to the liberalisation aims of the European Union as set out in its First and Second packages of railway measures (see footnote 20) in relation to single market integration and the wider policy objectives of the European Parliament to purposefully tackle the liberalisation of European railways.

20. In summary, the aspects of EWS's agreements and conduct described in part II A (*Exclusionary contracts*), part II B (*Discrimination*) and part II C (*Predatory pricing on flows to Cottam and West Burton*) below, constitute infringements of Article 82 EC (from the time when they were applied) as well as of the Chapter II prohibition of the Act (from March 2000 to 2004). In part D ORR sets out the Penalty it is imposing on EWS and the Directions it is making in order to bring any continuing infringement to an end.

# Part IIA: Assessment of abuse of dominance – Exclusionary contracts

---

## Introduction

A1 It has already been demonstrated in part I, *Market definition and Assessment of dominance*, that EWS is dominant in the relevant market for coal haulage by rail in Great Britain. This part (II A) considers whether EWS abused its dominant position, contrary to Chapter II of the Act and Article 82 EC, by entering into, applying and maintaining certain agreements with industrial users of coal for the haulage of coal by rail (the 'CCAs' or coal carriage agreements). In particular, this part assesses the extent to which vertical restraints within these agreements had and have the effect of foreclosing coal haulage by rail to actual and potential competitors.

A2 The effects of the contracts have to be assessed in the context of the prevailing market conditions. As identified in part I *Market definition and Assessment of dominance*, the market for coal haulage by rail in Great Britain is characterised by various structural limitations, including limited infrastructure (access to the track) and wagon availability. The assessment, therefore, considers whether particular clauses in the CCAs added to the structural barriers to entry already existing in the market and thereby strengthened EWS's dominant position.

## Background to the allegations

A3 The Complaint refers to the operation of exclusive long-term supply contracts with power stations, which, the complainant alleged, acted to foreclose competition. The use of certain types of commercial restrictions and incentives within the contracts between EWS and its customers, which by intent and/or in operation have an exclusionary effect, is just one element of anti-competitive behaviour addressed by ORR in this Decision.

A4 The finding of abuse concerns the terms of the following CCAs:

- (a) The E.ON CCA
- (b) The RWE CCA
- (c) The AES Drax CCA; and
- (d) The Corus CCA

A5 Within this part, the term vertical restraint is used to describe an agreement between undertakings operating at different levels of the supply chain (between a supplier and its customer) which restricts the commercial freedom of one or more of the parties to the agreement. A review of the CCAs has identified various types of vertical restraint. These vertical restraints either provide exclusivity for EWS or have some other anti-competitive effect, whereby incentives or obligations agreed

between EWS and the buyer make the latter concentrate its purchases to a large extent with EWS.

A6 The particular vertical restraints which have had an exclusionary effect on the market for coal haulage by rail in Great Britain are as follows:

- (a) Exclusivity or near exclusivity provisions
- (b) Scope to extend contractual exclusivity to new business
- (c) Minimum annual payments
- (d) Loyalty-inducing discounts.

A7 The effect of these clauses has been assessed in the light of the long duration of the CCAs in question.

### **Applicable legal principles**

A8 According to the case law of the European Court of Justice (ECJ), an ‘abuse’ is an objective concept referring to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is already weakened and which, through recourse to methods different from those governing normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition<sup>22</sup>.

A9 A dominant undertaking has a special responsibility, irrespective of the causes of that position, not to allow its conduct to impair genuine undistorted competition on the common market<sup>23</sup>. Whilst the fact that an undertaking is in a dominant position cannot deprive it of its entitlement to protect its own commercial interests when they are attacked, and whilst such an undertaking must be allowed the right to take such reasonable steps as it deems appropriate to protect those interests, such behaviour cannot be allowed if its purpose is to strengthen that dominant position and thereby abuse it<sup>24</sup>.

A10 In *Claymore*<sup>25</sup> the Competition Appeal Tribunal (‘the Tribunal’) stated that the relevant considerations for the application of the Chapter II prohibition include, amongst other matters:

---

<sup>22</sup> See, for example, Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461 (“HLR”), paragraph 91; Case 322/81 *Michelin v Commission* [1983] ECR 3461 (“Michelin I”), paragraph 70; Case C-62/86 *AKZO v Commission* [1991] ECR I-3359, paragraph 69; and Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969, paragraph 111.

<sup>23</sup> *Michelin I*, paragraph 57, and *Irish Sugar*, paragraph 112.

<sup>24</sup> Case 27/76 *United Brands v Commission* [1978] ECR 207, paragraph 189.

<sup>25</sup> Case 1008/2/1/02 *Claymore Dairies Limited and Arla Foods UK PLC v Office of Fair Trading* [2005] CAT 30, §188.

- (e) whether the actions of the dominant firm go beyond what may be considered “normal” competition in a market where competition is already weak as a result of the presence of the dominant firm;<sup>26</sup>
- (f) whether the firm’s conduct was reasonable and proportionate;
- (g) whether the conduct was intended or likely to affect the structure of the market, by preserving or strengthening its dominant position.

A11 The application by a dominant company of **exclusionary** contractual terms falls under the first head of abuse listed in the Chapter II prohibition/Article 82, i.e. directly or indirectly imposing unfair trading conditions. Where an economic operator holds a strong position in the market, the conclusion of exclusive supply contracts in respect of a substantial proportion of purchases generally constitutes an unacceptable obstacle to entry to that market. Vertical restraints that may operate to foreclose a market include exclusive purchasing, quantity forcing and fidelity discounts.

A12 In assessing whether an abuse has been committed, consideration is given to the likely effect of the dominant undertaking’s conduct on customers and on the process of competition (*OFT Notice on an Abuse of Dominant Position* “OFT 402” §5.2). This will depend on the individual circumstances of the case. The impact on competition will depend on the form of the conduct and the supplier’s market power. The degree of foreclosure effect will depend on the scope of the restrictions imposed, the market power of other parties to the agreement and the duration of the restrictions.

A13 Abusive conduct cannot be exempted. There is no block or individual exemption for contractual terms in the same way as for the Chapter I prohibition or Article 81 (see OFT 402 §2.10-2.11). Even if the agreement falls within the terms of a block exemption, that will not prevent the behaviour from constituting an abuse. The assessment of an agreement under Article 81 EC is irrelevant for its assessment under Article 82 EC<sup>27</sup>.

A14 However, conduct may not be regarded as an abuse (even if it restricts competition) where there is an objective justification for such conduct. Economic benefits, such as economies of scale or relationship-specific investments, may provide an objective justification if the dominant undertaking can show that its conduct is proportionate and the least anti-competitive way of achieving those benefits (OFT 402, §5.3).

A15 The EC’s Guidelines on Vertical Restraints<sup>28</sup> (‘the guidelines’) discuss (paragraph 137 et sequitur) common vertical restraints and note that one of the

---

<sup>26</sup> See also the Opinion of AG Kokott of 23 February 2006 in Case C-95/04P *BA v Commission* (not yet published; “the BA Opinion”), at paragraph 26.

<sup>27</sup> Joined Cases C-395/96 P and C-396/96 P *Compagnie maritime belge transports and Others v Commission* [2000] ECR I-1365, paragraphs 30 and 130 to 136; Case C-310/93 P *BPB Industries and British Gypsum v Commission*, [1995] ECR I-865, paragraph 11.

<sup>28</sup> OJ [2000] C 291/1, [2000] 5 CMLR 1074, at paragraph 95 (section 1.1).

negative effects on the market that may result from them, which EC competition law aims to prevent, is “foreclosure of other suppliers or other buyers by raising barriers to entry.”

A16 The assessment of the effect of vertical restraints within each EWS CCA has taken account of the extent of the restraint, i.e. the percentage of the market, which it secures, and its duration. Contract length is problematic where anti-competitive clauses or effects are present because it extends the market foreclosure over a longer period, thereby allowing the dominant firm to leverage its dominance in the current period into future periods.

A17 The Tribunal addressed the issue of the foreclosure effect of exclusive arrangements in *Claymore*, from which the following principles emerge:

- (a) Conditions that the customer will be obliged to obtain all or most of its requirements exclusively from the dominant undertaking will be abusive (paragraph 291 referring to *Hoffman-La Roche*<sup>29</sup> (*HLR*), paragraph 89).
- (b) It is irrelevant that the customer may have asked for the exclusive arrangement (paragraph 291, again referring to *HLR*, paragraph 89).
- (c) The watering down of the classic principle expressed in *HLR* by the introduction of a *de minimis* exception could produce uncertainty and is not justified by authority (paragraph 307).
- (d) Asymmetry in the market between the dominant undertaking and its nearest competitor(s) will be a relevant consideration: in *Claymore*, Wiseman had 74% of the market and was 9-10 times larger than *Claymore*, which had 6% of the market. (In the case of EWS’s position on the market for coal haulage, the asymmetry was clear throughout the period under investigation. Indeed, EWS faced no direct competitor in the market for coal haulage by rail in Great Britain before January 2001.)
- (e) Another material factor was that the contract in *Claymore* lasted for 3 years (*Claymore*, paragraph 295).
- (f) Foreclosure issues are “more acute” where the pricing is also below average total cost (*Claymore*, paragraph 296).

A18 Contractual exclusivity is the most serious contractual restraint. This unambiguously forecloses a proportion of the relevant market to competition. However, other contractual clauses which have the effect of exclusivity through inducing customer loyalty or which give the undertaking an anti-competitive advantage over its rivals are also a concern.

---

<sup>29</sup> Hoffman-La Roche & CO AG v EC Commission 85/76 (1979), ECJ.

## *Exclusivity*

A19 Exclusive purchasing agreements are arrangements that prevent the customer either directly or indirectly from purchasing competing products from any other supplier. The Court of Justice has stated that where a dominant undertaking ties purchases by an obligation to obtain all or most of their requirements from it, the dominant undertaking abuses its dominant position<sup>30</sup>. The abuse consists in further weakening the structure of competition in the market where the undertaking is already dominant.

A20 The extent and impact of contractual exclusivity in the market for the carriage of coal by rail is discussed in more detail below in relation to the CCAs with E.ON and Corus.

## *Quantity forcing (including minimum purchase amounts)*

A21 A minimum annual payment (MAP) clause is sometimes referred to as a take or pay arrangement or quantity forcing. A take or pay contract is a form of volume commitment where the purchaser explicitly agrees to purchase (or make a payment corresponding to) a given level of volume, regardless of whether or not it eventually needs or even actually receives that volume. Contracts that contain minimum annual purchase amounts while not necessarily exclusive outright might nevertheless confer de facto exclusivity on the supplier and restrict competition. This is discussed in more detail below in relation to the AES Drax CCA.

## *Volume discounts and English clauses*

A22 Volume discounts can also result in potentially strong anti-competitive effects. These effects can take various forms depending on the structure of the volume discount offered. Broadly, there are two ways to structure a volume discount: uniformly or by tiers. The applicable legal principles and their application in this case are discussed in greater detail below in relation to the RWE CCA.

A23 According to paragraph 152 of the guidelines, Article 82 specifically prevents dominant companies from applying English clauses or fidelity rebates schemes. English clauses requiring the buyer to report any better offer, may also work as a form of quantity forcing, making it harder for rivals of the dominant undertaking to win business with the buyer than if there were no such clauses.

## **Relevant market context**

A24 Previous sections of this Decision contain discussions on the position of EWS and its competitors in the market for the haulage of coal by rail and the factors set out at paragraph 121 of the guidelines have, therefore, been addressed in assessing whether the restraints in EWS's coal haulage contracts are likely to constitute an appreciable restriction of competition i.e:

---

<sup>30</sup> *Hoffman La Roche*, paragraph 120.

- (a) The market position of the suppliers
- (b) The market position of competitors
- (c) Entry barriers
- (d) Buying power
- (e) Maturity of the market
- (f) Level of trade
- (g) The nature of the goods or service; and
- (h) Other factors.

A25 Taken into particular consideration is the fact that the market for coal haulage by rail in Great Britain was characterised by numerous structural constraints that operated to reinforce EWS's dominant position and that, during the period under investigation, EWS was either an outright monopolist with 100% share of the relevant market, or a dominant firm facing very limited competition from a single rival whose presence did not reduce EWS's market share below 84%.

### **The ESI background**

A26 Electricity generation has gone through a period of significant change since privatisation. EWS's 'legacy contracts' with, amongst others, National Power<sup>31</sup> from 1998 and with Powergen<sup>32</sup> from 1996 have continued in existence without notice being served by either party, even following subsequent divestments and acquisitions by new owners. EWS has continued to move coal under those contracts.

A27 At the time of privatisation and the establishment of the new electricity licensing regime in 1990, almost all of the coal-fired power stations were in the hands of two companies, National Power and Powergen. Following a period of industrial reorganisation, both companies divested many of their coal-fired plants to other undertakings, such as Eastern Electricity (later TXU) and various US based power companies, which, in many cases, subsequently re-sold the power plants (see Annex D, *History of coal power station ownership since 1990*). These corporate transactions have resulted in some complex contractual arrangements.

A28 National Power and Powergen had agreed to purchase large volumes of indigenous coal at a time when those generators accounted for almost all UK generating capacity. As explained in part I (*the electricity supply industry, how the generators procure rail transportation*), the take or pay commitments between UK

---

<sup>31</sup> Contract expiry date 1 April 2008 at earliest if nominated by EWS or 1 April 2003 if nominated by National Power on 12 months notice.

<sup>32</sup> Contract expiry date 31 March 2003 at the earliest with 24 months notice.

coal suppliers and Powergen, National Power and TXU (at that time Eastern)<sup>33</sup> continued even following the divestment of power stations to new entrants and thus onward coal supply formed a part of the divestment package.

A29 Thus, much of the coal hauled under the contracts between EWS and RWE (formerly the National Power contract) and between EWS and E.ON (formerly the Powergen contract) is not coal for use in (current) RWE and E.ON power stations but is delivered to stations now owned by other generating companies. The restrictions that exist within those contracts, therefore, have the potential to affect a greater share of UK coal fired generation than that currently represented by E.ON and RWE.

A30 Moreover, the extension of the provisions of those contracts to new flows and new business liberated as a result of power station divestment enables EWS to secure additional volumes of coal haulage that might otherwise have been open to competition outside the terms of the E.ON and RWE contracts and therefore available to rival coal haulage operators to bid for. Although EWS attempted to characterise its involvement in such extensions as passive, on the basis that it is an entirely voluntary decision by the customer<sup>34</sup> with which it does not have to comply, a dominant undertaking should avoid taking steps that would distort competition in the market. EWS's system of incentives and quantity-forcing provisions have had the opposite effect and have encouraged customers to show loyalty to EWS for their additional business at the expense of new entrants.

### **Contemporaneous evidence of EWS's exclusionary strategy**

A31 Evidence relating to specific CCAs entered into by EWS is considered further below. However, the individual CCAs need to be seen in the light of the general exclusionary strategy and intent of EWS, evidenced by contemporaneous documents and considered in this section.

A32 Contemporaneous documents provided by EWS illustrate how it considered contractual restrictions on purchasers, either in the form of explicit exclusivity or restraints tending to have a similar effect, to be an important element of its strategy to retain control over the coal haulage market. This became particularly evident as new contracts were pursued following the entrance of new generators and divestment of power stations and when the prospect of new entry became apparent.

A33 EWS certainly considered contracts to be a powerful tool to stave off potential competition. The notes of a minerals marketing team meeting entitled, "ESI Business Strategy" held on 20 January 2000 noted<sup>35</sup>,

---

<sup>33</sup> UK Coal reports, for example, that, "*the contracts UK Coal acquired on the privatisation of British Coal for the supply of coal to electricity generators National Power, Powergen and Eastern, expired in March 1998. Replacement contracts were subsequently agreed for the supply of up to 109 million tonnes by 2003*" [www.rjb.co.uk/top/docprof.htm](http://www.rjb.co.uk/top/docprof.htm)

<sup>34</sup> Response, paragraph 5.3(c)(ii) and 5.33 *et seq.*

<sup>35</sup> Document 362 of Volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

‘Freightliner – establishes ‘Heavy Haul Division’ – we are particularly vulnerable where customers have own wagon fleets. Freightliner could ‘cherry pick’ key power stations. We must act very promptly with customers who are not contracted.’”

A34 EWS contended in its Response<sup>36</sup> that this evidence, at its highest, only reveals the desirability to EWS of winning the business of customers which were not currently contracted and does not show either that existing contracts were exclusionary or that EWS planned to enter into exclusionary contract terms with new customers. If viewed in isolation this statement, in the context of an effectively competitive market, might reflect a legitimate commercial desire to win business. However, FHH did not enter the market for the haulage of coal until January 2001. In January 2000, the EWS minerals marketing team identified an opportunity to secure, by contract, the new customers currently without long-term contracts and who would otherwise provide entry opportunities into coal haulage by rail.

A35 The EWS Minerals Business Plan, 2000<sup>37</sup>, demonstrates that this strategy to pre-empt competition by securing business by contract continued for the next 6 months. It stated, “[t]here is currently no on-rail competition in this sector”, and noted that, “customers would welcome an alternative supplier, if only for putting negotiating pressure on EWS.” It noted that some of the newer customers might see the benefit in persuading a third party leasing group such as GE Capital to invest in new wagons and that, “[t]his underlines the importance of negotiating new arrangements with these customers as quickly as possible.” It referred also<sup>38</sup> to the need for EWS to secure new customers’ business “by negotiating with new power station owners to **pre-empt competition**”. (Emphasis added.)

A36 A slide presentation to the EWS Board in March 2000<sup>39</sup> specifically addressed the question, “[h]ow can EWS maintain market control and deter the threat of an Open Access Operator<sup>40</sup>?” The same presentation went on to describe EWS’s approach as being, “[w]orking with the Generators to reach direct commercial

---

<sup>36</sup> Section 5 paragraph 5.6(a).

<sup>37</sup> Document 342 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002 (section 4, page 9). This paper is undated, however, EWS confirms in its Response (section 2 paragraph 2.70) that this was written in June/July 2000 and therefore after the entry into force of the Act.

<sup>38</sup> Section 3 (page 8) of the Minerals Business Plan, entitled Minerals Marketing Strategy.

<sup>39</sup> Document 401 of Volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>40</sup> This term is generally applied to a passenger undertaking, other than a franchised operator, providing passenger services. In rail freight it is commonly used to describe a contractual relationship whereby the customer negotiates their own access rights to the track with Network Rail (otherwise known as “third party access rights”) and then contracts for haulage with a freight train operator. To date freight customers have not pursued this option. It is a term also loosely applied to rail freight undertakings which were not created out of the privatisation of British Rail.

*arrangements.*” This was identified as being the best way of, “*avoiding the Fiddlers Ferry situation*”<sup>41</sup> and *continuing to control the market*”.

A37 These documents are evidence of EWS’s intent to use direct contractual arrangements with generators (particularly the new owners of the divested power stations) as a means of foreclosing new entrants (such as FHH). EWS’s overall aim was to “*control the market*” by precluding the prospect of competition from new entry and prolonging its position as the monopoly supplier in the market for existing and future deliveries.

A38 EWS submitted within its Response<sup>42</sup> but without giving any supporting evidence, that the slides were prepared at a time of severe operational difficulties of hauling coal into Fiddler’s Ferry for ECSL and indicated the meaning of “control” (as in “*maintain market control*” and “*to control the market*”) should be interpreted in an operational rather than an exclusionary sense. This alternative interpretation must be viewed in the light of all the documentary evidence. The reference to the “*Fiddlers Ferry situation*” where EWS lost out to ECSL indicates that EWS did not want to repeat that scenario and wanted to retain coal haulage opportunities for itself. In that light, “*control the market*” should be read as retaining control through direct contractual relationships with the generating companies.

A39 EWS further submitted in its Response<sup>43</sup> that this slide presentation was for the information of the EWS Board only and that none of the matters set out therein received any Board endorsement or approval. In support of this EWS appended to its Response a copy of the Board minutes<sup>44</sup>. The minutes do not record that the Board rejected the strategy set out in the presentation but equally that there is no evidence to suggest positive endorsement by the Board of these matters. The minutes state that: “there was a discussion about the previous day’s presentations. It was felt that a commercial strategy on coal was lacking”.

A40 EWS’s strategy of attempting to secure contracts directly with generating companies, and of using those contracts to foreclose the market was re-emphasised in Summer 2000. In a draft paper which provided the material for the memorandum, sponsored by Graham Smith and Allen Johnson, to the EWS Board Meeting of 12 July 2000<sup>45</sup> dated 23 June 2000<sup>46</sup> which discussed road and on-rail competition (but was not coal specific) it is stated:

---

<sup>41</sup> Fiddlers Ferry is a power station for which the owners at that time, EME, contracted with ECSL directly for the provision of coal on an E2E basis, ECSL then contracted for haulage with EWS.

<sup>42</sup> Section 7, paragraph 7.63.

<sup>43</sup> Section 5 paragraph 5.6 and section 7 paragraph 7.62.

<sup>44</sup> Which EWS states were not responsive to any of ORR’s requests for information.

<sup>45</sup> Document 528 of Volume 5 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>46</sup> Document 519 of Volume 5 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

**“Wherever possible, we should aim to tie customers into long term deals (for existing and additional traffic) to prevent leakage of revenue/traffic in the future.”** (Emphasis added.)

A41 EWS submitted in its Response<sup>47</sup> that EWS employees who were not employed in and had no involvement in the activities of the coal team prepared this paper. Nor, EWS submitted, were they members of EWS’s board or senior management. EWS also submitted that as far as it could establish the paper was never endorsed or approved by any member of the EWS Board or senior management.

A42 A paper which was submitted to the Board, on this subject, on 12 July 2000<sup>48</sup> and which drew heavily upon the cited draft paper was<sup>49</sup> sponsored by Graham Smith (Planning Director, EWS since 1996) and Allen Johnson (at that time Marketing Director, EWS<sup>50</sup>). This paper stated (at section 4, page 5):

“The primary response to competition, by whatever mode, is the provision of high quality customer service through improved train planning, better resource utilisation and attention to detail. We will discuss other competition issues at the Board meeting”.

In relation to the last sentence above, EWS argued in its Supplementary Response<sup>51</sup> that this does not relate to the matters contained in the June paper. In particular, EWS referred to the recollections of one of the authors of the July paper who “*to the best of [his] knowledge and recollection*” believed this to be a reference to problems regarding complaints made to EWS and ORR by UK coal producers regarding coal haulage prices on Anglo-Scottish flows<sup>52</sup>. In light of this, ORR considers it is not clear that the matters set out in the June paper were actually raised at the July Board meeting. However, in ORR’s view, even if it is the case that the matters specified in the June paper were not raised at the July Board this does not neutralise the earlier statement of intent contained in the June document.

A43 Taken as a whole, the contemporaneous documentation discussed above clearly reveals the importance that EWS attached to securing direct and restrictive contracts with the generators in the context of defending its position against potential competitors.

---

<sup>47</sup> Section 5 paragraph 5.6(d).

<sup>48</sup> Document 528 of Volume 5 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>49</sup> The bullet points on page 4 of that paper, for example, repeat the points made at page 4 of document 519.

<sup>50</sup> With effect from 1 March 2000, Mr Johnson was responsible for authorising all new coal contracts, estimated as having a value of £1 million over the term of the contract: see EWS response dated 10 May 2002 to a section 26 notice dated 19 March 2002.

<sup>51</sup> See Paragraph 3.9 of the Supplementary Response.

<sup>52</sup> See paragraph 6.13 of the Supplementary Response.

## Response to EWS's arguments on exclusionary intent

A44 This section responds to various general arguments advanced in the Response in respect of the CCAs under consideration. Arguments relating to specific CCAs are addressed in the sections below that consider each CCA in turn.

### *Timing*

A45 In paragraph 5.3 of its Response, EWS argued that the legacy contracts (with E.ON and RWE) were entered into before the Act came into force and cannot be used as evidence of exclusionary intent or effect. This argument is not accepted for the following reasons:

- (a) The Tribunal has indicated that regulators can rely on evidence pre-dating 1 March 2000 provided there is other evidence postdating the implementation of the Act to found the elements of an infringement of the Act<sup>53</sup>.
- (b) In assessing the application of Article 82 EC, which has applied in the UK since the European Communities Act 1972, ORR is entitled to take into consideration evidence pre-dating the implementation of national competition law provisions.
- (c) The legacy contracts, including the restrictions within them, have been maintained in force since 1 March 2000.
- (d) In any event, as shown above, many of the documents relied upon as evidence of intent post-date 1 March 2000.

A46 In its Response, EWS stated<sup>54</sup> that five of the six contracts originally identified by ORR in its Notice<sup>55</sup> as giving rise to foreclosure effects were entered into in the period between 1995 and April 1999, and thus before any of the documents relied on by ORR as evidencing EWS's alleged strategy to foreclose the market were created.

A47 This part contains a discussion as to the extent to which the contracts acted to hinder competition during their currency as well as any exclusionary intent that existed at the outset or subsequently. The evidence above is cited in order to demonstrate the importance EWS continued to place on exclusivity and committed volume, in the face of actual or potential entry, and how it relied on such provisions to its advantage to secure rights to haul marginal tonnage. This became particularly evident as new contracts were pursued following the divestment of power stations and the entrance of new owners of power stations, when EWS showed unwillingness

---

<sup>53</sup> Case 1008/2/1/02 *Claymore Dairies Limited and Arla Foods UK PLC v Office of Fair Trading* [2005] CAT 30, §273 and 280

<sup>54</sup> Section 5, paragraph 5.7 et sequitur

<sup>55</sup> In its Response, EWS submitted that the CCAs with AES Fifoots and Celtic Energy were not exclusive and did not have any exclusionary effect. In view of the doubts about the obligations arising under those contracts, ORR did not pursue those allegations any further.

to serve notice on existing contracts in spite of legacy prices which offered low returns<sup>56</sup>.

### *No evidence of implementation*

A48 EWS claimed that there is no mention in the documents cited above of the steps that EWS should take to contract with owners of the newly divested power stations nor any evidence that its alleged strategy was actually implemented (Response, paragraph 5.6, 5.7, 5.8). However, EWS took active steps to pursue negotiations with EME and BE on terms that made it unreasonably difficult for its newly established competitors to compete. (See in particular, part II B below headed *Discrimination*.) Moreover, EWS leveraged its position with established generators, through the extension of the scope of business covered by the terms of the existing CCAs, to reserve rights over indirect coal supply. These steps implemented part of its exclusionary strategy by “*control[ling] the market*”, through direct contractual relationships with the generating companies.

### *Exclusivity and objective justification*

A49 EWS’s argued that the CCAs do not confer exclusivity on EWS and leave its customers free to contract with competing suppliers<sup>57</sup>. In its letter to ORR of 19 October 2001, EWS noted that:

“EWS has not concluded “exclusive supply contracts” of “unreasonably long duration” with power stations so as to foreclose Enron’s competitive prospects. From the documents we have submitted to ORR, it can be seen that EWS’s coal haulage agreements with each of AES and Edison confer neither outright nor de facto exclusivity upon EWS. EWS was unsuccessful in the BE tender (which was awarded to Enron). Coal haulage contracts can generally be terminated after (at most) 5 years. Furthermore, the CRA report recognises (at page 16)<sup>58</sup> that such terms are typical for contracts for haulage of bulk products”.

A50 In EWS’s view, the terms of the CCAs are justified by the prevailing market conditions at the time of their negotiation and had nothing to do with any exclusionary strategy<sup>59</sup>. At Annex 1 to a letter of 20 December 2001, EWS argued that its contracts with E.ON, RWE and TXU reflect the countervailing buyer power enjoyed by these generating companies (an argument dealt with below and in part I in *Assessment of Dominance* above). It referred on its part to a need to “[...] *obtain a*

---

<sup>56</sup> The low returns earned on these contracts is identified by EWS in its Response, see, for example, paragraph 2.60: “[...] *the Legacy Contracts had a significant adverse effect on EWS’s profitability in the period 1996 to 1999/2000* [...]”

<sup>57</sup> Response, paragraph 5.3.

<sup>58</sup> *UK Rail Freight Haulage Services – Market Definition and Dominance Analysis*, Charles River Associates Ltd., March 2001.

<sup>59</sup> Response, paragraph 5.6 and 5.9.

return on its substantial capital tied up in this part of its business<sup>60</sup>.” EWS continued<sup>61</sup>:

“At the time these contracts were concluded, EWS considered that a number of direct benefits could be expected to result from term contracts of this kind in terms of operating costs savings and lower financing costs. On the operating cost side, the process of planning services and scheduling staff and rolling stock could be simplified and the increased certainty in operational requirements could allow for some reduction in the margin of spare capacity that the business needs to maintain. In addition, some savings in transactions costs were also likely. With regard to financing costs, the reduction in risk generated by increased certainty in demand would have tended to lead to a reduction in EWS’ cost of capital which in turn would facilitate EWS’ investment in its rail freight business, including the procurement of new rolling stock [...]”

A51 In the letter dated 19 October 2001 EWS stated that it had not entered into contracts to “foreclose Enron’s competitive prospects” and stressed that it considered none of its contracts to be exclusive or of “unreasonably long duration”, while in its letter dated 20 December 2001 EWS noted, “the need to obtain a return on its substantial capital tied up in this part of its business” and stressed that “increased certainty in operational requirements” could generate cost savings in terms of planning and scheduling staff and rolling stock.

A52 Long-term and exclusive contracts cannot be justified, however, simply because these allow EWS to face less uncertain demand. Uncertain demand is a feature of many markets, and indeed is one of the characteristics of markets that exhibit effective competition: suppliers face the risk that business is lost to rivals. The reduced uncertainty of demand that the contracts provide to EWS derives primarily from the likelihood that these contracts shield EWS from competition. This effect is particularly acute for contracts where EWS is guaranteed X% of a customer’s coal haulage requirements rather than guaranteeing EWS Y millions tonnes of coal haulage per annum: terms expressed as a percentage of customer demand do not protect EWS against variations in a customer’s total coal haulage needs (e.g. as might follow from changes in gas prices) but do protect EWS against the risk of a customer choosing to contract with a rival haulage provider.

A53 An objective justification cannot rest simply on the fact that a contract offers such a form of protection and EWS cannot credibly maintain that the RWE and AES Drax CCAs were not exclusionary. Although according to the terms of the agreement, the customer may have some marginal discretion to contract with competing suppliers, for the reasons set out in more detail below, such discretions are not sufficient to prevent EWS from impeding effective competition. ORR is also not persuaded by EWS’s attempts to justify the contracts by reference to countervailing buyer power. As discussed in the *Assessment of dominance* in part I above, there is no convincing evidence of countervailing buyer power. Moreover,

---

<sup>60</sup> Annex 1 paragraph 5.

<sup>61</sup> Annex 1 paragraph 9.

EWS would not be absolved even if it were able to argue convincingly that anti-competitive terms were included in its coal haulage contracts at the insistence of powerful purchasers. In dealing with the appeal in *HLR*<sup>62</sup> the ECJ held that:

“An undertaking which is in a dominant position on a market and ties purchasers – even if it does so at their request – by an obligation or promise on their part to obtain all or most of their requirements exclusively from the said undertaking abuses its dominant position”.

A54 Thus, the issue is not simply whether the agreement is unattractive to the customer, but whether it forecloses competition in the relevant market. For the reasons set out below, the CCAs had a significant exclusionary effect to the detriment of actual and potential competitors in the market for coal haulage by rail in Great Britain.

## REVIEW OF COAL CARRIAGE CONTRACTS

### Powergen/E.ON

A55 The CCA, which was entered into by EWS and Powergen (henceforth referred to as E.ON) on 14 March 1997, has a commencement date of 1 April 1996<sup>63</sup>. The E.ON contract is typically the second largest in terms of volume of coal hauled in a given year. Table 2 below shows the share of coal haulage by rail accounted for by this contract alone across the investigatory period.

**Table 2. Share of coal haulage by rail accounted for by E.ON contract**

Year	ESI coal haulage by rail (%)	All coal haulage by rail (%)*
2000 <sup>64</sup>	18	16
2001	15	14
2002	19	17

\* Calculated on the assumption that demand for coal haulage by rail is split between ESI and non-ESI in the ratio 89:11

### Exclusivity provisions

A56 The E.ON contract contains clauses that give EWS effective exclusivity over E.ON flows. This was the contemporaneous view of EWS. In a February 2001 Coal

<sup>62</sup> Case 85/76 (q.v. footnote 22).

<sup>63</sup> EWS Response [Footnote 51/Page 15] confirms that although this contract became terminable by E.ON on 24 months notice from 1 April 2003, “[E.ON] and EWS have agreed that notice shall not be served before 31 December 2005”.

<sup>64</sup> Data amended from that in the Notice following RWE submission of 29 July 2005 updating figures with haulage for Dec 2000 which were omitted from original submission of February 2003. [28/323]

Business Budget Commentary<sup>65</sup>, prepared by the coal team for the EWS Board, EWS remarked:

“EWS contracts with Innogy, [E.ON] and TXU all implicitly assumed no on-rail competition...**only [E.ON’s] offers us any real protection against Freightliner.**” (Emphasis added.)

A57 It went on to say:

“Our agreement with TXU has no exclusivity clause, only our agreement with [E.ON] has any meaningful tie ins.”

A58 This shows that EWS was fully aware of the advantage afforded to it by the “*meaningful tie ins*” in the E.ON contract. Although the exclusivity arrangements were negotiated when there was no alternative rail haulier in operation, EWS was aware of the potential for entry by another operator<sup>66</sup>. Furthermore, EWS’s subsequent reliance on the exclusionary terms in an attempt to reserve to itself all of E.ON’s coal haulage requirements and stave off competition from actual or potential new entrants is contrary to its obligations as a dominant undertaking.

A59 An undated contemporaneous review of ESI contracts<sup>67</sup> noted that clause 4.2 of the E.ON contract provided an “*Exclusivity deal for EWS*”. Clause 4.2 of the contract states that:

“[...] all Reference Coal will be moved under the terms of this Agreement<sup>68</sup> [...]”

A60 Clause 4.3 defines Reference Coal as:

“[...] all Coal which [E.ON] requires to be moved to a Power Station<sup>69</sup> from a Supply Point<sup>70</sup> excluding:

---

<sup>65</sup> Provided at document 43 et sequitur of Volume 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>66</sup> See for example Document 519 of Volume 5 of documents provided by EWS in response to a section 26 notice of 19 March 2002 (also cited above).

<sup>67</sup> Provided at document 431 of volume 4 of supplemental documents provided by EWS in response to a section 26 notice of 19 March 2002, following letter of 25 September 2002.

<sup>68</sup> “Agreement” means this agreement including the Power Station Schedules and the Tables.

<sup>69</sup> “Power Station” means:-

“(i) each of the power stations listed in Clause 5; and

(ii) any other power station or other facility which the parties may from time to time agree shall be treated as a Power Station for the purposes of this Agreement”

Clause 5 lists the Power Stations as Cottam, Ferrybridge, Fiddlers Ferry, Ratcliffe, Drakelow and High Marnham.

<sup>70</sup> “Supply Point” means in respect of each Power Station:-

“(i) the location from which Coal will be collected and carried by EWS hereunder as listed in the relevant Power Station Schedule; and

- (a) movements of coal by canal to Ferrybridge; and
- (b) movements by rail under coal supply commitments entered into before 30 August 1996 where the coal supplier has undertaken to provide transport; and
- (c) coal which [E.ON] may, from time to time, require to be transported from supply points which are not Supply Points in this Agreement and where the parties have followed the procedure set out in Clause 6.1<sup>71</sup> and have failed to reach agreement on a Train Movement Charge<sup>72</sup> for the coal to be conveyed under the terms of this Agreement; and
- (d) coal moved from a Supply Point to a Power Station in circumstances where [E.ON] has in good faith provided a notice to EWS specifying:
  - (i) that another haulier has quoted to provide transport for such coal; and
  - (ii) the Train Movement Charge that EWS would be required to offer within the terms of this Agreement to hold [E.ON] financially neutral to such alternative quote;

and EWS has declined to offer a Train Movement Charge which holds [E.ON] financially neutral for the period quoted by the other haulier; and

- (e) coal which [E.ON], after discussion with EWS, reasonably considers to be unsuitable for movement by rail due to its handling characteristics;
- (f) up to 8% of the remaining coal available for movement by rail;
- (g) any Failed Tonnage<sup>73</sup> as defined in accordance with the provision of Clause 4.6”.

(ii) such further location or locations which the parties may from time to time agree shall be treated as a Supply Point for the purposes of this Agreement.”

where

“Coal” means “coal which is to be carried by EWS pursuant to the terms of this Agreement”;

“Power Station Schedules” means “each of the Schedules numbered 1 to 6 attached hereto and which contain details specific to each Power Station”.

<sup>71</sup> Set out in full below

<sup>72</sup> “Train Movement Charge” means “in respect of each Power Station, the amount payable by [E.ON] in respect of each tonne of Coal collected by EWS from the Supply Points and carried to each Power Station, as set out in the relevant Power Station Schedule and as may be varied from time to time in accordance with Clause 8.”

Clause 8 sets out the procedures and mechanisms for calculating price variations over time

<sup>73</sup> The provisions of clause 4.6 state:

“If EWS fails to collect and carry Coal in accordance with the provisions of this Agreement, so that in any Week there is a tonnage amount that would have been collected and carried but for EWS failure then the following will apply:-

A61 The widely drawn definition of Reference Coal gives EWS exclusive rights to transport almost all E.ON's rail haulage requirements<sup>74</sup> save for coal which, under pre-existing contracts<sup>75</sup>, is transported by rail under arrangements entered into by the supplier. E.ON is allowed some future flexibility to use another haulier in circumstances where it wishes to source coal from new supply points (Clause 4.3(c)) and in circumstances where another haulier has offered a lower price and EWS has declined to match it (Clause 4.3(d)). Other than through these (limited) provisions for flexibility, E.ON is only provided with unfettered choice of coal haulier for 8% of the *remaining* coal available to rail (Clause 4.3(f)). One further exclusion gives E.ON discretion in the event of poor performance, where EWS has failed to collect and deliver the weekly forecast tonnage (Clause 4.3(g)).

A62 Those discretions are insufficient in light of the responsibility placed on EWS as a result of its dominant position in the market for coal haulage by rail for the following reasons:

- (a) The discretion in Clause 4.3(c) to use an alternative supplier for new supply points is not absolute but rather is conditional upon the outcome of a prior procedure (set out in Clause 6.1). That procedure effectively gives EWS a pre-emptive right to negotiate for such flows thereby reducing the scope for the discretion to be exercised in practice.
- (b) The discretion in Clause 4.3(d) is circumscribed by an English clause and so will only be exercised in the event that EWS has declined to match a lower competitive price.
- (c) E.ON is entitled to release only a maximum of 8% of the remainder of its haulage requirements (Clause 4.3(f)). This is a small proportion of marginal tonnage. Furthermore, should E.ON choose to exercise the

- 
- (a) [E.ON] may require EWS to collect and carry such tonnage amount in the next following Week or such other Week(s) as the parties acting reasonably may agree
  - (b) EWS will use reasonable endeavours to collect and carry such tonnage amount to meet [E.ON's] requirements in the Week(s) determined in Clause 4.6(a)
  - (c) At the conclusion of the specified Week(s), if EWS has again failed to have collected and carried such tonnage amount, it will be declared "Failed Tonnage" unless the parties acting reasonably agree that such failure was reasonably justified in the circumstances. Any failure to agree shall be resolved in accordance with the provisions of Clause 33
  - (d) [E.ON] will at its discretion have the right in these circumstances to engage another haulier to collect and carry such Failed Tonnage
  - (e) The list of exclusions to Reference Coal specified in Clause 4.3 will be amended to also include the amount of coal which has been declared Failed Tonnage."

Where

"Week" means: "a period of seven days commencing at 00.01 hours on a Monday and ending at 24:00 hours on the following Sunday and "Weekly" shall be interpreted accordingly."

Clause 33 sets out procedures for dispute resolution

<sup>74</sup> Excluding canal movements (Clause 4.3(a)) and coal which is unsuitable to move by rail (Clause 4.3(e))

<sup>75</sup> Commitments entered into before 30 August 1996 where the coal supplier has undertaken to provide transport

other discretions available to it, the volume of coal identified as Reference Coal would diminish and, in turn, this 8% would represent a lower volume of coal available for haulage by rail operators other than EWS.

A63 At paragraphs 5.38 et sequitur of its Response, EWS claimed ORR has mischaracterised the provision in Clause 4.3(d) as an “English clause” and denies that it has any exclusionary effect. In its view, firstly the clause is permissive and imposes no requirement on the customer to inform EWS of competing rates. Secondly, it does not remove any incentive to use an alternative supplier and does not induce the customer to approach EWS.

### **The English clause**

A64 The English clause does not compel E.ON to inform EWS of the precise prices submitted by its competitors. However, it places severe restrictions on E.ON’s freedom to switch haulage to alternative suppliers of coal haulage by rail, outside of the 8% allowance provided under Clause 4.3(f).

A65 If E.ON is considering taking up an offer from an alternative coal haulage supplier, the coal does not cease to be “Reference Coal” unless the precise procedures under Clause 4.3(d) have been followed. Pursuant to this Clause E.ON must notify EWS that another haulier has quoted and moreover specify the Train Movement Charge that EWS would have to offer in order to leave E.ON financially neutral. In effect, this means that EWS is entitled to information on what price that supplier has offered E.ON. Having been given this information, EWS is provided with the opportunity to offer E.ON a revised price for the relevant flow. If EWS chooses to offer E.ON a price that would match the price offered by the rival supplier, E.ON is required to accept EWS’s offer. Only if EWS “has declined to offer” a matching price is that volume of coal deemed to be outside of the terms of the contract.

A66 This means that potential competitors have limited opportunities to supply coal haulage to E.ON. Their ability to win business from E.ON (outside the 8% or new flows) is curtailed not only by the requirement for E.ON to tell EWS the rival’s offer, but also by the prohibition on E.ON accepting a rival bid if EWS has made an equivalent offer.

A67 These likely effects of the terms of the E.ON CCA are consistent with the way in which this CCA has worked in practice. As discussed below, all of E.ON’s rail requirements were met by EWS.

### **Scope to extend the exclusivity provisions**

A68 Clause 4.3(c) envisages that the parties will seek to follow a procedure (set out in Clause 6.1) to include deliveries from new supply points within the definition of “Reference Coal” and therefore within the scope of the exclusivity arrangements.

A69 Clause 6.1 states:

“If [E.ON] requires EWS to collect and carry coal from an additional supply point, whether rail connected or not, which is not at the relevant time included

in the list contained in the relevant Power Station Schedules then such supply point will only be regarded as a Supply Point for the purposes of this Agreement after agreement between the parties in accordance with the following procedures:

- (a) [E.ON] will notify EWS of its requirement for collection and carriage of coal from additional supply points as soon as practicable after it has identified the same and shall give EWS an estimate of the likely tonnage of coal per Year to be carried from any additional supply point and of the prospective period of supply from that supply point;
- (b) on receipt of the notice and information referred to in Clause 6.1(a) EWS will assess its ability to collect and carry coal from that supply point as required by [E.ON] and the parties will meet as soon as reasonably practicable but in any event no later than four weeks after [E.ON's] notice under Clause 6.1(a) to discuss in good faith and determine whether EWS is able to carry coal from that additional supply point and, to agree the applicable Train Movement Charge. In determining the applicable Train Movement Charge for an additional supply point, EWS acting in good faith, will offer a Train Movement Charge which is consistent with the 1998/99 Train Movement Charges for comparable flows as set out in the Power Station Schedules. Providing EWS propose such Train Movement Charge in accordance with this Clause 6.1(b), [E.ON] will accept the Train Movement Charge and it will be added to the list in the relevant Power Station Schedules(s);
- (c) EWS will use reasonable endeavours to provide the capacity to collect and carry coal from such additional supply points as required by [E.ON];
- (d) if the parties agree that, following the procedure laid down in paragraphs (a) and (b) of this Clause 6, EWS will collect and carry coal in respect of an additional supply point, then:
  - (i) that supply point will become a Supply Point for the purposes of this Agreement and the relevant Power Station Schedule will be amended accordingly; and
  - (ii) the coal to be collected and carried by EWS from that Supply Point shall be regarded as Coal for the purposes of this Agreement".

A70 As well as the ability to expand the contract to include new Supply Points, Clause 5.4 allows for the scope of the contract to be expanded, by agreement, to include the carriage of coal to a power station **or other facility** (emphasis added), not included within the contract. E.ON is quoted [...] <sup>76</sup>.

---

<sup>76</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.1]

A71 Clause 5.4 states:

“If [E.ON] requires EWS to carry coal to a power station or other facility which is not at the relevant time included in the list contained in Clause 5.1<sup>77</sup> the matter will be subject to agreement in accordance with the following procedure:

- (a) [E.ON] will notify EWS of its requirements with respect to any such additional power station or other facility as soon as practicable after it has identified the same, and shall provide to EWS the following details:-
  - (i) an estimate of the likely tonnage of coal to be carried per Year to that power station or facility;
  - (ii) an indication of the Supply Points or other sources from which such coal would be collected;
  - (iii) an indication of the prospective period during which carriage of coal to that power station or other facility will be required by [E.ON];
- (b) on receipt of the notice and the information referred to in Clause 5.4(a), EWS will assess whether it can meet [E.ON’s] requirements. As soon as reasonably practicable but in any event no later than four Weeks after EWS has received [E.ON’s] notice under Clause 5.4(a), the parties shall meet to discuss in good faith whether EWS is able to provide the capacity to carry coal to such additional power station or other facility.
- (c) EWS will use all reasonable endeavours to provide the capacity requested by [E.ON] to collect and carry coal from the identified Supply Points or other sources to the additional power station or other facility.
- (d) if the parties agree that, following the procedure laid down in paragraphs (a) – (c) of this Clause 5.4, EWS will arrange to service such additional power station or facility, and:-
  - (i) that power station or other facility will become a Power Station for the purposes of this Agreement and the list in Clause 5.1 will be amended accordingly in accordance with the provisions of Clause 31<sup>78</sup>; and

---

<sup>77</sup> Clause 5.1 lists the Power Stations of Cottam, Ferrybridge, Fiddlers Ferry, Ratcliffe, Drakelow, High Marnham.

<sup>78</sup> Clause 31 states “Except as otherwise provided herein, this Agreement shall not be varied otherwise than by an instrument in writing executed by or on behalf of EWS and [E.ON].”

- (ii) the sources of coal specified by [E.ON] and agreed by EWS as being applicable to each Power Station will become Supply Points for the purposes of this Agreement; and
- (iii) the coal to be collected and carried by EWS to that Power Station shall be regarded as Coal for the purposes of this Agreement”.

A72 As discussed in part I, *Introduction to market definition and assessment of dominance, The electricity supply industry, How generators procure rail transportation*, E.ON’s historical position means that it has significant take or pay contracts for coal (supply not haulage), which it uses to supply coal outside its own operations. Much of this is supplied to power stations, which it previously owned and, which are included as destination points in its contract with EWS. However, the provision in Clause 5.4 also enables E.ON to extend its contract with EWS to include other destination points, even outside the electricity generation industry. By virtue of this provision, the contract can be extended to include any (rail connected) destination point for any customer E.ON acquires as a supplier of coal. This clause has made it easier for E.ON to act as an E2E supplier of coal (rather than supplying coal alone) and in doing so effectively to act as a reseller of EWS’s haulage.

A73 Had the clause limited E.ON to the use of its contract with EWS for ESI coal, its anti-competitive effects would not have extended further. However, the fact that it explicitly permits the contract to be used for non-ESI coal, means that there is no such limit on the anti-competitive effects of EWS’s conduct.

A74 At paragraph 5.33 et sequitur of its Response, EWS emphasised the voluntary nature of the route extension clauses which are dependent on the customer’s election and impose no requirement on EWS to provide the additional services. It stated that it has refused formally to extend the E.ON CCA to certain additional power stations, but it conceded that “*in practice*” it has serviced such requests (footnote 217).

A75 Indeed, there is evidence that this clause has been used precisely to allow E.ON to sell coal on an E2E basis, using EWS as haulier. E.ON has advised that:<sup>79</sup>

“[...]”.

A76 E.ON has stated<sup>80</sup> that the contract “*provides the flexibility [E.ON] needs to add new flows or vary tonnages as required*”. The provisions at Clauses 5.4 and 6.1 certainly facilitate the inclusion of new business in the current contract and provide [E.ON] with a certainty as to the prices it will be charged should it require EWS (and

---

<sup>79</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.1]

<sup>80</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.1]

EWS agrees to be the haulier) to expand the scope of the contract to include new flows. E.ON has also advised<sup>81</sup> that:

“EWS has in some instances – primarily for flows to non-[E.ON] locations – [...]”.

A77 There is, therefore, some limited discretion available to E.ON (other than the 8% residual flexibility allowed for at Clause 4.3(f)) to use an alternative rail haulier in circumstances where it wishes to source coal from new Supply Points or where it wishes to supply new destination points and there has been failure to agree charges.

A78 Such transfer is unlikely to occur, however, for the marginal tonnage which is likely to result from such discretions, even in the face of a lower price, particularly when the customer takes into account the transactions costs of going out to tender and placing a contract with a competitor, together with the risks associated with placing business with an untried operator. The importance of marginal tonnage to a new entrant in this market, which is characterised by significant barriers to entry (as described in Part I of this Decision), is considered in detail below in the discussion of the RWE elective discounts.

### **Actual coal haulage undertaken for E.ON**

A79 E.ON has confirmed this view that the discretions available within the contract for E.ON to use an alternative supplier are unlikely to be exercised. When asked to make representations on the impact on the future operation of the contract should clauses such as those discussed above be removed<sup>82</sup>, E.ON responded<sup>83</sup> (particularly in respect of Clauses 5.4 and 6.1):

“If the ORR were to require these provisions to be removed the contract would still be able to stand due to the effect of clauses 34 and 35 of the CCA. [...]”.

A80 It re-iterated this view in a later response<sup>84</sup> in which it stated that Clauses 5.4 and 6.1 are a ‘necessary’ feature of any coal haulage agreement due to the nature of the business in that coal suppliers are constantly developing their portfolio of reserves or may offer new coals as substitutes from new supply points. It considered that the removal of such provisions “[...] and may create both a barrier to new entrants and market activity by impairing E.ON’s ability to sell coal on”. It stated moreover that the additional tonnage may not be attractive to competitors (which ORR refutes given the importance of marginal tonnage to new entrants) and referred to the additional cost of health and safety contract administration to both parties. Although ORR accepts that E.ON may prefer to deal with one supplier for a

---

<sup>81</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.1]

<sup>82</sup> Letter from ORR to E.ON dated 5 August 2004, providing a non-confidential version of the Notice issued on 6 May 2004. [25/47]

<sup>83</sup> E.ON representations dated 2 November 2004 to a non-confidential version of the Notice issued on 6 May 2004. [25/80.4]

<sup>84</sup> E.ON response dated 5 June 2006 to a non-confidential version of the SO [33/679E].

number of legitimate commercial reasons, ORR believes that the choice of supplier, in those circumstances, should be based purely on its merits and should not require the maintenance of exclusive contract terms.

A81 EWS submitted in its Supplementary Response<sup>85</sup> that although it currently hauls approximately [ ... ] to [ ... ] trains per week to Cottam and West Burton power stations (now owned by EDF) and the terms of the CCA have not been amended formally, it will no longer be conducting any coal haulage in the future to ESI or non-ESI facilities not owned by E.ON at the rates specified in the contract. Those Clauses have, however, been activated in the past and E.ON, has clearly demonstrated in its response, that it would otherwise continue to use those Clauses to contract marginal tonnage to EWS in the future.

A82 Data provided by E.ON has demonstrated that all of E.ON's rail requirements are met by EWS and it has confirmed that<sup>86</sup> it has not moved any coal by rail outside the terms of its contract with EWS. It has agreed that the effect of Clause 4.2 *"is to give EWS contractual exclusivity over most of E.ON's coal movements [...]"*<sup>87</sup>. Moreover the various contractual flexibilities discussed above, including by way of Clauses 5.4 and 6.1, provide incentives for additions or variations to those rail requirements over time to be captured by EWS, even in the face of entry.

## Duration

A83 Finally, the long-term duration of the E.ON contract should be recognised. The E.ON contract contains no specified end-date, instead being terminable by either party on 24 months notice after 31 March 2003. The contract ran for a minimum of nine years; even after that date, should any potential competitor to EWS seek to win significant haulage business from E.ON, that competitor would come up against the 24-month termination period.

## Conclusion on E.ON CCA

A84 EWS has provided no good objective justification for its conduct in relation to the E.ON contract. For the reasons set out above, EWS is found to have abused its dominant position through the agreement, application, maintenance and extension of the exclusionary terms of the E.ON contract.

## National Power/RWE

A85 The CCA, entered into by EWS and National Power (hereafter, in this section, referred to as RWE) on 31 March 1998, has a commencement date of 1 April 1998. The contract term is 10 years, although it is terminable by RWE on 12 months notice, after 5 years. ORR understands that no such notice has been given.

---

<sup>85</sup> Paragraph 6.19(c).

<sup>86</sup> E.ON response dated 17 January 2003 to an ORR information request of 20 December 2002. [12/1026/2.1]

<sup>87</sup> E.ON representations dated 2 November 2004 to a non-confidential version of the Notice issued on 6 May 2004. [25/80.2]

A86 The RWE contract is the single largest in terms of volumes of coal hauled in the period under consideration. Table 3 below shows the volumes hauled under the contract for the years 2000-2002 as a percentage of ESI coal hauled by rail and of all coal hauled by rail.

**Table 3. Share of the market for coal haulage by rail covered by RWE contract**

Year	ESI coal haulage by rail (%)	All coal haulage by rail (%)*
2000 <sup>88</sup>	49	43
2001	31	28
2002	17	15

\* Calculated on the assumption that demand for coal haulage by rail is split between ESI and non-ESI in the ratio 89:11.

A87 The objection to the RWE contract is directed towards the type and level of discounts that EWS has offered to RWE and the extension of the discounting arrangements to cover new routes and additional business. EWS's discounting structure is designed and operates so as to induce loyalty from RWE to concentrate its marginal tonnage requirements for coal haulage with EWS to the exclusion of potential competitors and new entrants.

### Applicable legal principles

A88 Any rebate system which has a foreclosure effect on the market will be regarded as contrary to Article 82 EC if it is applied by an undertaking in a dominant position without any objective justification. According to the case law of the Community courts, there is a distinction between loyalty rebates and quantity rebates:

- (a) **Loyalty rebates** which, by offering customers financial advantages, tend to prevent them from obtaining their suppliers from competing suppliers<sup>89</sup>. Accordingly, rebates, which depend on a purchasing target being achieved by the customer, will normally be contrary to Article 82 EC if they have a foreclosure effect on the market.
- (b) **Quantity rebates** linked solely to the volume of purchases from a dominant undertaking are, in themselves, generally considered not to have the foreclosure effect prohibited by Article 82 EC<sup>90</sup>. If increasing the quantity supplied results in lower costs for the supplier, the latter is entitled to pass on that reduction to the customer in the form of a more favourable tariff. Quantity rebates are therefore deemed to reflect gains

<sup>88</sup> Data amended from that in Notice following RWE submission of 29 July 2005 updating figures with haulage for Dec 2000 which were omitted from the original submission of February 2003. [28/323]

<sup>89</sup> Joined Cases 40/73 to 48/73, 50/73, 54/73 to 56/73, 111/73, 113/73 and 114/73 *Suiker Unie and Others v Commission* [1975] ECR 1663, paragraph 518; *Hoffmann-La Roche*, paragraphs 89 and 90; *Michelin I*, paragraph 71.

<sup>90</sup> *Michelin I*, paragraph 71, and Case C-163/99 *Portugal v Commission* [2001] ECR I-2613, paragraph 50.

in efficiency and economies of scale made by the undertaking in a dominant position. Quantity rebates will not infringe Article 82 EC unless the criteria and rules for granting the rebate reveal that the system is not based on an economically justified countervailing advantage but tends to prevent customers from obtaining their supplies from competitors<sup>91</sup>.

A89 The Court of First Instance (CFI) has held that a rebate does not have to be discriminatory in order to have foreclosure effects<sup>92</sup>. Furthermore, rebate schemes may be abusive even if they are not linked to a condition of exclusivity: even where there is no such conditionality, the foreclosure effect of a rebate or bonus scheme may arise from the other circumstances of the particular case<sup>93</sup>. The incentive to purchase additional units, faced by a customer under a quantity rebate or discount scheme, is much greater where the discounts are calculated on total turnover achieved during a certain reference period (“uniform discount”) than where they are calculated only tranche by tranche (‘tiered discount’). The longer the reference period, the more loyalty-inducing the quantity rebate scheme will tend to be<sup>94</sup>.

A90 In determining whether a rebate scheme is abusive, it is necessary to consider all the circumstances, particularly the criteria and rules governing the grant of the rebate, and to investigate whether, in providing an advantage not based on any economic service justifying it, the rebates tend to remove or restrict the buyer’s freedom to choose his sources of supply, to bar competitors from access to the market, to apply dissimilar conditions to equivalent transactions with other trading parties or to strengthen the dominant position by distorting competition<sup>95</sup>.

A91 The CFI has held that, for the purposes of establishing an infringement of Article 82 EC, it is sufficient to show that the abusive conduct of the dominant undertaking “*tends to restrict competition or, in other words, that the conduct is capable of having that effect*”<sup>96</sup>. Furthermore, where a dominant company has pursued a particular practice with the object of limiting competition, the conduct that has been implemented will also be liable to have such an effect<sup>97</sup> and there is no need to demonstrate the actual effects of the discounting practice. Thus it not

---

<sup>91</sup> *Hoffmann-La Roche*, paragraph 90; *Michelin I*, paragraph 85 and *Portugal v Commission*, paragraph 52.

<sup>92</sup> Case T-203/01 *Manufacture française des pneumatiques Michelin v Commission* [2003] II-4071 (“*Michelin II*”), paragraphs 239 to 245. The point has recently been affirmed by AG Kokott in the BA Opinion at paragraph 132.

<sup>93</sup> Opinion of AG Kokott of 23 February 2006 in Case C-95/04P *BA v Commission* (not yet published; “the BA Opinion”), paragraph 44.

<sup>94</sup> *Michelin II*, paragraph 88.

<sup>95</sup> *Hoffmann-La Roche*, paragraph 90; *Michelin I*, paragraph 73.

<sup>96</sup> Case T-203/01 *Manufacture française des pneumatiques Michelin v Commission* [2003] II-4071 (“*Michelin II*”), paragraph 239.

<sup>97</sup> *Michelin II*, paragraph 241.

necessary to show that an aim of excluding competition was actually achieved, to find an abuse under Article 82 EC<sup>98</sup>.

A92 This approach to competitive effects has recently been affirmed in the BA Opinion. Application of Article 82 EC is not deferred until there is practically no effective competition in the market but also protects existing competition that is already weakened by the presence of the dominant undertaking<sup>99</sup>. Article 82 EC protects the structure of the market and competition as such, not only the immediate interests of individual competitors or customers. The conduct of a dominant undertaking is not regarded as abusive only once it has had concrete effects on individual market participants but also where a line of conduct runs counter to the protection of competition from distortion and the dominant undertaking's duty not to impede effective competition<sup>100</sup>.

A93 An abuse of a dominant position may therefore consist in the application of a discount scheme that goes beyond normal competition on the merits and is capable of making it impossible or more difficult for competitors to gain access to the market or for customers to choose between various sources of supply.

A94 Moreover, where the discounted prices are predatory, they may be regarded as abusive. If the discounted prices are below average variable costs, the Court will infer that the only interest that the dominant company could have in applying such prices is that of eliminating competitors<sup>101</sup>. Where the prices are above average variable cost but below average total costs, they will be abusive if they form part of a plan to eliminate a competitor<sup>102</sup>.

### **Tiered vs uniform discounts**

A95 The contract between RWE and EWS contains discounts with two structures. One is a pure form of tiered discount<sup>103</sup>, referred to within the contract as a "Progressive" discount, and the other is a uniform discount, referred to within the contract as an "Elective" discount<sup>104</sup>.

---

98 Michelin II, paragraph 245.

99 BA Opinion, paragraph 44.

100 BA Opinion, paragraphs 68–74.

101 AKZO, paragraph 71 and Michelin II, paragraph 242.

102 AKZO, paragraph 72 and Michelin II, paragraph 242.

103 Details of this discount are contained in note ii to Schedule 1 of the contract.

104 Note iii to Schedule 1 of the contract defines the elective discount as follows:

Tables indicated to be "Elective" means that [RWE] shall nominate at the same time as the Annual Forecast is issued a column and shall pay the rates set out in that column. If [RWE] fails to achieve the minimum volume of movements stipulated in its nominated column, it shall pay the rates set out in the column which covers the volume it has actually moved in that Contract Year. If [RWE] exceeds the volume of movements stipulated in its nominated column the volume of excess movements shall be paid for at the rates set out in the column which covers the volume it has actually moved in that Contract Year.'

A96 Under a tiered discount scheme, the discounted price is applicable only when additional (i.e. marginal) tonnage exceeds a particular threshold or band and the discount is applied on that tonnage in excess of the threshold only, i.e. tonnage less than the threshold is charged at the higher, pre-existing, price(s).

A97 Under a uniform volume discount, if a discount threshold is passed, the discount is applied uniformly to all units purchased over the reference period to which the discounts applied. Volume discounts offered by large incumbent undertakings can result in a strong anti-competitive effect by reducing the incentives on the buyer to make use of potential competitors to the incumbent supplier. This can work in two ways:

- (a) If the buyer were to shift some **existing** coal haulage to a competitor of the incumbent supplier, it could risk dropping below the existing threshold in the discount structure, thus facing an increase in the price of all remaining units purchased from the incumbent supplier.
- (b) If the buyer were to place any **new** coal haulage with a competitor rather than the incumbent supplier, it could reduce the chances of the buyer moving up to another threshold on the discount structure, thus lowering the price of all its pre-existing units.

A98 As a result of these effects, a potential competitor to the incumbent supplier would need to offer the buyer prices that are sufficiently low not just to be competitive with the prices that the incumbent supplier has set for additional volumes purchased by the buyer, but also to compensate the buyer for any effective price rise (or increased risk of a price rise) that the buyer would experience on the units that it continues to purchase from the incumbent.

A99 Uniform discount schemes were found to be an abuse of dominance in *Michelin II*<sup>105</sup>. In the absence of evidence that the scheme in question reflected economies of scale, the CFI found it to be abusive, emphasising its duration and the fact that rebates were payable on sales back to one unit.

A100 The potential for foreclosure effects with uniform discounts is most acute when marginal prices are below cost, or in the extreme, negative. ORR uses the concept of marginal price to denote the additional expenditure (per tonne) that the customer would incur, under the discount scheme, if it were to purchase additional volume. This marginal price depends on both the volume that the customer has already taken (or expects to take) from EWS and the additional volume that the customer would be purchasing.

A101 Marginal prices are relevant to the analysis of foreclosure since it is marginal prices against which alternative suppliers compete. For example, in the case of new business, if the increase in volumes purchased takes the customer to a new discounted price, then the marginal price is calculated as the increase in expenditure from new purchases (i.e. new discounted price multiplied by the increase in quantity)

---

<sup>105</sup> OJ 2002, L 143, p.1 and on appeal to the CFI Case T-203/01.

minus the reduction in expenditure on existing sales (i.e. price reduction multiplied by existing sales), all divided by the increase in quantity purchased.

A102 If the marginal price is less than average variable costs, then an equally efficient competitor will be unable to compete effectively for that specific volume of new business. However, because competitors will need to recover fixed costs in order to justify continuing in the market, such exclusion can take place even when the marginal price is above the level of variable costs.

A103 ORR focuses on the 'elective discount' within RWE's contract with EWS rather than the 'progressive' discount scheme.

### Overview of key evidence

A104 When assessing the RWE contract it is important to consider it in its surrounding context. This contract arose out of and was part of the sale of the National Power Rail Unit to EWS in 1998. Contemporaneous documents provided by EWS have suggested that EWS priced aggressively on this contract. An internal EWS memorandum of 11 May 1997<sup>106</sup> referred to emerging agreement on coal haulage rates as presenting a reduction on current prices of as much as 43.9% and a return on sales as little as 7%. The same note reveals EWS's strategic intention of:

**"[...] trying to prevent NP expanding their area of operation and, through exercising their option for more loco's [locomotives], possibly competing with us for other forms of traffic."** (Emphasis added.)

A105 This document reveals EWS's motive, at the time, of keeping its monopolistic position as coal haulier and to deter RWE from expanding its own coal haulage business, beyond self-supply, and into competition with EWS.

A106 In this context, it is also important to understand the significance of marginal tonnage for a new entrant to the market for coal haulage by rail. Given the significant barriers to entry identified in part I of this Decision in *Assessment of dominance*, not least capacity constraints, a new entrant will not be in a position to enter and compete for the whole of a customer's coal haulage demand. Entry requires, in the first instance, a committed contract, thereafter expansion typically involves securing marginal tonnage.

A107 By offering significant discounts for a marginal increase in expenditure, EWS's elective discount scheme restricts the ability of potential new entrants to compete for that business which would otherwise be most susceptible to competition after new entry.

---

<sup>106</sup> Provided at document 78 of file 1 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

## **The nature of the RWE elective discount scheme**

A108 Under the elective discount scheme, different prices apply to coal haulage on particular flows, depending on the volumes of coal hauled on that flow (or on a specified group of flows including that flow).

A109 The elective discounts specified in the original RWE contract cover the following flows:

- (a) Specific English source points (Harworth, Maltby, Rossington, Thoresby, Welbeck, Rufford, Oxcroft and Clipstone) to Eggborough and Drax. Separate discounted prices apply depending on whether the destination is either Eggborough or Drax although the price is calculated in each instance according to the combined tonnage hauled to both power stations from the source points in question;
- (b) Daw Mill to Didcot; and
- (c) Specific Scottish source points (Ayr Harbour, Blindwells, Carstairs, Holehouse, Killoch, Knockshinnoch, Law Junction, Millerhill, Mossend, Ravenstruther, Thornton, Westfield) to Eggborough and Drax. The discounted prices are calculated according to the combined tonnage to each power station from the source points in question and are identical for either Eggborough or Drax.

A110 The discount scheme is 'elective' in the following sense. Before the start of a 'contract year', RWE elects which rates to pay on each flow within the scheme. It does so by choosing columns of rates that correspond to particular discount bands, where each discount band represents rates applicable for different volumes of haulage over the contract year. The Table below provides an illustration of the discount bands applicable, taken as an extract from the elective discount prices for Scottish source points to Eggborough and Drax.

**Table 4. Extract from RWE elective discount prices for Scottish source points to Eggborough and Drax**

Origin	Band A (less than 500kt)	Band B (500kt-749kt)	Band C (750kt to 999kt)	Band D (1000kt and above)
Ayr Harbour	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Blindwells	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Carstairs	[ ... ]	[ ... ]	[ ... ]	[ ... ]

A111 As can be seen from the Table, each column provides rates, for each flow, that correspond to different volumes under the discount band structure.

A112 Schedule 1(iii) of the RWE contract states:

“Tables indicated to be “Elective” means that [RWE] shall nominate at the same time as the Annual Forecast is issued a column and shall pay the rates set out in that column. If [RWE] fails to achieve the minimum volume of movements stipulated in its nominated column, it shall pay the rates set out in the column which covers the volume it has actually moved in that Contract Year. If [RWE] exceeds the volume of movements stipulated in its nominated column the volume of excess movements shall be paid for at the rates set out in the column which covers the volume it has actually moved in that Contract Year.’

A113 Therefore, once RWE had elected a discount band for a particular set of flows, there are three possible outcomes for the rates that RWE is charged at the end of the contract year:

- (a) The volume of coal moved on the relevant flows is within the range of volumes for the elected discount band. If so, RWE is charged at the same rates as it had elected.
- (b) The volume of coal moved on the relevant flows is insufficient to reach the minimum volume required for the elected discount band. If so, RWE is charged uniform rates, on each unit of volume, which correspond to the rates shown for the volume of coal actually moved.
- (c) The volume of coal moved on the relevant flows is higher than the upper threshold of the elected discount band elected. If so, RWE is charged rates for each flow as follows: (i) for the tonnage corresponding to the upper threshold of the elected discount band, RWE pays at the rates it had elected; (ii) for the additional volume moved, RWE pays at the rates that it would have paid had it elected the band corresponding to the total volume it actually moved.

A114 The impact of the elective discount scheme results from a combination of two stages of decision-making by RWE.

- (a) First, at the start of each contract year, RWE will elect bands for the different flows, taking into account the way that election of alternative

bands affects its expected payments for coal haulage.

- (b) Second, during the course of the contract year, and having elected a discount band for each flow (or set of flows), RWE will make choices on which coal haulage supplier(s) to use on different flows.

A115 The discount scheme is asymmetric. If RWE moves a volume lower than that of the elected band, it must pay higher rates on all units it moves. However, if RWE exceeds the volume of the elected band, it only benefits from a lower price on that tonnage which exceeds the elected band threshold. At the same time, as can be seen from the wording of Schedule 1(iii), there is no penalty (other than loss of discounts) if RWE elects a column of tonnage at the start of the year which it then fails to achieve. Therefore, at the time of election, RWE would minimise its expected expenditure on coal haulage by ensuring that it elects a discount band that corresponds to the maximum volume it might potentially move over the contract year. RWE would therefore be expected to elect the highest band possible at the start of the contract year.

A116 The view that RWE can be expected to elect a band that will more than accommodate its maximum expected usage is consistent with evidence provided by RWE. This evidence indicates that on no occasions did RWE actually achieve the volumes corresponding to a higher discount than it had received, but that on three occasions RWE achieved volumes insufficient for the elected discount threshold<sup>107</sup>.

A117 During the year, RWE will be aware that placing tonnage with a competitor to EWS may risk taking its actual tonnage at the end of the contract year below the volume for the elected band, and thereby exposing RWE to higher rates on the entire tonnage of the relevant flows. In practice, the effects of this depend on the likelihood that small changes in volume will affect which threshold is reached, and on the differences in applicable rates under different discount bands. This is discussed further below, in the context of the specific discounts available on different flows.

A118 Note also that RWE has the possibility to affect the applicable discounts not only by achieving higher volumes on particular flows, but also by adding new flows to the scheme. For instance, in respect of Scottish flows to Drax and Eggborough, the RWE response dated 1 July 2005<sup>108</sup> reveals that:

“[...] during the course of the coal contract year it is not unusual for new routes to be added to the contract. In negotiation with EWS some of these routes have been included in the ‘elective discount’ structure.”

A119 This, therefore, indicates that the scope of the RWE discount scheme has a greater loyalty inducing effect (actual or potential) than it appears on paper since

---

<sup>107</sup> RWE e-mail response dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.1-6]

<sup>108</sup> RWE e-mail response dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.4]

RWE can cross discount thresholds not only by increasing volume on the pre-specified flows but also by adding new flows to the elective discount structure.

### Analysis of marginal prices in the RWE elective discount scheme

A120 The marginal prices produced by the uniform discount scheme are shown in the Tables below in relation to marginal volumes of 50kt that would take RWE from one side of a discount threshold to the other. Under a uniform discount scheme, the marginal price is higher the larger is the marginal tonnage (until the next discount threshold is reached, at which point the marginal price falls). For example, in Table 5 below, for Harworth-Eggborough the marginal price is –[ ... ]/t based on marginal tonnage of 50kt and a starting tonnage of 999,999 tonnes. However, if marginal tonnage were 128,866 tonnes (as in the final column) rather than 50kt, the marginal price would increase from –[ ... ]/t to [ ... ]/t.

A121 Clearly the precise marginal price applicable, in any given situation, will depend on both existing (or forecast) tonnages and the marginal tonnage.

A122 The figure of 50kt is used for illustrative purposes although evidence indicates that ‘spot’ tonnages have been awarded significantly below this level. For example, in a letter to ORR dated 26 February 2003<sup>109</sup>, RWE stated:

“During the period 1 October 1999 to 20 December 2002 [RWE] has, on a very limited number of occasions, moved modest quantities of coal on a “spot” basis outside the terms of a rail haulage contract. For example, in December 2001 Freightliner moved in the region of [...]tonnes of coal for Innogy from Immingham Bulk Terminal to Eggborough Power Station on a “spot” basis. Generally speaking [RWE] would always prefer to move coal under a fully termed written haulage contract and would thus only elect to move coal on a “spot” basis on an ad hoc basis when operational circumstances require.”

A123 This statement suggests both that:

- (a) of RWE’s rail coal haulage demand very little will be moved outside the EWS contract and thus very little of RWE’s demand will be open to entrants or existing competitors to bid for on a spot basis; and
- (b) such marginal tonnage as may arise, may itself be small in magnitude.

A124 A further example of the size of marginal tonnages is to be found in the first tranche of business put out to tender by UK Coal for haulage from Thoresby, Welbeck and Maltby to Cottam or West Burton. That first tranche was for approximately 100kt<sup>110</sup>. While this is larger than the figure noted above for RWE in December 2001, as can be seen from the Tables below, for all flows to Eggborough and Drax from English source points, even at marginal tonnage of 100kt the marginal

---

<sup>109</sup> RWE response of 3 February 2003 to an ORR information request of 20 December 2002. [12/1020-1.5]

<sup>110</sup> See the ‘*Rail haulage contract quotation form*’ provided at document 63 of documents provided by EWS at a section 27 site visit of 22 October 2002. (the ‘site visit’)

price would be negative (this is shown in the final column which gives the marginal tonnage necessary for a non-negative marginal price).

### **Exclusionary effect – English flows to Eggborough and Drax**

A125 Tables 5 and 6 below show calculations of marginal prices (as described above) based on volumes of 50,000 tonnes, for the flows from English source points to Eggborough and Drax. The Tables also show the minimum marginal tonnage required for non-negative marginal price to be achieved for volumes that would allow RWE to cross a discount threshold.





A126 As can be seen from Tables 5 and 6, even for marginal tonnages significantly in excess of 50kt from English source points<sup>111</sup>, the marginal prices to Drax and Eggborough are negative.

A127 In the market for coal haulage by rail, a potential competitor to EWS would need to price significantly above £0 per tonne (to recover both variable costs and some portion of fixed costs). The effect of the discount scheme is, therefore, that, at certain volumes, potential competitors will be unable to offer RWE a price low enough to make it worth RWE's while to use them for marginal volumes of coal haulage. That inability does not stem from competitors' inherent inefficiency in undertaking the provision of coal haulage by rail. Rather it stems from the terms of the RWE contract.

A128 EWS has thereby used its dominant position to set terms for coal haulage that induce loyalty from RWE and shield EWS from the prospect of full and effective competition for the supply of marginal tonnages of coal haulage to RWE.

A129 The circumstances under which competition is restricted are not limited to specific and identifiable volumes of coal haulage that take RWE from one side of a discount threshold to the other. This is because RWE will not know with certainty how much coal it will move on specific flows over the course of a contract year. RWE will not necessarily be able to calculate whether or not placing a specific volume of coal haulage with a competitor to EWS would cause it to fail to reach the volumes necessary for it to reach the elected discount threshold.

A130 The effects of uncertainty in respect of the volumes expected to be hauled on specific flows under the RWE contract are, in turn, exacerbated by the reference period over which the discount thresholds apply (the thresholds relate to volumes over a one-year period). For instance, compared to an otherwise equivalent discount structure but with a three-month reference period, the RWE contract means not only that RWE has more money to lose if it does fail to reach the elected discount threshold (because it would face a price increase applied to a full year's volumes rather than three months' volumes) but also that RWE faces far greater uncertainty as to how placing volume with FHH would affect which discount threshold is reached.

A131 In terms of the volumes hauled during the investigatory period for the English source points to Drax and Eggborough, it appears that RWE only elected the lowest band, band A, for the contract years in the period 2001/02 to 2003/04<sup>112</sup>. It also appears from data received from RWE that volumes were insufficient for the band A threshold to be reached. This does not mean, however, that the discount structure in respect of these flows was legitimate.

---

<sup>111</sup> From the Tables it can be seen that the minimum tonnage for even a non-negative marginal price (let alone a marginal price above cost) is at least 105,085. In some cases the minimum tonnage for a non-negative marginal price is in excess of 200,000 tonnes.

<sup>112</sup> RWE e-mail response dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.4]

A132 RWE’s June 2005 response to a section 26 notice<sup>113</sup> emphasises RWE’s understanding that the volume discounts could apply in future should it commit more tonnage to EWS:

“RWE places value upon the discount structure set out in the CCA for a number of reasons. RWE has paid for coal hauled from Scotland to Drax and Eggborough during the period April 2000 to March 2001 at rates other than band A. Although RWE is no longer supplying coal to either Drax or Eggborough in sufficient quantities to trigger the discounted rates RWE has done so in the past. As RWE has now moved towards securing more third party business in the capacity of a coal trader, RWE may benefit from the discounted rates in the future. Also in the light of the on-going consolidation of the electricity industry, RWE will always consider adding to its generation portfolio should attractively priced assets become available. Part of that consideration, in the case of coal fired plant, would be the presence of attractive rates for the provision of rail haulage.”<sup>114</sup>

A133 Furthermore, RWE’s practice of including new routes within the elective discount structure demonstrates the way in which the discount structure has not just the aim but also the likely effect of inducing loyalty on the part of RWE towards EWS, the dominant rail haulier. If there was no expectation that the discount thresholds could be reached, RWE would have had nothing to gain from including new routes in the scheme.

A134 It is found, therefore, that EWS’s discounting structure for the Eggborough and Drax English flows is capable of having a loyalty inducing effect on RWE’s purchasing decisions and may have the effect of artificially restricting opportunities for competitors to secure haulage contracts for marginal tonnage.

### Exclusionary effect – flows from Daw Mill to Didcot

Table 7. Marginal prices under RWE elective discount for Daw Mill to Didcot

Band	Marginal price (£)	Relevant tonnage		Nominal prices (£)		Minimum marginal tonnage required for non-negative marginal price
		From	To	Lower volume price	Higher volume price	
A to B	[ ... ]	249,999	299,999	[ ... ]	[ ... ]	22,425
B to C	[ ... ]	499,000	549,000	[ ... ]	[ ... ]	47,178

A135 While the marginal prices from Daw Mill to Didcot (Table 7) are positive at marginal tonnages of 50,000, they are very low in comparison to the nominal prices (particularly for movements from band B to band C).

A136 In contract year 2000/01 (beginning 1 April), total tonnage from Daw Mill to Didcot was just under 486kt, well within band B and only 14kt short of band C.

<sup>113</sup> RWE response dated 13 June 2005 to a section 26 notice dated 27 May 2005. [27/257C.2]

<sup>114</sup> Where RWE has stated that the discounts have been triggered in the past, ORR presumes this to mean prior to the period under investigation.

A137 RWE confirmed that for the routes between Daw Mill and Didcot, it elected band C in the contract years 2002/03 and 2003/04<sup>115</sup>.

A138 Having elected band C, RWE would have recognised a risk that placing volumes with a competitor to EWS during the contract year could cause it to fail to reach the volume threshold for the elected band. Thus, RWE would have been aware of the risks that placing marginal tonnage with a competitor to EWS could have had on the effective prices it would face for all units of coal moved on this flow.

A139 Furthermore, the RWE response dated 1 July 2005<sup>116</sup> to an ORR information request reveals that in contract years 2002/03 and 2003/04 band C was elected and that RWE did not receive “[...] a reconciliation invoice from EWS for failure to reach the Column C volume.” This indicates that during the course of these contract years, RWE would have been acutely aware of the risk of not meeting the volumes required for the elected discount band, and thereby facing a higher rate on all tonnage hauled on the flow.

A140 Thus, for flows from Daw Mill to Didcot, potential competitors to EWS would have been impeded from fully competing for marginal tonnage by the fact that RWE faced very low marginal prices around the threshold. In addition, the discount scheme has the potential to have further anti-competitive effects in the future.

#### Exclusionary effect – Scottish flows

A141 Table 8 below provides a summary of the discount structure applicable for flows from Scottish source points to Eggborough and Drax. Table 8 shows marginal prices (for volumes of 50,000 tonnes) arising under this discount structure, and compares these with indicative cost estimates that have been based on evidence supplied by EWS<sup>117</sup>.

---

<sup>115</sup> RWE e-mail response dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.5]

<sup>116</sup> RWE e-mail response from dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.5]

<sup>117</sup> Costs have been obtained from print outs from the Standard Cost Model, which was used by EWS from July 2000 until Summer 2002. The print outs are for flows to Drax as the data for Eggborough are not available to ORR. For Ayr Harbour see EWS response of 11 May 2001 File 9, page 289; for Killoch see File 9, page 295; for Knockshinnoch see File 9, page 290; for Mossend see File 9, page 312; for Ravenstruther see File 9, page 293. The following changes have been made to the cost calculations provided in these Standard Cost Model print-outs. First, ORR has changed the way that track access costs are calculated. In the print outs, “Track access Variable” is calculated as £[ ... ] per kgm multiplied by the gross tonne miles per train for the flow (i.e. the “loaded” gtms per train plus the “empty” gtms per train), and divided by the tonnes of coal carried per train. However, this overstates variable costs because not all of this track access charge was actually variable. The relevant variable charge at the time was only £[ ... ] per kgm. ORR has therefore calculated variable track access charges, included in AVC, using £[ ... ] per kgm instead of £[ ... ] per kgm. It has then calculated a fixed track access charge, which is only included in ATC, using £[ ... ] per kgm - this is effectively an allocation of the fixed part of EWS track access charge. This treatment of track access charges means that ORR’s calculations of AVC are considerably lower than the

**Table 8. Summary of RWE elective discount prices for Scottish source points to Eggborough and Drax**

Origin	Band A (less than 500kt)	Band B (500kt-749kt)	Band C (750kt to 999kt)	Band D (1000kt and above)
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]

---

calculated levels of “Direct Costs” shown for the Standard Cost Model print outs for these flows (e.g. for Ayr Harbour to Drax, File 9, page 289 shows Direct Costs as £[ ... ] per tonne, which is much lower than ORR’s calculation of AVC as £[ ... ] per tonne). The change does not affect ATC: the effect of ORR’s approach is not to change the total track access costs per flow, but rather to treat some of these costs as fixed rather than variable. Second, ORR has included “field support” as part of the calculation of AVC. This is consistent with the treatment of “groundstaff” costs in EWS’s next development of its cost model, the Frontier model introduced in summer 2002, and with ORR’s cost analysis in part II C, *Predatory pricing on flows to West Burton and Cottam*. Third, ORR’s calculation of ATC includes an allowance for cost of capital employed at 10% (see part II C, *Predatory pricing on flows to West Burton and Cottam* for brief discussion of the cost of capital). The Standard Cost Model does not produce an estimate of ATC including an allowance for the cost of capital, and instead provides the ROCE for a given proposed price.



for which indicative cost data was available, it can be seen from Table 10 below that in all cases for marginal tonnages below 25kt (to the nearest thousand tonnes), marginal price would be less than AVC. In some cases even marginal tonnages as high as 46kt would still produce marginal prices less than AVC.

**Table 10. Minimum marginal tonnages to Eggborough or Drax from Scottish source points necessary for marginal price to exceed AVC\***

Origin	Band A to B	Band B to C	Band C to D
[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]
[ ... ]	[ ... ]	[ ... ]	[ ... ]

\* See above for basis for calculation of AVC estimates

A144 This evidence indicates that even if a competitor to EWS faced as low (average) variable costs as EWS (as calculated by the ORR's use of the Standard Cost Model), and was furthermore willing to price down to its own variable cost (thereby earning no return on capital or contribution to fixed costs), that competitor would still be unable to compete effectively for volumes of the order of 24,000 to 46,000 tonnes (see Table 11) should RWE expect such volumes to cause it to fall below elected discount thresholds.

A145 Although it appears from the initial data received from RWE for the Scottish source points to Drax and Eggborough that volumes during the period under investigation were insufficient for the band A threshold to be reached, more recent data from RWE indicates that this was in fact not the case<sup>118</sup>. Table 11 below summarises the actual tonnages hauled per contract year and the discount band applied. As can be seen from Table 11, in each of the contract years 2000/01, 2001/02, and 2002/03, RWE elected a band higher than band A. Indeed in the first two of these contract years, RWE elected the highest-volume band, band D. RWE was therefore clearly making use of the discount scheme during this period.

A146 Furthermore, Table 11 shows that RWE failed to achieve the volumes necessary for the band elected in 2002/03. In circumstances where RWE had failed to reach the elected band, it seems reasonable to suppose that during the contract year, RWE would have been acutely aware of the risks of small variations in the

---

<sup>118</sup> RWE e-mail response from dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.1-6]

volume placed with EWS affecting whether the elected band was met. In these circumstances, there is a particularly high likelihood that potential competitors would have been impeded from competing for marginal tonnage because of the negative marginal prices around the threshold.

**Table 11. Actual tonnages on Scottish flows to Drax and Eggborough and the corresponding elective discount**

Contract year	Actual tonnage (thousands of tonnes)	Corresponding Band	Elected band (i.e. at start of contract year)	Band actually applied (i.e. subject to any reconciliations)
2000/01	[ ... ]	[ ... ]	[ ... ]	[ ... ]
2001/02	[ ... ]	[ ... ]	[ ... ]	[ ... ]
2002/03	[ ... ]	[ ... ]	[ ... ]	[ ... ]

Source: RWE e-mail to ORR dated 1 July 2005 in response to an ORR information request of 17 June 2005<sup>119</sup>

\* Confirmation of band actually applied not received but such confirmation is not needed as the actual tonnage was sufficient for the elected tonnage to be applied (i.e. no reconciliation would have been required).

A147 In contract year 2002/03, although RWE had elected band B and volume was insufficient to meet that band, there was no reconciliation<sup>120</sup>. RWE did not pay the higher prices it should have done (i.e. those corresponding to band A for that year) and benefited from band B discounts. As far as ORR is aware, EWS did not engage in a consistent strategy of allowing RWE discounts that it was not entitled to (under the contract), and therefore it is not appropriate to consider how a pattern of such behaviour might have altered the effects of the scheme from those described above.

A148 Further, ORR considers that RWE could reasonably have expected that if it shifted tonnage to another operator then reconciliation might have occurred: that is, simply failing to move volume would be unlikely to provoke EWS to initiate the transactions costs and possible lost goodwill of raising further invoices in relation to insufficient volumes under the discount scheme.

A149 Finally, it appears that additional flows were added to the elective discount scheme, effectively increasing the ability of RWE to achieve sufficient volumes for the discount bands above A to apply in the future<sup>121</sup>.

---

<sup>119</sup> [27/273.4-6]

<sup>120</sup> RWE e-mail response from dated 1 July 2005 to an ORR e-mail request for clarification dated 17 June 2005 of data provided on 13 June 2005 in response to a section 26 notice of 27 May 2005. [27/273.1-6]

<sup>121</sup> The spreadsheet attached to *ibid* above, indicates that Dalquhandy; Skares Road; Chalmerston; Garleffan; Cadzow; and Boglea were all added to the qualifying tonnages for Scottish flows to Drax and Eggborough.

A150 Therefore, the elective discount scheme was actually applied in respect of the flows from the Scottish source points. Moreover, even though the 1 July 2005 e-mail from RWE reveals that no tonnages were moved to Drax or Eggborough between 2003-2005, RWE continues to value the discount scheme because of its potential to apply in future. As noted above:

“[...] As RWE has now moved towards securing more third party business in the capacity of a coal trader, RWE may benefit from the discounted rates in the future. Also in the light of the on-going consolidation of the electricity industry, RWE will always consider adding to its generation portfolio should attractively priced assets become available. Part of that consideration, in the case of coal fired plant, would be the presence of attractive rates for the provision of rail haulage.”<sup>122</sup>

## **Response to EWS’s arguments**

### *Relevance of marginal prices*

A151 EWS argued that the ORR’s analysis of marginal prices is misleading on the basis that the “marginal cost” identified by ORR is not, in fact, the marginal cost that RWE would experience at any point and has no relevance to the behavioural impact of any such “elective” discounts.

A152 The analysis does not, however, rest on the use of the term ‘marginal price’ and the same view would have been reached had another term, such as ‘average price for incremental volumes that cross discount thresholds’ been used. The fundamental point would be the same. This is that alternative suppliers have to compete against the marginal price, i.e. the additional expenditure (per tonne) that the customer would incur, under the discount scheme, if it were to purchase the additional volume.

A153 At 8.184(a) of its Response, EWS identified that if the customer does not expect to meet the discount threshold then it will only be charged at the price applying to the existing band of tonnage.

A154 Similarly, at paragraph 8.148(b) of its Response, EWS argued that if the customer knows that it will meet a threshold in a given year, it will assume the marginal price will be the price applicable to that threshold. To illustrate, with the Harworth to Eggborough band at 1m tonnes, EWS argued that if the customer knows at the start of the year it will meet the 1m tonne threshold, it will assume the marginal price to be £[ ... ] because it knows it will be the effective price by the year end. In EWS’s view, a competitor would have to match or beat £[ ... ]. EWS has correctly identified that if a customer does not entertain the possibility that placing some tonnage with an alternative supplier to EWS could affect which discount threshold is

---

<sup>122</sup> Where RWE states that the discounts have been triggered in the past, ORR presumes this to mean prior to the period of investigation. [27/257c]

reached, the relevant marginal price will be the rate for the existing (or elected) band<sup>123</sup>.

A155 However, the proposition is not that negative marginal prices will necessarily apply for every flow at every point in time. Rather, it is that it seems likely that there have been, and could be, situations where the risk of RWE crossing a discount threshold means that RWE effectively faces a negative (or very low) marginal price for placing marginal volumes of coal haulage with EWS. In turn, it seems likely that there have been, and will be, situations where a potential competitor to EWS (such as FHH) is impeded from competing effectively for marginal coal haulage not by any inherent inefficiency in the supply of coal haulage for marginal volumes, but instead as a result of the elective discount structure.

A156 EWS also argued<sup>124</sup> that an entrant's ability to compete against EWS, given the structure of the RWE contract, does not depend upon the cost of an arbitrary increment at the threshold but rather the cost that a reasonably efficient competitor could achieve over that element of the contract that could be contested by the entrant. EWS suggested that as in EWS's view FHH had the ability to supply all the RWE volumes, the correct benchmark to establish whether the RWE contract could have foreclosed part of the market to EWS's rivals was whether the price paid by RWE in any volume bound on a new route was less than the AVC of a reasonably efficient competitor. It argued that the price paid by RWE significantly exceeds EWS's own AVC as estimated by ORR.

A157 ORR does not accept this analysis. As noted above, marginal prices are relevant to the analysis of foreclosure since it is marginal prices against which alternative suppliers compete. Moreover, ORR does not argue that the abuse forecloses access to the entire coal haulage market but that the contract unfairly risks preventing effective competition for marginal amounts of coal that may come up from time to time. Again, this is of particular importance for FHH in the early stages following its new entry in order to enable it to gain a foothold in the market at relatively low volumes of supply.

A158 In ORR's view, EWS's discount scheme is designed to induce such loyalty. The loyalty of RWE to EWS is demonstrated by evidence that RWE appears to have used FHH only once and then for less than [...] <sup>125</sup>.

---

<sup>123</sup> To illustrate consider Table 5. If the customer currently had tonnages of 800,000 to Eggborough, the price for haulage from Harworth to Eggborough would be £[ ... ] per tonne. Total expenditure would be £[ ... ]. For marginal tonnage of 50,000 tonnes, the new total tonnage would be 850,000 tonnes and therefore insufficient to reach the next threshold for which a lower price per tonne for all tonnage would apply, i.e. £[ ... ] per tonne. Thus, the 850,000 tonnes would continue to be charged at £[ ... ] rather than £[ ... ] per tonne and total expenditure would be £[ ... ]. The change in expenditure would be £[ ... ], which divided by the increase in tonnage of 50,000 tonnes yields (by definition) a price for the marginal tonnage of £[ ... ].

<sup>124</sup> See Paragraph 6.24 of the Supplementary Response.

<sup>125</sup> RWE response of 3 February 2003 to an ORR information request of 20 December 2002. [12/1020-1.5]

## *Profit sacrifice*

A159 EWS also argued at paragraph 8.185 of its Response that the prices in each band in Schedule 1 of the RWE contract:

“[...] are not in fact below AVC and cannot have the predatory effect alleged by the ORR as there is no element of ‘profit sacrifice’ (in the sense of incremental cost exceeding price) capable of being recouped in the longer term as a result of a consequential reduction in competition.”

A160 The conclusion that the RWE elective discounts are exclusionary is not predicated on a ‘profit-sacrifice’ test in the form suggested by EWS. Such a standard for assessing uniform discounts has no UK or EC case law precedent.

A161 Although EWS attempted to use a speech by Sir John Vickers<sup>126</sup>, former Chairman of the OFT, to lend credence to its argument on ‘profit sacrifice’, it is clear from that speech that Sir John Vickers does not consider a sacrifice test to be either necessary or sufficient to prove harm to competition and hence an abuse of dominance:

“[...] **the sacrifice test seems incapable of providing, by itself, a sufficient condition for a finding of unlawfully exclusionary behaviour** by firms with market power. As a test of wilfulness or intent [...] it obviously has to be combined with an independent specification of what is substantively exclusionary (or anti-competitive or competition distorting or whatever). Attempts to cast the test as a substantive standard appear to face a fundamental problem of being circular or ungrounded – as with, for example, saying that conduct is exclusionary if it does not make business sense but for distorting or harming competition. Such formulations restate the fundamental question, more or less helpfully, rather than answering it.” (Page 16, emphasis added.)

A162 He goes on to say:

“Recall that in European law abuse of dominance is an objective concept and can exist without anti-competitive intent – hence Richard Whish (2003, Fifth edition, page 194) says that “intention is not a key component of the concept of abuse”. The dominant firm has a special responsibility not to impair undistorted competition. This suggests that the dominant firm must not only refrain from deliberately impairing such competition but on occasion, because of its special responsibility, might have to depart from what would otherwise be profitable in order not to cause impairment. Then sacrifice would in a sense be required of the dominant firm. **As a matter of European law, therefore, sacrifice is by no means necessary for abuse.**” (Page 17, emphasis added.)

---

<sup>126</sup> Sir John Vickers, ‘*Abuse of market power*’, Speech to the 31<sup>st</sup> conference of the European Association for Research in Industrial Economics, Berlin, 3 September 2004.

A163 Comments on profit sacrifice made by EWS, in its Response, might have been prompted by discussion contained in the Notice of potential predatory aspects of the RWE discount structure. However, the SO clarified that the objection to the RWE elective discount structure lies in its [anti] competitive effects. The discussion presented above of the effects of the discount structure is not intended to identify a predatory abuse (of the nature found in part II C in respect of the prices set by EWS for coal haulage for LEG and UK Coal). As a result, the point made by EWS regarding profit sacrifice is not considered relevant in the context of the abuse in question.

#### *Actual vs potential effect*

A164 At paragraph 8.186(a) of its Response EWS argues that the elective discount cannot be said to produce an exclusionary effect because the discounts relating to flows from English source points to Eggborough and Drax were never triggered and there was little prospect of the structure ever being triggered in future because RWE sold Drax and Eggborough and as a result EWS ceased to recognise the stations as covered by the rates in the contract. Further, EWS argues that the scheme is only triggered in respect of minimal volumes of coal hauled from Scottish source points to Eggborough and Drax; and that none of the additional origin points identified by RWE amount to extensions of the scheme.

A165 These arguments are not persuasive for the following reasons:

- (a) In respect of Scottish flows to Drax and Eggborough it is clear that the discounts were triggered. For two contract years the highest discount band was elected and achieved. In addition, for one contract year, RWE failed to meet the elected discount suggesting that it would have been well aware during the course of that year that placing marginal tonnage with a rival to EWS could have tipped it below the volumes required for the elected discount threshold to apply. This demonstrates that thresholds are regularly crossed.
- (b) As the Tribunal emphasised in *Claymore*<sup>127</sup>, the concept of exclusionary abuse should not be watered down by a *de minimis* exception. The tonnages on this flow in [2001] were almost 900,000 tonnes (i.e. approximately [3]% of ESI coal haulage or [2.5]% of the relevant market of coal haulage by rail in Great Britain) and it matters that marginal tonnages are potentially foreclosed. Such tonnages represent the entry opportunities for new competitors. By definition marginal tonnages will not comprise a significant element of the total market.
- (c) *Michelin II* remains the law and EWS does not refer to any contrary case law.

---

<sup>127</sup> Case 1008/2/1/02 *Claymore Dairies Limited and Arla Foods UK PLC v Office of Fair Trading* [2005] CAT 30, §307.

- (d) Furthermore, as set out above, not only is EWS's discounting structure *liable to have* exclusionary effects, but also it did in fact have such an effect on RWE's purchasing decisions, impeding the ability of FHH to compete for marginal tonnage<sup>128</sup>.
- (e) Finally, although EWS has attempted to argue that it "[...] ceases to recognise Drax and Eggborough as being covered by the rates in the Innogy Contract [...]" because it no longer owns these stations, it nevertheless recognises in footnote 501 of its Response and in paragraph 6.28(d) of its Supplementary Response that the application of the contract rates/discount to these stations is a matter of disagreement between itself and RWE. Indeed, it is clear that RWE continued to 'elect' flows under the elective discount in Contract Years commencing April 2001 and April 2002, i.e. both years in which it did not actually operate either Drax or Eggborough, and EWS continued to haul coal to these stations, for RWE, under the terms of the contract<sup>129</sup>. EWS argues again that the volumes of coal hauled for RWE to Drax and Eggborough after divestment by RWE of those stations has been minimal. ORR refers to the comments made at (b) above, explaining that it does not view a *de minimis* argument as a defence to the exclusionary abuse.

A166 Moreover, in respect of possible future rail haulage, RWE has stated<sup>130</sup>:

"You will appreciate that any measure which results in an increase in the rates payable by us under the CCA is likely to have a material adverse impact upon us as the structure of prices and discounts are crucial to our business".

A167 This strongly suggests that the elective discount is capable of having an ongoing loyalty-inducing effect, even if the customer continues to have primarily an 'option value' for the contract (i.e. the contract gives it the option to use particularly advantageous discounts even if these are not currently being triggered). The discounts were also triggered for the flow from Daw Mill to Didcot. Indeed for two contract years the highest discount band was elected. In addition, as above, RWE failed to meet the elected discount suggesting that it would have been well aware during the course the period that placing marginal tonnage with a rival to EWS could have tipped it below the volumes required for the elected discount threshold to apply.

A168 At paragraph 8.186(b) of its Response EWS, while accepting that the band B threshold of the Daw Mill-Didcot flow was reached during the period under investigation, attempts to dismiss the relevance of this flow given "*the minimal flows of traffic to Didcot from UK pits*".

---

<sup>128</sup> See RWE's response dated 26 February 2003. [12/1020]

<sup>129</sup> Volume data provided by RWE in a letter dated 3 February 2003 to an ORR information request of 20 December 2002, clearly demonstrates that coal was moved by EWS to Eggborough and Drax for RWE in years 2000, 2001 and 2002. [12/1020-1.7-46]

<sup>130</sup> RWE representations dated 2 November 2004 to a non confidential copy of the Notice issued on 6 May 2004. [25/81.4]

A169 Again, these arguments are not accepted. First, as stated earlier in relation to the flows to Eggborough and Drax the Tribunal emphasised in *Claymore*<sup>131</sup>, that the concept of exclusionary abuse should not be watered down by a de minimis exception. Secondly, the tonnages on this flow in 2000/01 were almost ½ million tonnes (i.e. approximately 1.5% of ESI coal haulage or 1.3% of the relevant market of coal haulage by rail in Great Britain) and it matters that marginal tonnages are potentially foreclosed. Such tonnages represent the entry opportunities for new competitors. By definition marginal tonnages will not comprise a significant element of the total market.

A170 ORR notes that EWS argued that RWE's comments should be viewed in the context of its response to the Rule 14 Notice and that these comments do not relate to the behavioural effects of the discount scheme itself (see paragraph 6.28 of the Supplementary Response). ORR does not accept this: RWE's comments apply equally in the context of ORR's analysis of the elective discount scheme. Although it is true that RWE has focussed in its Nov 2004 response on the possibility that prices will rise as a result of a finding of predation, that does not discount RWE's general observation that "*You will appreciate that any (emphasis added) measure which results in an increase in the rates payable by us under the CCA is likely to have a material adverse impact upon us as the structure of prices and discounts.*" (Emphasis added.)

### *Timing*

A171 At paragraph 8.190 of its Response, EWS claimed that ORR cannot rely on evidence that pre-dates the entry into force of the Act. In particular it claimed that the Drax, Eggborough and Daw Mill-Didcot aspects of the pricing structure were "*a dead letter*" by March 2000. This argument is ill-conceived for the following reasons:

- (a) The Tribunal has indicated that regulators can rely on evidence pre-dating 1 March 2000 provided there is other evidence postdating the implementation of the Act to found the elements of an infringement of the Act<sup>132</sup>.
- (b) RWE's responses show that it considers that even though it no longer supplies coal to Eggborough and Drax, it is entitled to benefit from the discounting structure for its third party and new business in future.
- (c) RWE continued to elect bands for Dawcot Mill to Didcot and benefit from the applicable discounts for the contract years 2002/3 and 2003/4.
- (d) In assessing the application of Article 82 EC, ORR is entitled to take into consideration behaviour pre-dating the implementation of national competition law provisions.

---

<sup>131</sup> Case 1008/2/1/02 *Claymore Dairies Limited and Arla Foods UK PLC v Office of Fair Trading* [2005] CAT 30, §307.

<sup>132</sup> *Ibid.*

### *Commercial rationale and lack of intent*

A172 EWS argued (at paragraphs 8.177-8.178 of its Response) that there was a legitimate commercial rationale for including the elective discount scheme in question in the RWE contract. EWS claimed, but without any supporting evidence, that the discounts were stipulated by the customer to:

“[...] protect it from being ‘stranded’ with high, non-volume related rates calculated on the assumption of minimal flows from the North Nottinghamshire pits to Drax and Eggborough in the event that the pit at Selby closed and significant volumes of traffic (in the region of 8 to 9 million tonnes annually) had to originate from the North Nottinghamshire pits instead of from Gascoigne Wood.” (Paragraph 8.177.)

A173 At paragraph 8.186(a) EWS went on to argue that:

“[...] the pit closure against which they were designed to protect Innogy never eventuated in that period, the existence of the discount did not act as any disincentive upon Innogy to use a competing carrier to EWS if it wished to.”

A174 These assertions are not sufficient to find the elective discount scheme compatible with the obligations faced by EWS in consequence of its dominant position on the market for coal haulage by rail, for the following reasons:

- (a) It is irrelevant whether the discounts were stipulated by the customer or otherwise<sup>133</sup>.
- (b) EWS points to the possibility of the events unfolding such that RWE had to source significant volumes from the North Nottinghamshire pits instead of from Gascoigne Wood. However, EWS has not explained why it was therefore necessary to institute a complex set of elective discounts (in some cases producing negative marginal prices for significant marginal tonnages) in order to protect RWE from facing high, non-volume related rates. EWS has failed to justify the need to set a discount structure at all, or the necessity of setting such high rates for the flows from the North Nottinghamshire pits that RWE would need “protection” in case it hauled large volumes on those flows. Furthermore, even if there were some need for volume-dependent rates on the flows from the North Nottinghamshire pits, EWS has still not justified the use of an elective uniform discount structure, rather than a tiered discount structure which reflected any cost savings available to EWS as a result of economies of scale<sup>134</sup>.
- (c) EWS have confirmed that a fixed rate applied to flows from Selby/Gascoigne Wood to Eggborough and Drax and therefore EWS’s

---

<sup>133</sup> *Hoffman La Roche*, paragraph 89 and *Claymore*, paragraph 291.

<sup>134</sup> The discussion above under the sub-heading “*Applicable legal principles*” notes that the case law on Article 82 EC recognises a potential difference between uniform and tiered discount structures.

professed commercial rationale equally be capable of explaining a discount for haulage from the Selby complex (for which Gascoigne Wood was the surface despatch point).

- (d) EWS's claimed understanding for the reasons behind its pricing structure is not supported by reference to any evidence and is contradicted by the contemporaneous internal memorandum of 11 May 1997 during the pre-contractual negotiations, which acknowledged the low return on sales and revealed EWS strategic intention to be one of stopping RWE from exercising its option for locomotives and setting up a competitive freight operation to EWS. That document is direct evidence of EWS's intent to foreclose emerging opportunities for competition.
- (e) Even if the original purpose of the elective discount was not primarily or explicitly to foreclose RWE's potential demand from other rail hauliers, EWS's motives may have shifted emphasis over time. EWS has not sought to renegotiate the terms of the contract once the reason behind the structure did not materialise or once RWE sold Drax and Eggborough.

A175 The discount structure for these English flows continued to have a foreclosure effect on competition and EWS took advantage of the existing structure to maintain RWE's loyalty. The evidence from RWE (noted above) reveals that the customer continues to attach value to the elective discount, which presumably it would do only if it considered that the discounted rates could be invoked in the future. RWE has further indicated that it has in fact added additional flows to the elective discount (at least in respect of Scottish flows) and it cannot be ruled out that flows might be added in future, particularly if RWE were to acquire new power stations or were awarded coal supply contracts by the existing or future owners of the plants.

### **Conclusion on the RWE CCA**

A176 In the light of all the evidence and its surrounding context, it is found that EWS's elective discounting structures on the English and Scottish flows constitute loyalty rebates that tend to restrict competition in the market for coal haulage by rail or, at the very least, are capable of having such effect. In particular, the grant of a uniform discount at elected tonnage bands is designed and operates so as to induce loyalty from RWE, influencing it to concentrate its tonnage requirements (including those from new flows) with EWS and denying potential new entrants, such as FHH, opportunities to compete effectively for marginal tonnage.

A177 Overall, the elective discount scheme has the effect of strengthening EWS's dominant position in the market for coal haulage by rail in Great Britain and shielding it from the effects of new entry and competition. For all the reasons set out above, EWS is found to have abused its dominant position through the agreement, application, maintenance and extension of the elective discount scheme in the RWE contract.

### **AES DRAX**

A178 AES Drax<sup>135</sup> entered coal-fired electricity generation in November 1999 with the acquisition of the Drax plant from RWE and from acquisition until September 2001<sup>136</sup> received its coal, free-on-rail, by means of a divestment coal supply contract from RWE<sup>137</sup>. However, it secured its own coal supply arrangements with UK coal suppliers commencing in April 2001 and in parallel tendered for the rail transport of that coal. An ensuing CCA was entered into by EWS and AES Drax on 12 July 2001 with a commencement date of 1 April 2001<sup>138</sup>. It was of 4 years duration with an expiry date of 31 March 2005.

A179 Table 12 below shows the proportion of the market for coal haulage by rail covered by this contract.

---

<sup>135</sup> From August 2003, Drax is referred to as Drax Power Limited.

<sup>136</sup> AES Drax response dated 25 April 2002 to a section 26 Notice of 20 March 2002. [5/317/1.2]

<sup>137</sup> Delivered by EWS under its CCA with RWE.

<sup>138</sup> AES Drax entered into a CCA with FHH on 19 February 2001 with a commencement date of 1 April 2001.

**Table 12. Share of the market for the carriage of coal by rail covered by EWS actual haulage under the AES Drax contract**

Year	ESI coal haulage by rail (%)*	All coal haulage by rail (%)**
2000	[...]	[...]
2001	[...]	[...]
2002	[...]	[...]

\* Based on the actual volumes carried by EWS under the AES contract in each year not the forecast tonnage

\*\* Calculated on the assumption that demand for coal haulage by rail is split between ESI and non-ESI in the ratio [...]

### Evidence of intent

A180 There is evidence to suggest that EWS attempted to make a deal with AES Drax which would obviate the need for it to go out to tender and thereby preclude others from the opportunity to bid. In an e-mail from Nigel Jones to Allen Johnson and Philip Mengel (CEO from January 2000) of 28 April 2000<sup>139</sup>, Nigel Jones stated,

“AES have made it clear that they will move coal on their own account from 30.9.01. They have said that they intend to go out to competitive tender for transport. We have set out to dissuade them from this by launching a major initiative to improve train performance into Drax. They have indicated that they might be willing to consider a deal that excludes the need for a tender if the terms etc are right [...].”

A181 Although EWS was not successful in convincing AES Drax that a tender was unnecessary, it continued to attempt to secure an exclusive deal with AES Drax during the subsequent tender negotiations. In an internal briefing memorandum from David Griffiths (EWS retained coal consultant) to Allen Johnson about the Drax tender, dated 4 July 2000<sup>140</sup>, David Griffiths stated,

“We are looking for endorsement of our pricing policy on the basis that our rates will be quoted for the full tonnage taken by the power station.”

A182 These attempts notwithstanding, the contract contains no specific clauses that confer outright exclusivity on EWS. Objection is focused on the MAP amount, discussed below, which is found to have had a significant foreclosure effect.

<sup>139</sup> Document 431 of Volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>140</sup> Document 164 of file 5 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

## Minimum annual payment

A183 Drax has advised<sup>141</sup>:

“[d]uring the detailed tender negotiations with EWS & Freightliner, both counterparties were looking for the contracts to be “take-or-pay” in nature, so they could be certain of the minimum sterling volume of business, before they committed existing and new resources to this contract. [...]”

A184 In the eventual contract, the 80% MAP is included in clause 7.3.2. It states that, after the first contract year, AES Drax has a commitment to a MAP of 80% of the “*sum which would have been paid to the Operator had all Services been run based on the Assumed Volume of Traffic*”. The “*Assumed Volume of Traffic*” is defined as “*in respect of each Contract Year (other than the first Contract Year) during the term of this Contract, [...] tonnes of coal.*”

A185 AES Drax has stated<sup>142</sup>, [...]”

## Response to EWS’s arguments

A186 At paragraphs 5.52 to 5.57 of its Response, EWS attempted to downplay the effect of the volume secured by the MAP. EWS argues that the contracts of EWS and FHH with AES Drax did not account for the whole of AES Drax’s requirement for coal:

“At the time the contracts to EWS and Freightliner were awarded, AES Drax had a further anticipated requirement for up to an additional [...] tonnes per annum of imported coal. This additional tonnage was not put out to tender at this time due to uncertainties regarding the source of this coal.

Subsequently, AES Drax entered into arrangements with AEP for the E2E supply of coal to Drax. This coal is hauled on AEP’s behalf by both EWS and Freightliner.”

A187 At footnote 226 of its Response EWS noted that in the contract year 2000/01 it hauled [...] kt into Drax, in 2001/02 it hauled [...] kt, in 2002/03 it hauled [...] kt and in 2003/04 it hauled [...] kt, from which it estimates that AES Drax’s total demand is approximately [...] to [...] million tonnes p.a.

A188 Nonetheless, in the absence of objective justification, the inclusion of the MAP in the AES Drax contract is not compatible with EWS’s obligations not to distort competition because:

- (a) Based on forecast customer demand for coal haulage of [...] tonnes, the 80% of EWS assumed tonnage (the latter at [...] million tonnes

---

<sup>141</sup> AES Drax response of 14 January 2003 to an ORR information request of 20 December 2002. [12/1022/1.1]

<sup>142</sup> AES Drax response of 14 January 2003 to an ORR information request of 20 December 2002. [12/1022/1.1]

p.a.) represents around 60% of the customer's total demand. Consequently, the majority of AES Drax's demand would be entirely foreclosed as a result of its CCA with EWS.

- (b) Data from AES Drax indicates that its total demand during 2002/03<sup>143</sup> was less than [...] million (at the bottom of EWS's inferred range). Therefore, the 80% MAP would have accounted for significantly more of the customer's total volume of demand in that period.
- (c) Data from AES Drax reveals that the AEP E2E contract was not applicable at any time during the period under investigation which is consistent with the Response at paragraph 5.52. While after the period under investigation it is possible that the AEP contract might account for up to [...] million tonnes per annum, the MAP with EWS would still have accounted for around 60% of the customer's anticipated demand at the time of contracting. As the data for 2002/03 reveals, if customer demand actually fell, the MAP could account for significantly more than 60% of AES Drax's coal haulage demand.

## Conclusion on AES Drax CCA

A189 The volume secured by the MAP represents a significant foreclosure effect and EWS is found to have abused its dominant position through the agreement, application and maintenance of the MAP term.

## CORUS

A190 The contract was between Loadhaul Limited (purchased by EWS) and British Steel (later to become Corus) and was entered into on 20 September 1995 and was terminable on 6 months notice by either party on or after 1 April 2005. A five year break clause, however, allowed termination prior to that date, by agreement. The contract covers the movement of "Traffic"<sup>144</sup> from any "Loading Station"<sup>145</sup> to the "Customer's works"<sup>146</sup> at Scunthorpe and associated terminal facilities. The

---

<sup>143</sup> ORR does not have data for actual haulage in the last three months of the Contract Year 2002/03 and the actual tonnages for those months have been derived by scaling the April to Dec 2002 data in accordance with preceding year monthly tonnage weightings.

<sup>144</sup> "Traffic" is defined as "the raw materials used at the Customer's Works that the Customer requires to be hauled from any Loading Station. These raw materials shall include coal, both for coking and direct injection purposes, iron ore and any other raw materials that the Parties may, from time to time agree be subject to the provisions of the Agreement."

<sup>145</sup> "Loading Station" is defined as "a rail connected location where the Customer has made arrangements for Trains incorporated in the Service to be loaded by his servants or agents, with Traffic."

Where

"Service" is defined as "the operation of the services as set out in the relevant Schedules that shall include the specified times services and any variation thereto or any additional services provided under this Agreement."

<sup>146</sup> Defined as "the Works of the Customer situated at Scunthorpe, South Humberside and having rail terminals for the Service at Dawes Lane Coal Handling Plant, Santon Ore Terminal and/or

Schedules (1 and 2) of the contract set out the services as coal from Immingham Bulk Terminal (“IBT”) to the Dawes Lane Coal Handling Plant at Scunthorpe and for the carriage of iron ore from IBT to Santon Ore Terminal. EWS advised in its Supplemental Response<sup>147</sup> that the Corus contract expired on 30 September 2004 and pending conclusion of a new agreement, EWS is hauling for Corus pursuant to its General Conditions of Carriage. The contract remained in effect, therefore, for 9 years prior to its expiry.

A191 Network Rail advised<sup>148</sup> that in the calendar year 2002<sup>149</sup> [...]kt of coal moved from Immingham to Scunthorpe, which would have moved pursuant to this contract. Network Rail has also confirmed<sup>150</sup> that the volume would be substantially the same for the year 2001 aside from an additional [...]kt which previously ran for 9 months from Port Talbot to Llanwern, which Corus has advised<sup>151</sup> that this latter coal was not hauled under the terms of this contract but under a separate contract with EWS.

A192 The Corus contract was the largest non-ESI contract for coal haulage by rail and ORR estimates that it represented at least 7% of the total market for coal haulage by rail.

A193 The features of the Corus CCA that were of concern to ORR were its (i) exclusivity terms (ii) duration and (iii) extendable scope to cover additional business. As will be seen below, ORR finds that (i) and (ii) represent infringements of the Act and Article 82 but it is not satisfied that the available evidence shows that (iii) represents such breach.

---

elsewhere within the Customer’s Works as the Parties may from time to time agree shall be used in connection with the Service.”

Where

“Schedule” means “any document headed “Schedule” that may from time to time be attached to this Agreement as agreed by the Parties containing details of Traffic to be conveyed by the Trains comprising the Service, together with the Movement Charges and other relevant arrangements.”

<sup>147</sup> Paragraph 6.38.

<sup>148</sup> Network Rail e-mail response dated 28 March 2003 to an ORR information e-mail request of 25 March 2003. [16/1442.4]

<sup>149</sup> Confirmation that data provided in 28 March 2003 e-mail referred to calendar year 2002 provided in confirmatory e-mail from Network Rail dated 20 May 2003 in response to an e-mail ORR information request of 8 and 20 May 2003. [17/1578.1]

<sup>150</sup> Network Rail e-mail response of 20 May 2003 response to an e-mail ORR information request of 8 and 20 May 2003. [17/1578.1]

<sup>151</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO [33/677A.4].

## **Contractual exclusivity**

A194 Clause 4.4.1 of the Corus contract stated:

“The Customer shall offer to the Operator for conveyance by the Service, the Customer’s Requirements for the haulage of Traffic as defined in this Agreement and the Operator shall commit to the Customer to service those requirements, from IBT or any other Loading Station as may be from time to time agreed between the Parties to the Customers Works, for the period of this agreement.”

A195 Clause 4.4.3 established “Customer’s Requirement” as:

“The tonnage of the defined Traffic destined for use at the Customer’s Works, that the Customer requires to be hauled from IBT or any other Loading Station as described in paragraph 4.4.2 above.”

A196 Taken together, these clauses and their associated definitions compelled Corus to provide EWS with exclusivity over all coal traffic between IBT and the Customer Works at Scunthorpe which, as the data from Network Rail<sup>152</sup> shows, serviced almost all of Corus’s coal rail haulage requirements.

## **Duration**

A197 In effect, therefore, the whole of Corus’s rail haulage traffic was foreclosed from competition for the lifetime of this contract. Corus has drawn attention<sup>153</sup> to a break clause in the contract which permitted Corus to re-tender with effect from 1 October 2000. However, this could only be activated by agreement between the parties to the contract. The contract was eventually terminated on 30 September 2004 and thus remained in effect for 9 years prior to its expiry. The foreclosure effect was therefore very long term and certainly the contract was in existence at the time FHH entered the market.

## **Extendable scope**

A198 ORR in its Notice described the contract as being extendable in scope, by agreement. Clause 4.4.2 stated:

“If the Customer decides for whatever reason to source Traffic as defined in this Agreement from a Loading Station other than IBT, then subject only to

---

<sup>152</sup> E-mail dated 28 March 2003 from Network Rail to ORR, following an e-mail from the ORR dated 25 March 2003. [16/1442.4-16.1442.5]

<sup>153</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO [33/677A].

agreement between the parties of the Movement Charge(s)<sup>154</sup> for such Traffic, such Traffic will be encompassed by the scope and term of this Agreement.”

A199 ORR considered that this clause together with the definition of “Traffic” (which inherently, in the term “any Loading Station” (emphasis added), made provision for the potential for Corus to require the “Operator” (EWS) to collect material from a loading station other than that already listed) providing an expectation that that traffic would be placed with EWS.

A200 EWS advised at paragraph 5.62 of the Response that “*Corus has never sought to activate Clause 4.4.2 over the lifetime of the contract*” and this has been confirmed by Corus<sup>155</sup> who has also advised that this clause was included in order to cope with a situation whereby Immingham Bulk Terminal (IBT) was for any reason made unavailable for the unloading, storage and reloading of iron ore and coal. In the light of the evidence, advanced by Corus, that the volume of traffic moved from Port Talbot to Llanwen in 2001 (referred to above) was not moved under the scope of this contract but under a separate set of arrangements ORR is inclined to the view that Clause 4.4.2 was in fact interpreted by the parties in a way that did not amount to an infringement of the Act or Article 82.

### **Conclusion on Corus CCA**

A201 For the reasons set out above, and in light of the market context, EWS abused its dominant position through the maintenance and application of the Corus CCA.

A202 EWS advised at paragraph 5.63 of its Response that the parties are currently in the process of renegotiating a new contract for the carriage of coal by rail, which does not include any of the provisions to which ORR has previously objected.

### **SUMMARY ON CONTRACTS WITH EXCLUSIONARY EFFECT**

A203 An overview of the exclusionary aspects of the contracts discussed above is summarised in Table 13 below.

---

<sup>154</sup> “Movement Charge” is defined as “a charge due to the Operator for every tonne of Traffic that is conveyed by the Service [...]”

<sup>155</sup> Corus response dated 26 May 2006 to a non-confidential version of the SO [33/677A].

**Table 13. Restrictions in EWS's coal haulage contracts**

Customer	Exclusionary terms	Duration of contract
E.ON	Exclusivity provisions applying to 92% of customer's rail haulage (unless EWS declines to match a rival's offer for haulage on a flow) Extendable scope of exclusivity	Minimum of 9 years w/e from 1 April 1996 (terminable by E.ON on 24 months' notice from 1 April 2003)
RWE	Uniform discount scheme restricts competition for customer's coal haulage on various flows	10 years with effect from 1 April 1998 or on 12 months' notice by RWE to expire on the 5 <sup>th</sup> or any subsequent anniversary of the agreement
AES Drax	MAP based on 80% of [...] million tonnes (approximately [...] million tonnes, which was around 60% of customer's expected haulage at time of contract)	4 years with effect from 1 April 2001 The 80% MAP applied with effect from 1 April 2002
Corus	Full exclusivity on flows representing almost all of customer's coal rail haulage requirements	Entered into on 20 September 1995 for period of 10 years; terminable on 6 months' notice by either party thereafter

A204 For the reasons set out above, EWS is found to have abused its dominant position in the market for coal haulage by rail in Great Britain through the agreement, application, maintenance and extension of contracts for coal haulage with exclusionary terms. In particular, EWS committed abuse in respect of each the following coal carriage agreements,

- (a) The Powergen/E.ON CCA
- (b) The National Power/RWE CCA
- (c) The AES Drax/Drax Power Limited CCA; and
- (d) The Corus CCA.

A205 This part II A relates to contracts agreed in different years, and also to conduct at different stages of the contractual process, including the initial agreement of the relevant CCAs but also their subsequent application, maintenance and extension. To the extent that the identified abusive conduct took place after the coming into force of the Act in 2000, ORR considers it to be contrary to Article 82 EC and the Chapter II prohibition. To the extent that the identified abusive conduct took place before the coming into force of the Act, ORR considers it to be contrary to Article 82 EC.

A206 Table 14 below gives a broad indication of the combined market coverage and minimum exclusionary scope of the contracts found to be abusive.

**Table 14. Proportion of relevant market under exclusionary contracts**

	<b>2000</b>	<b>2001</b>	<b>2002</b>
<b>Total volume under E.ON, RWE, AES Drax and Corus<sup>156</sup> contracts</b>	66%	53%	52%
<b>Minimum volume reserved to EWS under exclusionary provisions of E.ON,<sup>157</sup> RWE,<sup>158</sup> AES Drax<sup>159</sup> and Corus contracts</b>	29%	27%	37%

---

<sup>156</sup> As noted in the discussion of the Corus contract above, tonnages under the contract were available for 2002 (see Network Rail e-mail response dated 28 March 2003 to an ORR information e-mail request of 25 March 2003 [16/1442.4]) and 2001 (where the latter was estimated to be the same as for 2002 except for an additional [...]mt, see Network Rail e-mail response of 20 May 2003 response to an e-mail ORR information request of 8 and 20 May 2003 [17/1578.1]). It has been assumed that tonnages in 2000 were the same as in 2002.

<sup>157</sup> Figures for E.ON contract based on 92% of E.ON's actual demand. This could be argued to overstate that volume of coal haulage that is strictly exclusive to EWS (see the discussion above of Clause 4.3). However, as explained above, within the 92%, the discretions available to E.ON to use an alternative to EWS are severely restricted by the terms of the abusive contract. E.ON has never used a haulier other than EWS for coal haulage by rail.

<sup>158</sup> Figures for RWE are based on coal haulage to the flows specifically covered by the elective discount scheme in the RWE CCA, as discussed above.

<sup>159</sup> The AES Drax contract commenced in April 2001. For each quarter in the first Contract Year, the MAP was based on 80% of the sum that would have been paid to EWS had all services been run according to the "quarterly phased tonnage estimate" for the relevant three-month period. As ORR does not have data for the "quarterly phased tonnage estimates" that AES Drax provided to EWS, the estimates of the volumes committed to EWS under the MAP for the period April 2001 to December 2001, and for the first quarter of 2002, are based on 80% of the actual volumes carried. From April 2002, the MAP was based on an annual volume of 80% of [...] million tonnes, and AES Drax was required to make monthly payments to EWS calculated as one twelfth of the MAP. Thus for the calendar year 2002, ORR's estimate of the minimum volume reserved to EWS is based on 80% of actual volumes for the first three months and then 80% of nine twelfths of [...] million tonnes for the nine months from April 2002 ORR would note that even accepting EWS's estimate of the total coal moved under the AES Drax contract, EWS's estimate only differs from the ORR's estimate by approximately 3%. ORR's estimate of the amount of coal covered by the AES Drax contract of [...] tonnes per annum, whilst EWS's estimate is [...] tonnes per annum. It therefore has little effect on the portion of the relevant market that was reserved to EWS as set out in Table 14 above.

# Part IIB: Assessment of abuse of dominance – Discrimination

---

## Introduction

B1 This section considers further abusive conduct by EWS, specifically discrimination between customers. For a specific time period, this continued EWS's overall strategy of foreclosing actual and potential competitors.

B2 EWS has engaged in abusive discrimination between its customers. In particular, EWS set an existing customer, ECSL, selectively higher prices than it charged other customers directly for the same flows without objective justification.

B3 This behaviour was a further manifestation of EWS's wider strategy to exclude or limit competitive opportunities for potential new entrants to the market for coal haulage by rail in Great Britain. EWS was concerned that ECSL could facilitate such entry into this market by developing an intermediary role, including through the negotiation of E2E contracts with new owners of power stations. EWS sought to constrain this competitive threat by ensuring that it, and not ECSL, secured direct contracts with the power stations.

B4 ECSL provided a number of services to the owners of power stations including sourcing and trading on coal and providing straight to stock-pile deals (sourcing coal and arranging its transport from source to the power station's stockpile as part of an E2E deal). An integral part of this service was the management of risk not only in the purchase of coal but also in the entire supply chain. It presented itself as a manager of risk in the 'freight' market which it achieved through buying and managing capacity at ports, in vessels and in inland transport, particularly rail. It was prepared, for example to purchase track and rail operator capacity and to take on the performance risk of that element of the deal<sup>160</sup>, "[...] *even when the national rail operators cannot guarantee performance, Enron will*".<sup>161</sup>

B5 EWS's discriminatory treatment of ECSL placed ECSL at a competitive disadvantage in respect of two specific sets of flows:

- (a) Flows to the Fiddler's Ferry and Ferrybridge power stations, operated by Edison Mission Energy (EME). Between May 2000 and October 2000, EWS imposed higher prices on ECSL. This placed ECSL at a competitive disadvantage in its contractual negotiations with EME relating to coal haulage supply to Fiddler's Ferry and Ferrybridge power stations. Prior to the period of discriminatory pricing, ECSL had supplied EME on these flows on an E2E basis. Following the period of

---

<sup>160</sup> The Complaint – Annex 1 "*Description of ECSL's coal delivery business*".

<sup>161</sup> *ibid*

discriminatory pricing, ECSL was unsuccessful in renewing that relationship.

- (b) Flows to Eggborough power station, operated by British Energy (BE). Between May 2000 and November 2000, EWS imposed higher prices on ECSL which placed ECSL at a competitive disadvantage in its contractual negotiations with BE. Even though ECSL was eventually successful in the tender negotiations, EWS sought to undermine ECSL's ability to contract with BE as an intermediary.

### **Applicable legal principles**

B6 Discriminatory pricing by a dominant company falls under the third head of abuse listed in the Chapter II prohibition/Article 82, i.e. applying dissimilar conditions to equivalent transactions, thereby placing trading parties at a competitive disadvantage. Such dissimilar conditions normally arise in the form of different prices charged to different sets of customers.

B7 Price discrimination can take two basic forms:

- (a) An undertaking might charge different prices to different customers, or categories of customers, for the same product, where the differences in prices do not reflect any differences in relative cost, quantity, quality or any other characteristics of the products supplied.
- (b) An undertaking might charge different customers, or categories of customers, the same price even though the costs of supplying the product are in fact very different. A policy of uniform delivered prices throughout the country, for example, could be discriminatory if differences in transport costs were significant.

B8 Price discrimination by a dominant undertaking is not always abusive. However, discriminatory pricing without objective justification is contrary to the Article 82/Chapter II prohibition where it distorts conditions of competition in a downstream or derivative market by placing a customer at a competitive disadvantage<sup>162</sup>. The supplier does not have to be dominant or even present in the same market as the customer. It is sufficient for Article 82 to apply that the recipient of the service is in a situation of economic dependence vis-à-vis the dominant supplier in the sense that the service offered by the supplier is necessary to the exercise by the recipient of its own activity<sup>163</sup>.

B9 Furthermore, if the dominant undertaking also competes with a customer dependent on it for a key input, it may commit an abuse by subjecting that customer to a discriminatory "price or a margin squeeze". By raising the cost of the key input

---

<sup>162</sup> Case T-128/98 *Aéroports De Paris v Commission* [2000] ECR II-3929, §§164-165.

<sup>163</sup> *Aéroports de Paris*, §165.

and/or by lowering its prices to other customers, the dominant undertaking may distort conditions of competition in the downstream or derivative market<sup>164</sup>.

B10 In *British Airways*<sup>165</sup>, the CFI upheld the Commission's finding that BA performance reward schemes constituted an abuse of BA's dominant position in the UK market for air travel agency services on the basis that they produced discriminatory effects within the network of travel agents in the UK and inflicted on some of them a competitive disadvantage. BA's commission structure depended on its agents attaining ticket sales growth targets. Once the agent attained the threshold, it gained an increased bonus on all BA tickets sold during the reference period.

B11 The CFI held:

“325. To that extent, the performance reward schemes at issue could result in different rates of commission being applied to an identical amount of revenue generated by the sale of BA tickets by two travel agents, since their respective sales figures and hence their rates of growth, would have been different during the reference period.

326. By remunerating at different levels, services that were nevertheless identical and supplied during the same reference period, those performance reward scheme distorted the level of remuneration which the parties concerned received in the form of commissions paid by BA.”<sup>166</sup>

B12 Price discrimination refers to situations where the difference in prices cannot be justified by difference in costs or other objective criteria. If there are legitimate reasons for differentiating between customers based on the underlying costs structures, these will constitute objective justification. However, business considerations that in reality amount to anti-competitive behaviour cannot be used as justification for unequal treatment<sup>167</sup>. The burden of proof rests on the dominant company to justify the reasons for any disparity in the prices charged during the relevant time.

### Relevant market context

B13 As explained in part II A above – *Exclusionary Contracts*, the conduct of a dominant company has to be seen in the context of the prevailing market conditions. EWS's conduct in its negotiations with ECSL and the new owners of power stations has to be assessed in the light of the fact that the market was already subject to structural constraints, including the effect of the exclusionary provisions in EWS's coal carriage agreements which reduced the opportunities for new entrants. The

---

<sup>164</sup> Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969, §§166-167.

<sup>165</sup> Case T-219/99 *British Airways plc v Commission* [2003] ECR II-5917, §§233-240.

<sup>166</sup> These findings have been endorsed recently by Advocate General Kokott in her Opinion of 23 February 2006 in Case C-95/04 *British Airways v European Commission*.

<sup>167</sup> *ibid* (§114).

following market developments created new coal haulage opportunities for new entrants or otherwise threatened EWS's market position:

- (a) The divestiture of power stations to new owners such as EME and AES.
- (b) The entry of ECSL as a coal trader, supply chain risk manager and E2E supplier in 1999.
- (c) The increase in imported coal between 1999 and 2000.
- (d) The possible role of ECSL as a facilitator of new entry to the relevant market.

B14 EWS's conduct also has to be seen in the context of the impending entry by FHH, into the market for coal haulage by rail, through its contractual relationship with ECSL from June 2000. In its Response (at paragraphs 7.267 to 7.268) EWS suggested that there are no significant barriers to entry and that its conduct has had no anti-competitive effect. ORR addresses these specific arguments in more detail in the section *Response to EWS's arguments* below. ORR remains of the view that potential entry to the market for coal haulage by rail is a relevant consideration when assessing EWS's behaviour towards ECSL.

B15 Entry into coal haulage by rail involves significant sunk costs, in particular as a result of the need to acquire wagons and locomotives. In order to recover such costs an entrant must be confident that it can secure a sufficient volume of business for sufficiently long a period of time in order to recover all its costs (both operating costs and capital costs, including an adequate return on its capital employed). As discussed above in part II A, a significant proportion of the market was (and remains) covered by exclusionary contracts (whether by way of exclusivity clauses, volume discounts or MAP amounts). Those contracts had the effect of significantly reducing the number of customers and volume of business open to a potential entrant.

B16 Moreover, notwithstanding the fact that not all the market was covered by exclusionary contracts (whether directly or in effect), it appears that there was some difficulty in securing contracts with other customers. In particular, customers were reluctant to sponsor new entry and, as a result, the risk associated with the sunk costs of entry (especially the investment in suitable wagons) remained with entrants.

B17 In the light of this, it was very important for a new entrant to establish customer contracts in order for entry to be viable. Of particular importance in this regard is the role played by ECSL in establishing relationships with generating companies and facilitating the route to market for new entrants in coal haulage by rail.

B18 The threat posed by ECSL establishing customer relationships and using these relationships to sponsor or facilitate entry was recognised by EWS at the time. ECSL became active as a supplier to UK power stations during 1999 at a time when EWS was the sole haulier of coal by rail. As shown in more detail below, EWS's response was to try to secure direct contracts with the generators.

B19 Therefore, in considering the evidence surrounding EWS's conduct towards

ECSL, it is important to appreciate the role that ECSL could have played as a facilitator of entry into the market for the supply of coal haulage by rail in Great Britain.

### **Focus of the assessment of alleged discriminatory abuse**

B20 In this section, ORR assesses whether EWS engaged in an abuse of its dominant position by discriminating between customers, without proper justification, and to the competitive disadvantage of ECSL.

B21 The objection concerns three particular aspects of the negotiations between EWS and ECSL:

- (a) around May 2000, when EWS offered ECSL rates significantly higher than rates that EWS had previously offered ECSL;
- (b) the period between May 2000 and November 2000 when EWS offered significantly lower rates to other customers; and
- (c) during the same time period, when active contractual negotiations between the two parties ceased<sup>168</sup> and ECSL was not offered price reductions similar to those offered to other customers of EWS.

B22 ORR's analysis is focused on rates for coal haulage applying to certain flows to Fiddler's Ferry and Ferrybridge power stations (operated by EME) and certain flows to Eggborough power station (operated by BE). ORR presents analysis of EWS's prices on these flows to different customers and at different points in time. ORR also considers how the discriminatory prices placed ECSL at a competitive disadvantage.

B23 As part of the assessment below, reference is made to the potential for EWS's conduct towards ECSL to have had an impact on FHH. The links between ECSL and FHH are particularly relevant to understanding the motivations that lay behind EWS's negotiations with ECSL.

B24 The assessment demonstrates that, between May 2000 and November 2000, EWS applied dissimilar conditions to equivalent transactions, with its customers for coal haulage by rail, and placed ECSL at a competitive disadvantage.

### **Evidence of exclusionary intent**

B25 The following documents are relied on as evidence of EWS's intent to limit ECSL's ability to negotiate terms with the new owners of power stations such as EME and BE and to forestall ECSL from sponsoring the entry of a new rail freight operator, such as FHH.

---

<sup>168</sup> Source Annex 9 of ECSL Complaint, entitled "Contract discussions": "*May 2000. EWS provides ECSL with new rates including performance bonuses and penalties. EWS later rescinds offer "due to the fact that the offer was not approved by management". EWS states it will send a new offer but to date [February 2001] no such offer has been received.*"

- (a) Internal exchanges between the General Manager, Coal, and the Managing Director;
- (b) Internal exchanges between the General Manager, Coal, and the Managing Director; and
- (c) Other Internal exchanges between senior management of EWS.

B26 Each is explored, in turn, below.

*Internal exchanges between the General Manager, Coal, and the Managing Director*

B27 In June 1999, EME informed EWS that it was dealing with ECSL for its coal supplies. EWS responded saying that it preferred to contract directly with the generator and avoid middlemen.

B28 An internal e-mail from Nigel Jones of 1 October 1999<sup>169</sup> recorded:

“Enron, the agents for Edison Mission, have been active in various fields. They appear to have taken a position on some cargoes of imported coal [...] that they are having difficulty finding a home for. They have therefore been going round the UK market trying to sell this on a delivered basis. **It is their stated intent to become big players in the UK and I believe their aim is to become the agent for all coal purchase/logistics for all the big players. We know they have talked to NP, Eastern and SP. Not a scenario that is good for EWS.**” (Emphasis added.)

B29 Further, evidence is provided in exchanges between Nigel Jones, Ian Braybrook (at that time Managing Director, EWS) and others dated 22 November 1999<sup>170</sup>:

“**Enron have been pushing hard for a contract; we have been very much less keen having a strong preference for a contract direct with Edison Mission.** This will not happen before next spring, if at all. We therefore have to conclude something with Enron and have been negotiating Heads of Terms recently. Although these are short term in that they will only apply until next April, they will need some wider consideration/endorsement [...]” (Emphasis added.)

B30 The Managing Director clearly shared this reluctance to contract directly with ECSL and responded in an e-mail dated 23 November 1999<sup>171</sup>:

---

<sup>169</sup> Document 274 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>170</sup> Document 321 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>171</sup> Document 326 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

“You need to rationalise further (other than their impatience) why we should offer all the elements of a long term deal without the term – **even at this stage is there not a prospect of driving a wedge between Enron and Edison[?]**”. (Emphasis added.)

B31 These e-mails are evidence of EWS’s aim to keep ECSL at arms’ length and offer contractual terms to ECSL which would preserve EWS’s ability to negotiate directly with EME. This aim is also demonstrated in a further internal [undated] handwritten brief from Nigel Jones to Ian Braybrook<sup>172</sup>. After noting that “*We currently have no direct EM[E] involvement*”, the note continues (at page 3):

**“Enron are still angry at the prices agreed for this winter’s deliveries. They know they are higher than comparable prices in other contracts although they can’t prove it without other parties being in breach of contract (Enron’s prices are 30% higher than others).**

“We only have an exchange of letters with Enron citing price and payment terms. There is no Traffic Agreement and the traffic passes under our Standard Conditions of Carriage. No commitment on capacity, no commitment on performance. **This is deliberate – We would strongly prefer to deal direct with Edison Mission and want to treat Enron with a long spoon. We do not want them getting too tied in.**” (Emphasis added.)

B32 The identification of the prospect of ECSL facilitating new entry is articulated explicitly (page 4):

**“Enron told SC [Scottish Coal] (and others) that they intend to bankroll an Open Access Operator”.**

#### *Other Internal EWS documents*

B33 An e-mail from Nigel Jones to Philip Mengel dated 4 February 2000<sup>173</sup>, stated:

**“Part of Enron’s desire for these two options<sup>174</sup> is to reduce the rail element to the status of a commodity and to circumscribe our ability to market price. We are now the only element of the “coal to electricity”**

---

<sup>172</sup> Document 272 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002. EWS entered into an agreement with ECSL in December 1999, it is possible, therefore, that this brief predates that time.

<sup>173</sup> Document 378 of Volume 4 of documents produced by EWS in response to a section 26 Notice dated 19 March 2002.

<sup>174</sup> Document 368 of Volume 4 of documents provided by EWS in response to a section 26 Notice dated 19 March 2002 contains copies of slides of an Enron North America presentation on January 26 2000, “EWS/Enron Rail Partnership Opportunities”. It proposes inter alia (page 9) that a proposed joint venture between EWS and Enron is “*granted exclusive marketing rights for all imported coal*”, or option 2 (page 11), “*Enron buys all import coal rail capacity and associated marketing rights from EWS*” and (page 12) “*Enron enters into term contract for all UK imported coal rail capacity with EWS*” through which Enron “*pays EWS capacity charge and transportation charge for each level of rail service*”.

**chain that has not been reduced to this status and I think we surrender this at our peril.”** (Emphasis added.)

B34 It therefore appears that EWS saw indirect relationships between ECSL and the generators as capable of undermining EWS’s own ability to preserve the prices it charged generators for coal haulage in future direct negotiations.

B35 The same e-mail continues: “*the only real benefits for EWS [...] are that it might be easier to negotiate higher prices on some routes sooner*”. This demonstrates that EWS intended to charge ECSL higher prices than those charged to its existing customers. The e-mail concludes “*At the same time we will redouble our efforts to contract directly with the actual customers, even if only for one or two years in the case of new customers*”. This statement demonstrates EWS’s desire to “tie up” available capacity through contractual arrangements and to reduce opportunities for ECSL to contract directly with the generating companies for the provision of rail haulage on an E2E basis or otherwise.

B36 A further e-mail dated 28 February 2000<sup>175</sup> from Graham Smith to Philip Mengel, Nigel Jones and David White, comments specifically on the early relationship which ECSL made with EME, as the new owners of Fiddler’s Ferry and Ferrybridge, whereby ECSL provided EME with an E2E deal for imported coal. Graham Smith advised that, as a strategy, EWS,

“[...] should strike an LBT to Fiddlers deal with Enron if only to give them comfort that we are happy to deal with them. **This will buy us time on the wider offer and will diminish any thoughts they have about an alternative operator.**” (Emphasis added.)

B37 These e-mails reveal that EWS’s pricing strategy toward ECSL had a three-fold aim; (i) to charge ECSL selectively higher prices on some routes; (ii) to buy EWS time to negotiate direct contracts with the new owners of power stations; and (iii) to deter ECSL from sponsoring the entry of a new freight train operator.

#### *March 2000 Board Paper*

B38 The recommended approach to ECSL and a strategy against the threat of entry into coal haulage by rail was presented to the EWS Board in March 2000. The “Coal Update” slides for the EWS Board of March 2000<sup>176</sup> refer to new power station owners (AES and EME) becoming the larger players who were evaluating whether to deal direct with EWS or offset risk by using intermediaries such as ECSL<sup>177</sup>. EWS stated that it wanted to “*handle Enron [...] against the end customers, the*

---

<sup>175</sup> Documents 53-55 of File 9 of documents provided by EWS in response to a section 26 Notice dated 11 May 2001.

<sup>176</sup> Pages 1-13 of document 401 of Volume 4 of documents provided by EWS in response to a section 26 notice of 19 March 2002. q.v section on EWS’s view on contractual restraints, above.

<sup>177</sup> Page 4 *ibid.*

*Generators*<sup>178</sup>. This suggests that EWS wanted to manage ECSL's ability to offer indirect rail haulage supply.

B39 The same slide presentation<sup>179</sup> (also cited in part II A *Exclusionary Contracts* above), recommended that EWS:

“Work[ing] with the Generators to reach direct commercial agreements. This is the best way of avoiding the Fiddlers Ferry situation and continuing to **control the market**”, and to work “with Enron for a further one year deal to **cover their supplies to Edison Mission and any other business they succeed in winning and to forestall their Open Access threats.**” (Emphasis added.)

#### *EWS-ECSL March 2000 telephone conversation*

B40 EWS's concern over the threat of entry into coal haulage by rail and ECSL's role in facilitating such entry is revealed in a telephone call that took place between Nigel Jones ('NJ') and Tom Kearney ('TK') of ECSL<sup>180</sup> on 15 March 2000. ECSL has reported that in this conversation:

“EWS [made] it clear that a deal [was] conditional on knowing more about ECSL's plans in the rail freight sector. EWS indicate[d] that a different contract [would] be offered if ECSL [was] planning to enter as a rail freight haulier or if ECSL support[ed] the entry of a competitor to EWS.”<sup>181</sup>

B41 The transcript of this conversation, the full text of which is set out at Annex F, demonstrates clearly that a powerful driver behind contract negotiations between EWS and ECSL was EWS's desire to ensure that ECSL could not emerge as a potential competitive threat. Nigel Jones made it clear that the terms of any agreement between EWS and ECSL would be conditional upon “a *common understanding*” that Enron would not “*do its own thing*” i.e. set up on its own, or buy its own wagons.

#### *Internal e-mail following EWS's successful tender for EME's flows*

B42 In June 2000, EME and EWS reached an agreement to negotiate towards a direct contract for coal haulage by rail (on a DIY basis), which would replace the previous indirect E2E arrangements that EME had in place with ECSL. An internal EWS e-mail<sup>182</sup> noted:

“We did the deal with Edison Mission yesterday morning for LBT-Fiddlers @ £[ ... ]/tonne as agreed. This rate until 16<sup>th</sup> September pending a contract.

---

178 Page 10 *ibid.*

179 Page 11 *ibid.*

180 Provided in the Complaint. [01/12/01-1/12/07]

181 Provided in the Complaint. [01/12/01-01/12/07]

182 Document 447 of file 3 of documents provided in response to a section 26 notice of 11 May 2001.

**Enron are now off our hands so far as Edison are concerned. The Enron flows we have left are to British Energy's station at Eggborough; from Immingham, Redcar and Hull.** Also to Enron's own power station at Wilton – 250,000 tonnes/year. I think we are stuck Enron [sic] on the Eggborough traffic until next April when British Energy will, hopefully take over their own coal procurement. **But we have got them out of Fiddlers Ferry and Ferrybridge – a big step forward.**" (Emphasis added.)

B43 This e-mail is evidence of both EWS's intent and, indeed, its success in stopping ECSL from carrying out indirect supplies to EME, one of the new generating companies.

B44 This e-mail is also evidence of EWS's general intent to stop ECSL's indirect supplies to *other* generators. The sentence referring to the "*Enron flows we have left*" suggests that EWS had a wider plan to target Enron's other customers in future, particularly BE. ORR relies on this e-mail as evidence of EWS's exclusionary intent in relation to haulage to BE's Eggborough power station.

### **Haulage to EME power stations at Fiddler's Ferry and Ferrybridge**

#### *Contractual background*

B45 EME acquired Fiddler's Ferry and Ferrybridge power stations from E.ON (Powergen) in July 1999. The stations were operated by Edison First Power Limited (EFPL), a subsidiary of EME. As part of the acquisition EFPL entered into two long-term contracts for the supply of coal with E.ON. EFPL subsequently entered into further contracts for coal supply with ECSL. Rather than use EWS as a direct haulier, EME appointed ECSL as an indirect supplier of coal pursuant to the terms of an E2E contract. ECSL initially used EWS as its haulier under EWS's standard conditions of carriage<sup>183</sup>.

B46 EWS and ECSL formalised their arrangements by entering into a 7-month contract for the rail haulage of coal to EME's power stations at Fiddler's Ferry and Ferrybridge on 1 December 1999<sup>184</sup>.

B47 From January 2000, however, EWS and ECSL conducted a course of dealing as part of a performance based contract, and in May 2000 EWS offered prices<sup>185</sup> covering a wider variety of routes from Hunterston, Redcar, Hull and Immingham to Fiddler's Ferry and the Aire Valley<sup>186</sup>. The contract and related prices were not agreed between ECSL and EWS and coal was not hauled under them. EWS did not

---

<sup>183</sup> Document 211 of volume 3 of supplemental documents provided by EWS in response to a section 26 notice dated 19 March 2002.

<sup>184</sup> An e-mail from EWS to ECSL dated 2 August 1999 confirms the rates charged which are the same as those which eventually appear in the contract.

<sup>185</sup> Documents 282-284 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>186</sup> The Aire Valley contains the power stations of Ferrybridge, Eggborough and Drax.

re-open negotiations with ECSL on that contract at any point during the period under consideration (i.e. May 2000 to November 2000)<sup>187</sup>.

B48 On 26 June 2000, EME issued an invitation to tender for rail haulage of coal and EWS responded with successful price quotes on 3 and 5 October 2000<sup>188</sup>.

#### *Specific instances of discriminatory prices*

B49 In its investigation of EWS's pricing behaviour, ORR was persistent in its attempts to understand EWS's internal price setting practices and cost modelling, and the underlying thinking of those taking decisions on rates for coal haulage. A summary of such attempts is set out at Annex G (parts 1 and 2). In the following analysis, prices, quoted or applied, have been adjusted to a common base-period, so that comparisons in real terms can be made (i.e. comparisons on the basis of constant values). The base period chosen is the year commencing April 2000 and price adjustments are modelled on EWS's own price adjustment mechanism described in its contracts with RWE and E.ON.

B50 The first set of prices offered by EWS to ECSL in June/July 1999 under its standard conditions of carriage and under the contract of 1 December 1999 enabled ECSL to deliver on an existing end-customer contract with EME.

B51 The initial rates agreed with ECSL were significantly higher than those charged to other customers of EWS for the same flows. An e-mail from Nigel Jones to Ian Braybrook dated 22 Nov 1999<sup>189</sup> refers to the fact that the prices charged to ECSL "*represent real price **increases** of up to 35% on existing rates*". EWS was also conscious that the level of the rates was important for ECSL's E2E business with EME. In a letter to Tom Kearney of ECSL of 29 July 1999<sup>190</sup>, Nigel Jones observed that the prices offered in his letter of 17 June 1999<sup>191</sup> were:

"very significantly below current coal delivered prices and [...] at a level that will give Edison Mission a significant price advantage over the sort of generator they can hope to compete with".

---

<sup>187</sup> Source Annex 9 of ECSL Complaint, entitled "Contract discussions"

<sup>188</sup> The EME invitation to tender is provided at documents 19-21 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001. The EWS 10 August 2000 quotes to EME in response to that tender are provided at document 560 of file 3 of documents provided by EWS in response to a section 26 notice of 11 May 2001. The 3 and 5 October quotes are provided at documents 159-161 and 162-163, respectively, of file 2 of the same response.

<sup>189</sup> Document 321 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>190</sup> Document 246 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>191</sup> Document 215 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

B52 When ECSL discovered that its prices were significantly higher than those charged to other generators, they were “angry” and “apoplectic”<sup>192</sup>. In an undated handwritten brief to Ian Braybrook, Nigel Jones commented<sup>193</sup>:

“They know they are higher than comparable prices in other contracts although they can’t prove it without other parties being in breach of contract (Enron’s prices are 30% higher than others)”.

B53 The subsequent prices offered by EWS in May 2000<sup>194</sup> formed part of a suite of prices within a performance based contract covering a wider variety of routes from Hunterston, Redcar, Hull and Immingham to Fiddler’s Ferry and the Aire Valley (which includes Ferrybridge and Eggborough)<sup>195</sup>. As shown below, those prices were considerably higher than the 1999 rates. By contrast, the prices provided by EWS to EME on 3 and 5 October 2000 in response to the invitation to tender were considerably lower than the rates that EWS had offered ECSL<sup>196</sup>.

B54 Table 15 and Tables 16.A to 16.D show comparisons of prices EWS offered to ECSL in May 2000 with prices that EWS had previously set to ECSL and prices that EWS subsequently offered to EME. The flows selected are flows to Fiddler’s Ferry and Ferrybridge (the latter falls within the set of Aire Valley flows) for which a May 2000 ECSL quote can be compared against a quote to EME for the same flow. The figures in the Tables below demonstrate two aspects of discriminatory pricing:

- (a) EWS set ECSL higher prices in May 2000 (compared to those in December 1999) once ECSL started to seek quotes for the haulage of coal *generally* (i.e. in order to provide haulage prices as an intermediary, including supply on an E2E basis, and not just in respect of a pre-existing E2E contract with a specific generator) and when EWS had become more concerned about the threat posed by ECSL as a facilitator of new entry to the market for coal haulage by rail<sup>197</sup>.

---

<sup>192</sup> Note from Nigel Jones to Ian Braybrook (undated) document 272 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002 (para 5.2, bullet point 1 and para 6, bullet point 3).

<sup>193</sup> Ibid (paragraph 5.2, bullet 1).

<sup>194</sup> Documents 282-284 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>195</sup> The Aire Valley contains the power stations of Ferrybridge, Eggborough and Drax.

<sup>196</sup> The EME invitation to tender is provided at documents 19-21 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001. The EWS 10 August 2000 quotes to EME in response to that tender are provided at document 560 of file 3 of documents provided by EWS in response to a section 26 notice of 11 May 2001. The 3 and 5 October quotes are provided at documents 159-161 and 162-163, respectively, of file 2 of the same response.

<sup>197</sup> The sub-section above entitled “*Evidence of exclusionary intent*” indicates that over the period November 1999 to March 2000, EWS became increasingly concerned about the role that ECSL could play in assisting a new operator of coal haulage services by rail. See, for instance, the reference to a March 2000 Board Paper which recommended forestalling Enron’s “Open Access threats”. To some extent, these concerns were realised in June 2000, when ECSL concluded a contractual relationship with FHH, ultimately leading to FHH hauling

- (b) EWS in May 2000 set ECSL higher prices (in the region of 5% to 36% higher) than it subsequently set EME for direct supply in respect of the same flows.

---

coal for ECSL from January 2001 from the east coast ports to power stations located in the Aire Valley (including Eggborough).

**Table 15. EWS prices for Hunterston to Fiddler's Ferry**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	wef Dec-99	[ ... ]	[ ... ]
ECSL	12-May-00	[ ... ]	[ ... ]
EME	10-Aug-00 (wef Jan 2001)	[ ... ]	[ ... ]

**Table 16.A. EWS prices for Hunterston to Ferrybridge**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	wef Dec-99	[ ... ]	[ ... ]
ECSL	12-May-00	[ ... ]	[ ... ]
EME	Aug-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	3-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	5-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]

**Table 16.B. EWS prices for Hull to Ferrybridge**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	wef Dec-99	[ ... ]	[ ... ]
ECSL	May-00	[ ... ]	[ ... ]
EME	10-Aug-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	3-Oct 00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	5-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]

**Table 16.C. EWS prices for Immingham to Ferrybridge**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	wef Dec-99	[ ... ]	[ ... ]
ECSL	May-00	[ ... ]	[ ... ]
EME	10-Aug-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	3-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	5-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]

**Table 16.D. EWS prices for Redcar to Ferrybridge**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	wef Dec-99	[ ... ]	[ ... ]
ECSL	May-00	[ ... ]	[ ... ]
EME	10-Aug-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	3-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]
EME	5-Oct-00 (wef Jan 2001)	[ ... ]	[ ... ]

B55 As can be seen from the Tables above, in each instance the price to ECSL in May 2000 is greater than that made available to ECSL in December 1999:

- (a) The Hunterston-Fiddler's Ferry price to ECSL in May 2000 is 16% greater in real terms than the December 1999 price to ECSL;
- (b) Similarly, the Hunterston-Aire Valley price to ECSL in May 2000 is 16% greater than the December 1999 price to ECSL;
- (c) Hull-Aire Valley is 21% greater;
- (d) Immingham-Aire Valley is 21% greater; and
- (e) Redcar-Aire Valley is 8% greater.

B56 Furthermore, as can be seen from the Tables above, EWS's prices to EME directly during the 2000 negotiations for rail haulage (following the invitation to tender in June 2000) are lower than offered to ECSL during the same period:

- (a) The May 2000 price to ECSL for Fiddler's Ferry was 10% greater than the EME price;
- (b) The Hunterston-Aire Valley price to ECSL was between 6%-11% higher than the prices given to EME; and
- (c) ECSL's prices to the Aire Valley from Hull, Immingham and Redcar were between 20%-36% higher than the final prices charged to EME on 5 October 2000.

B57 On the basis of all this evidence, EWS is found to have offered selective price reductions to EME, with prices considerably lower than those offered to ECSL in May 2000. EWS has not provided an objective justification for the price differences.

B58 Taken together with the evidence of the price increases to ECSL compared to the rates ECSL had previously been granted, and the evidence above of EWS's intent to impede ECSL's ability to contract directly with the generators for rail haulage, including by way of E2E supply, this evidence supports the finding that EWS discriminated against ECSL between May 2000 and November 2000 in respect of prices for coal haulage on the flows to Fiddler's Ferry and Ferrybridge.

B59 The section below *Response to EWS's Arguments* explains why the differences in prices cannot be justified by differences in the performance regime that ECSL sought, or by any objective justification.

#### *Competitive disadvantage*

B60 ECSL had supplied EME on an E2E basis since summer 1999 when EME had taken over Fiddler's Ferry and Ferrybridge power stations following acquisition of the power station from E.ON (Powergen). In June 2000, EME issued an invitation to tender for longer-term arrangements for coal haulage to these power stations.

B61 The tender negotiations between June 2000 and October 2000 were concerned with prices for the haulage element of supply, EWS, Mendip Rail, GB Railfreight, Freightliner, Direct Rail Services and ECSL were asked to bid. ECSL was, therefore, in this tender, competing directly with EWS for coal haulage by rail as

well as other operators.

B62 In bidding as part of these negotiations, EWS's discriminatory treatment of ECSL placed ECSL at a competitive disadvantage in two main ways:

- (a) First, having failed to agree the performance related contract it had sought from EWS, ECSL was in the position of having neither its own coal haulage operations nor a suitable contract with EWS (the only operator of coal haulage by rail at the time)<sup>198</sup>. This would have impeded ECSL's ability to offer competitive rates for coal haulage to EME. In bidding to supply EME, ECSL would have had to bear the business risks of subsequently needing to re-open negotiations with EWS and/or trying to assist the new entry of an untested rail haulage operator that had never previously carried coal (the substantial barriers to entry to the market for coal haulage by rail are discussed in part I – *Market definition and Assessment of dominance*).
- (b) Second, ECSL's ability to offer relatively attractive rates for coal haulage to EME was impeded by the fact that, between August 2000 and October 2000, EWS (i) offered EME rates for coal haulage that were lower than the rates it had offered to ECSL in May 2000 but (ii) did not make available to ECSL the reduced rates it was offering to EME.

B63 Furthermore, when EWS made its lowest offer to EME, it indicated that the further rate reductions were available to EME on the assumption that EME would be using EWS on an exclusive basis:

“We have agreed to amend our prices on a number of flows on the clear understanding between our companies that EWS will become your rail haulage provider for all of your forecast tonnages as outlined in our previous correspondence.”<sup>199</sup>

B64 EWS was therefore prepared to offer selective price cuts to EME as part of its “wider offer” and in exchange for exclusivity. This is further evidence of the discriminatory approach that EWS adopted towards ECSL and the intent by EWS to undermine ECSL. Moreover, such an approach would have exacerbated the competitive disadvantage faced by ECSL. Were EME to have contracted with both EWS and/or ECSL for its haulage requirements, it would have lost out on the low rates that EWS offered in October 2000. In the event, EME contracted only with EWS for coal haulage by rail.

---

<sup>198</sup> It has been noted in Part 1 that some haulage to Ferrybridge was undertaken by barge. However, as explained in Part 1, haulage by barge is not included in the relevant market. Moreover, whether it was possible to use barge transport to Ferrybridge was dependent on the source point, and there is no evidence that haulage by barge was practical and economic for the flows to Ferrybridge from Hunterston, Hull, Immingham and Redcar that are considered in this section.

<sup>199</sup> Document 163 of file 2 of documents provided in response to a section 26 of 11 May 2001.

B65 It is not possible to conclude that ECSL was displaced from supplying EME as a result only of the discriminatory terms from EWS. Nonetheless, for the reasons set out above, ECSL was clearly placed at a competitive disadvantage when competing against EWS, compared to the scenario that would have prevailed had EWS been willing to treat ECSL in a non-discriminatory manner (i.e had it offered ECSL similar rate reductions to those it had offered to EME).

## Haulage on flows to BE's Eggborough power station

### *Contractual background*

B66 BE acquired Eggborough power station from National Power in March 2000. Eggborough therefore appears as a destination in the National Power (now RWE) legacy contract with EWS (see part II A above *Exclusionary Contracts*).

B67 Having sold Eggborough to BE, National Power “retained a contract for the supply and delivery of approximately [confidential] million tonnes of coal to Eggborough over a period of [...] years”.<sup>200</sup> However, in Autumn 1999, prior to taking possession of Eggborough, BE began a tender process for a [...] year contract for delivery of coal to Eggborough, considering both E2E and DIY options. Negotiations in this tender continued until Spring 2000. The prices provided by EWS to BE in March 2000<sup>201</sup> formed part of EWS’s bid as part of a DIY option.

B68 The tender resulted in BE awarding a one year contract for E2E coal supply to ECSL to take effect from 1 April 2000<sup>202</sup>. The prices provided by EWS to ECSL in April 2000 were provided after ECSL had been awarded the contract and were for coal haulage pursuant to it.

B69 Although ECSL was using EWS to haul coal to Eggborough using prices based on the terms of its 1 December 1999 contract with EWS<sup>203</sup>, routes to the Aire

---

200 BE in its response dated 1 May 2002 to a section 26 notice of 20 March 2002. [5A/329/1.5]

201 Provided at document 240 of volume 3 of EWS response to a section 26 notice of 19 March 2002 following a letter dated 25 September 2002. (Quotes provided in response to an ITT for traffic commencing April 1 2000.)

202 Volume 2 Exhibit 2 of the BE response dated 1 May 2002 to a section 26 notice of 20 March 2002 is a contract between ECSL and BE providing for the supply and delivery of coal to Eggborough Power Station during the period 1 April 2000 to 31 March 2001. [5A/329/41.1-5A/329/41.31]

203 In its letter of 19 October 2001, EWS confirmed (paragraph 8.2) that subject to two specific exceptions which were detailed in an e-mail to ECSL dated 2 August 2000 (document 246 of file 2 of documents provided by EWS in response to a section 26 Notice of 11 May 2001), EWS derived rates for ECSL for Eggborough flows from the agreed rates for ECSL’s Ferrybridge flows. The e-mail of 2 August 2000 extends the CCA between EWS and ECSL which expired on 30 June 2000 until 30 September 2000 and “[...] Specifically we will honour the rates in Schedule 1 until 30 September 2000 should they be required by yourselves. We agreed **in March 2000** to move coal from Immingham NCB Sidings to Eggborough Power Station at a rate of £[ ... ] tonne and from Redcar to Eggborough at a rate of £[ ... ]/tonne [e-mail dated **28 March 2000** from EWS to ECSL, provided at document 302 to file 2 of documents provided by EWS in response to a section 26 Notice of 11 May 2001] under the

Valley (including Eggborough) also formed part of its attempt to negotiate a wider, performance based contract with EWS in May 2000<sup>204</sup>. These negotiations did not reach a conclusion and no coal was hauled at the May 2000 price quoted to ECSL.

B70 In June 2000, ECSL concluded a contractual relationship with FHH. FHH subsequently entered the coal haulage by rail market on 1 January 2001 hauling coal for ECSL from the east coast ports to power stations located in the Aire Valley (including Eggborough).

B71 On 5 October 2000<sup>205</sup>, BE issued an invitation to tender for its anticipated rail supply requirements from 1 April 2001<sup>206</sup>. New arrangements (either on an E2E or DIY basis) would commence following the expiry of its previous E2E contract with ECSL in April 2001<sup>207</sup>. EWS provided prices to BE in October and November 2000 as part of its bid in that tender; these prices were provided as part of a five-year contract option<sup>208</sup>.

B72 Following the Autumn 2000 tender process, ECSL was awarded a contract for the provision of imported coal to Eggborough on an E2E basis (as well as for what was effectively the management of coal haulage to the Eggborough power station for coal BE had purchased from UK sources).

B73 In evaluating EWS's pricing to ECSL in respect of the BE flows to Eggborough, ORR focuses on one specific time period, namely between May 2000 (when ECSL sought prices under a wider performance based contract) and November 2000, when EWS responded to the BE invitation to tender.

B74 The period under consideration represents a pivotal time, occurring immediately prior to the entry of FHH. It is clear that EWS's strategy was intended not only to impose selectively higher prices on ECSL and to limit its ability to negotiate with BE on an indirect E2E basis but also to foreclose potential opportunities for FHH as a new entrant.

---

*terms of the contract and I confirm that these rates and the associated conditions will also apply until September 30<sup>th</sup> 2000."*

Document 184 of file 6 of documents provided by EWS in response to a section 26 Notice of 11 May 2001 is an e-mail dated 13 April 2000 recording a telephone quote to ECSL for 1000,000 tonnes of coal over 12 months from Gascoigne Wood to Eggborough.

204 On 21 February 2000 ECSL approached EWS with proposals for a new 1-year performance based contract, covering a wider range of routes. Documents 273 to 276 of file 2 of documents provided by EWS in response to section 26 Notice of 11 May 2001.

205 Documents 182-185 of file 2 of documents provided by EWS in response to a section 26 Notice of 11 May 2001.

206 BE advised within that ITT that it would measure "[...] *these proposals* [bids received in response to this rail only tender] (*in combination with proposals from coal suppliers and ports against offerings from end-to-end suppliers.*" [5A/329/14.2]

207 Its coal supply arrangement with National Power (supplied free on rail) would continue for three years from acquisition of the power station. (Informed by BE response dated 1 May 2002 to a section 26 notice of 20 March 2002.) [5A/329/1.5]

208 The ITT provides bidders the following options against which to bid:  
[...] 5A/329/14.4]

B75 The strength of the link between FHH and ECSL was acknowledged by EWS in a memo to the Board of 13 September 2000<sup>209</sup> (not ESI coal specific) where Allen Johnson reported on revenue:

**“FL has become the key vehicle by which Enron are exerting pressure on EWS - especially prices.** It is clear from discussions with AES Drax and Edison Mission that our key competition in the power station coal market is Freightliner.” (Emphasis added.)

B76 An internal EWS e-mail dated 23 November 2000<sup>210</sup> from David White to Allen Johnson, discussed the prices to be provided to BE during that Autumn 2000 tender process. David White commented on the low prices offered by FHH:

“I believe that Roger [Roger Pettit, FHH] is desperate because he will know that if he doesn’t get Eggborough his business case on the basis of 1mnt to Drax and an unknown tonnage to Eggborough on Enron’s account is stuffed – especially as Enron have said that EWS will also get some of the Enron tonnage. More pertinently Eddie Fitzsimons [FHH] and their banks will think the same too. John Shedden [BE] strongly implied that of the total tonnage they buy the E2E proportion will fall over time – not to zero, but it will fall. **If we have stitched up all of the DIY tonnage – then strategically I don’t know where Roger goes next.** He will try Cottam – but we are well in there. I believe that we now need to open up contract negotiations very soon with TXU (Mark Waters) too. Roger has a hump big enough to do all this just to drive down our margins – but what else are we to do? **We can either walk away from what we need to do at Eggborough and run the risk of getting nothing or we can offer low prices to snooker Freightliner.**” (Emphasis added.)

B77 ORR relies on these documents as evidence of EWS’s exclusionary intent, which determined the lower levels of prices offered by EWS to BE in November 2000 as compared with those offered to ECSL.

#### *Specific instances of discriminatory pricing*

B78 Tables 17.A to 17.D show comparisons of prices EWS offered to ECSL in May 2000 with prices that EWS had previously set to ECSL and prices that EWS subsequently offered to BE. The flows selected are flows to Eggborough (which falls within the set of Aire Valley flows that EWS quoted for in May 2002) for which a May 2000 ECSL quote can be compared against a quote to BE for the same flow.

---

<sup>209</sup> Document 595 of file 5 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>210</sup> Provided at document 296 of file 3 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

**Table 17.A. EWS prices for Hull to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	12-May-00	[ ... ]	[ ... ]
BE	8-Mar-00 (wef February April 2000)	[ ... ]	[ ... ]
BE	26-Oct-00 (wef April 2001)	[ ... ]	[ ... ]
BE	27-Nov-00 (wef April 2001)	[ ... ]	[ ... ]

**Table 17.B. EWS prices for Hunterston to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	7-Apr-00	[ ... ] <sup>211</sup>	[ ... ]
ECSL	12-May-00	[ ... ] <sup>212</sup>	[ ... ]
BE	8-Mar-00 (wef Apr 2000)	[ ... ]	[ ... ]
BE	27-Nov-00 (wef Apr 2001)	[ ... ]	[ ... ]

**Table 17.C. EWS prices for Immingham to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	Mar-00 <sup>213</sup>	[ ... ]	[ ... ]
ECSL	12-May-00	[ ... ]	[ ... ]
BE	8-Mar-00 (wef February April 2000)	[ ... ]	[ ... ]
BE	26-Oct-00 (wef Apr 2001)	[ ... ]	[ ... ]
BE	27-Nov-00 (wef Apr 2001)	[ ... ]	[ ... ]

**Table 17.D. EWS prices for Redcar to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	28-Mar-00	[ ... ]	[ ... ]
ECSL	12-May-00	[ ... ]	[ ... ]
BE	8-Mar-00 (wef Feb-Apr 2000)	[ ... ]	[ ... ]
BE	28-Oct-00 (wef Apr 2001)	[ ... ]	[ ... ]
BE	27-Nov-00 (wef Apr 2001)	[ ... ]	[ ... ]

<sup>211</sup> In an e-mail dated 7 April 2000 (Document 414 of file 2 of documents provided in response to a section 26 notice of 11 May 2001), EWS confirmed to ECSL that a trial cargo moving from Hunterston to Eggborough would be charged at the same rate as Hunterston to Ferrybridge (described by EWS in its response of 20 December 2001 to an ORR letter of 21 November 2001, as “*geographically proximate*” to Eggborough”) within the 1999 contract i.e. £[ ... ]. Invoices supplied by ECSL show that traffic was moved at this rate during the month of April 2000.

<sup>212</sup> Quoted as headline rates in a fax to ECSL dated 12 May 2000 provided at document 282 of file 2 of documents provided in response to a section 26 notice of 11 May 2001.

<sup>213</sup> An e-mail of 2 August 2000 (provided by EWS at document 246 of file 2 of its response to a section 26 notice of 11 May 2001) informs us that the rate of £[ ... ] for this route was agreed in March 2000, traffic to be moved under the terms of the existing contract. Invoices provided by ECSL show that traffic was moved at this rate for ECSL from June 2000 to April 2001.

B79 Between May and November 2000, EWS pursued a practice of discriminatory pricing between ECSL and BE in the following ways: (i) it imposed large price increases on ECSL between March 2000 and May 2000<sup>214</sup>; (ii) it offered lower prices to BE in October 2000 than it had offered to ECSL in May 2000 (without making these lower prices available to ECSL) and (iii) it offered BE further reduced prices in November 2000 (again, the price reductions were granted selectively to BE).

B80 From Tables 17.A to 17.D it can be seen that the prices offered to ECSL in May 2000 represent, in some cases, substantial increases on the prices EWS had previously set ECSL and BE. For instance:

- (a) Hunterston-Eggborough, the May 2000 price to ECSL is £[ ... ] higher than the April 2000 price to ECSL, which represents a 16% price increase;
- (b) Immingham-Eggborough, the May 2000 price to ECSL is £[ ... ] higher than the March 2000 price to ECSL, which represents a 21% price increase; and
- (c) Redcar-Eggborough, the May 2000 price to ECSL is £[ ... ] higher than the March 2000 price to ECSL, which represents a 6% price increase.

B81 From Tables 17.A to 17.D it can also be seen that the May 2000 prices to ECSL are systematically higher than those quoted by EWS to BE directly during Autumn 2000 in response to BE's second tender:

- (a) Hull-Eggborough the May 2000 price to ECSL is higher by £[ ... ]/t (nearly 50%) than the final price to BE in Autumn 2000;
- (b) Hunterston-Eggborough the May 2000 price to ECSL is £[ ... ]/t (13%) higher than the final price to BE in Autumn 2000;
- (c) Immingham-Eggborough the May 2000 price to ECSL is £[ ... ] (47%) higher than the final prices to BE in Autumn 2000;
- (d) Redcar-Eggborough, the May 2000 price to ECSL was £[ ... ]/t (33%) higher than the final price to BE in Autumn 2000.

---

<sup>214</sup> Note also that the May 2000 prices to ECSL are considerably higher than the prices quoted to ECSL for the same flow in April 2001 (once FHH was operating on the market in competition with EWS). For example,

- (a) for Hull-Eggborough, the May 2000 price is £[ ... ]/t (48%) higher than the April 2001 price;
- (b) for Hunterston-Eggborough, the May 2000 price is £[ ... ]/t-£[ ... ]/t (13%-17%) higher in real terms than the other two prices to ECSL;
- (c) for Immingham-Eggborough the May 2000 price is £[ ... ]/t-£[ ... ] (21%-30%) higher than the other two prices to ECSL; and
- (d) for Redcar-Eggborough, the May 2000 price is £[ ... ]/t-£[ ... ]/t (6%-20%) higher.

B82 Thus, BE enjoyed a series of price reductions between March 2000 and November 2000.<sup>215</sup> This is shown not only by the quotes for the various Eggborough flows set out above, but also by evidence from certain other flows. Tables 18.A to 18.C show that on flows from Gascoigne Wood, Kellingley and Maltby, EWS offered BE substantial price reductions between March 2000 and November 2000. For the Gascoigne Wood and Maltby flows, these reductions also representations substantial decreases of prices that EWS had set ECSL in April 2000.

**Table 18.A. EWS prices for Kellingley to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
BE	8-Mar-00 (wef Feb Apr 2000)	[ ... ]	[ ... ]
BE	26-Oct-00 (wef Apr 2001)	[ ... ]	[ ... ]
BE	27-Nov-00 (wef Apr 2001)	[ ... ]	[ ... ]

**Table 18.B. EWS prices for Gascoigne Wood to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	13-Apr-00 <sup>216</sup>	[ ... ]	[ ... ]
BE	8-Mar-00 (wef Feb-Apr 2000)	[ ... ]	[ ... ]
BE	26-Oct-00 <sup>217</sup> (wef April 2001)	[ ... ]	[ ... ]
BE	27-Nov-00 <sup>218</sup> (wef April 2001)	[ ... ]	[ ... ]

**Table 18.C. EWS prices for Maltby to Eggborough**

Customer	Date of quote	Nominal EWS quote (£)	EWS quote in constant prices (£ April 2000)
ECSL	11-Apr-00 <sup>219</sup>	[ ... ]	[ ... ]
BE	8-Mar-00 (wef Feb-Apr 2000)	[ ... ]	[ ... ]
BE	26-Oct-00 (wef Apr 2001)	[ ... ]	[ ... ]
BE	27-Nov-00 (wef Apr 2001)	[ ... ]	[ ... ]

<sup>215</sup> These price reductions represent reductions not only on the rates offered to ECSL in May 2000 but also on certain prices agreed with ECSL in March 2000.

<sup>216</sup> The rate provided to ECSL on 13 April 2000 for traffic from Gascoigne Wood to Eggborough is apparently provided by telephone and recorded in an internal e-mail provided at document 184 of file 6 of documents provided in response to a section 26 notice of 11 May 2001 and is in relation to a rate request by ECSL for a volume of 100,000 tonnes over 12 months.

<sup>217</sup> 26 October 2000 quotes to BE in a response to tender and provided by EWS at documents 206-210 of file 2 of EWS response to a section 26 notice of 11 May 2001.

<sup>218</sup> 27 November 2000 quotes to BE in response to tender. Provided at documents 186-189 of file 2 of EWS response to a section 26 notice of 11 May 2001.

<sup>219</sup> 11 April 2000 quote to ECSL for Maltby to Eggborough recorded in manuscript on an e-mail dated 11 April 2000 provided at document 272 of file 2 of EWS response to a section 26 notice of 11 May 2001.

B83 In constant prices, the price reductions made available to BE were as follows:

- (a) Gascoigne Wood from £[ ... ] to £[ ... ] (40%);
- (b) Hull from £[ ... ] to £[ ... ] (25%);
- (c) Hunterston from £[ ... ] to £[ ... ] (5%);
- (d) Immingham from £[ ... ] to £[ ... ] (24%);
- (e) Redcar from £[ ... ] to £[ ... ] (20%);
- (f) Kellingley from £[ ... ] to £[ ... ] (34%); and
- (g) Maltby from £[ ... ] to £[ ... ] (22%).

B84 Whilst EWS was willing to make price reductions available to BE, reductions from the May 2000 quotes were not offered to ECSL. Furthermore, in specific instances where ECSL had contacted EWS in order to ask for lower rates on flows to Eggborough power station, EWS showed reluctance to negotiate downwards on price.

B85 For example, on 28 March 2000, ECSL was quoted a spot rate of £[ ... ] per tonne for a flow from Redcar to Eggborough commencing April 2000 (that rate was itself £[ ... ] lower than that which ECSL was offered in May 2000)<sup>220</sup>. ECSL responded that it was unhappy with the rate of £[ ... ] but would accept a temporary price of £[ ... ]<sup>221</sup>. EWS apparently does not concede and this is recorded in a letter from Tom Kearney of ECSL of 30 March 2000 in which he records that he is “*sincerely disappointed by [the EWS] response*” and “*reluctantly accept[s]*” the offer.

B86 It appears that EWS’s reluctance to negotiate downwards on price was demonstrated again between May 2000 and October 2000. ECSL shows its frustration at EWS’s prices in an exchange of e-mails in May 2000. In an e-mail dated 24 May 2000, David White of EWS confirms to Tom Kearney of ECSL rates that had been discussed in an earlier conversation:

“Some time ago we spoke about various rates from RJB sites to Eggborough – particularly Gas [sic] Wood. I know that you were looking for £[ ... ] per tonne. However I am really not able to move from £[ ... ].”<sup>222</sup>

---

<sup>220</sup> Document 302 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>221</sup> Document 279 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>222</sup> Document 280 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

B87 In response Tom Kearney writes in an e-mail of the same date<sup>223</sup>:

“sure you can...lets show a little positive creativity here!

How about:

UK £[ ... ] for first [ ... ] tons

UK £[ ... ] for the next [ ... ] tons

That sounds like a deal to me”.

B88 ORR has not been provided with documents that respond to this e-mail. However, a later exchange reveals that, five months later, EWS continued to show reluctance to negotiate downwards on price for the Gascoigne Wood to Eggborough flow. On 12 October 2000<sup>224</sup>, John Moran of ECSL e-mails David White of EWS seeking a rate for [ ... ] trains a week from Gascoigne Wood to Eggborough commencing 23 October 2000. He asks for confirmation of a rate of £[ ... ] per tonne. David White responds in an e-mail of the same date<sup>225</sup>:

“I only have a recollection of quoting £[ ... ]/tonne from Gas [sic] Wood to Eggboro’ [sic] to Tom [Kearney]. I know Tom was disappointed we could not agree £[ ... ]. Although it was quoted a long time ago – I am prepared to honour £[ ... ]”.

B89 Thus on 12 October 2000, EWS turned down ECSL’s request for a rate from Gascoigne Wood to Eggborough of £[ ... ] per tonne. EWS offered £[ ... ] per tonne, exactly the same rate that it had offered ECSL in May 2000. In contrast, as shown in the Table above, on 26 October 2002, EWS offered BE a rate of £[ ... ] per tonne for that flow before further reducing the rate to £[ ... ] per tonne on 27 November 2000. This highlights the discriminatory approach that EWS adopted in its dealings with ECSL.

B90 Taking together the evidence of EWS’s price increases to ECSL, the evidence of the price reductions made available to BE but not ECSL and the evidence above of EWS’s intent to impede ECSL’s operations, EWS is found to have discriminated against ECSL between May 2000 and November 2000 in respect of prices for coal haulage on the flows to Eggborough. The section below *Response to EWS’s Arguments* explains why the differences in prices cannot be justified by differences in the performance regime that ECSL sought, or by any objective justification.

---

223 Document 351 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

224 Document 266 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

225 Document 286 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

### *Competitive disadvantage*

B91 As explained at the beginning of this section, ECSL had been providing coal to BE on an E2E basis since March 2000. In October 2000 BE began a tender exercise for its coal haulage requirements from April 2001, upon expiry of its prevailing one-year deal with ECSL. BE was willing to consider options for E2E supply of coal, as well as options for procuring coal and coal haulage separately.

B92 In bidding as part of the BE tender in 2000, EWS's discriminatory treatment of ECSL placed ECSL at a competitive disadvantage in two main ways.

- (a) First, having failed to agree the performance related contract it had sought from EWS, ECSL was in the position of having neither its own coal haulage operations nor a suitable contract with EWS (the only operator of coal haulage by rail at the time). This would have impeded ECSL's ability to offer an attractive E2E (and intermediary) deal to BE, and placed ECSL at a competitive disadvantage compared to both EWS and to other coal suppliers (including other potential E2E suppliers who had coal haulage agreements already in place with EWS). In bidding to supply BE on an E2E basis, ECSL would have had to bear the business risks associated with the fact that, were it to win the tender on an E2E basis, it would subsequently need to re-open negotiations with EWS and/or try to assist the new entry of an untested rail haulage operator that had never previously carried coal (the substantial barriers to entry to the market for coal haulage by rail are discussed in part I – *Market definition and Assessment of dominance*).
- (b) Second, in seeking to reach an E2E (and intermediary) deal with BE, ECSL was effectively competing against both EWS and other suppliers of coal. ECSL's ability to offer a comparatively attractive E2E package to BE was impeded by the fact that, between October 2000 and November 2000, EWS (i) offered BE rates for coal haulage that were significantly lower than the rates it had offered to ECSL in May 2000 and (ii) EWS did not and would not make available to ECSL the reduced rates it was offering to BE (as is clearly demonstrated in the exchanges recorded above). This discriminatory treatment would not only have disadvantaged ECSL's E2E offer when compared against EWS's direct haulage offer, it would also have disadvantaged ECSL's E2E offer when compared against alternative E2E and coal-only offers that BE would be considering.

B93 Through these effects, ECSL was placed at a competitive disadvantage during the tender process, as a result of the discriminatory treatment by EWS.

B94 Despite EWS's pricing practices, ECSL was eventually successful as part of the BE tender process. [...]:

- (a) [...].

(b) [...] <sup>226</sup>.

B95 The intermediary service that ECSL offered is therefore not simply that of an E2E supplier making margins out of favourable coal input prices, but also that of a wider intermediary across BE's coal haulage requirements. Overall, this reduced the involvement that BE needed to take in coal haulage operations, whilst allowing BE to benefit from both imported and UK coal supplies.

B96 Under the arrangements, ECSL used FHH, as well as EWS, to haul coal to the power station at Eggborough.

B97 Nonetheless, the fact that ECSL was eventually successful in winning the BE business does not prove that ECSL was not placed at a competitive disadvantage during the tender process. EWS's selective discounting strategy impeded its customer and competitor, ECSL, in its negotiations with BE by subjecting it to a form of margin squeeze.

B98 Indeed, there is evidence that EWS's strategy risked undermining ECSL's negotiations with BE. The final outcome of the tender process reflects BE's subjective preferences for coal procurement rather than being based purely on the rates offered for the haulage element of the deal<sup>227</sup>. BE's tender was issued to both E2E suppliers (including ECSL) and to train operators (FHH, EWS and DRS, the latter of which declined to quote<sup>228</sup>). It was the intention of BE to consider the full range of options covering both E2E and DIY supply. The recommendation that BE pursue an E2E and haulage management deal with ECSL was submitted to the BE Board in March 2001<sup>229</sup>. The recommended fall back option was, however, to contract direct with EWS<sup>230</sup>:

“[...] we will need to re-commence negotiations with our preferred rail service provider, EWS, on an urgent basis to arrange for the delivery of our UK coal commitments.”

B99 For the reasons set out above (and also those discussed in the section below *Effect on competition under Response to EWS's arguments*) the discrimination against ECSL is found to have placed ECSL at a competitive disadvantage when it was negotiating with BE for the provision of E2E and intermediary services. The

---

<sup>226</sup> [...]. [5A/329/5.6]

<sup>227</sup> In a meeting with ORR on 19 April 2002 [access to file number 20/1868c, paragraph 6], David Love of BE explained that due to the high sulphur content of UK coal, the quantities able to be used within the UK are limited. BE therefore decided to enter into a further 3 year E2E supply contract with ECSL for imported coal. David Love also explained that BE also entered into an agreement with ECSL to manage its UK coal supply contracts avoiding the need for BE to become involved with haulage arrangements for any of its coal requirements.

<sup>228</sup> Paragraph 18 of Coal Procurement Plan dated 10 December 2000 provided by BE in response to a section 26 notice of 20 March 2002. [5A/329/5.5]

<sup>229</sup> Summary document, presented to the BE Board dated 26 March 2001, provided by BE in response to a section 26 notice of 20 March 2002. [5A/329/6.4, paragraph 7]

<sup>230</sup> Summary document, presented to the BE Board dated 26 March 2001, provided by BE in response to a section 26 notice of 20 March 2002. [5A/329/6.12, paragraph 47]

existence of the competitive disadvantage is not inconsistent with the fact that, in the end, ECSL did manage to reach an agreement with BE.

## **Conclusion**

B100 On the basis of all the evidence set out above, and the points made in response to EWS's arguments below, it is found that between May 2000 and November 2000, EWS pursued discriminatory pricing practices against ECSL. This discriminatory pricing placed ECSL at a competitive disadvantage when negotiating intermediary contracts (including E2E deals) with generating companies. EWS's intention was to reduce the threat that ECSL posed to its position in the market for coal haulage by rail in Great Britain. EWS has advanced no credible objective justification for the higher prices charged to ECSL. EWS's conduct distorted the competitive process and is inconsistent with the obligations of a dominant company. EWS's behaviour towards ECSL is therefore found to be abusive.

## **Response to EWS's arguments**

B101 In its Response, EWS denied that it had engaged in price discrimination so as to place ECSL at a competitive disadvantage and disputed ORR's preliminary finding that the differentials in its pricing were exclusionary<sup>231</sup>. It argued that ORR has misconstrued the facts and misapplied the law on equivalent transactions, competitive disadvantage and objective justification.

B102 ORR's response to these arguments, insofar as they relate to the specific flows to Fiddler's Ferry, Ferrybridge and Eggborough between May 2000 or November 2000, is structured as follows:

- (a) Price discrimination and equivalence of transactions.
- (b) Objective justification for prices.
- (c) Overall pattern of discrimination against ECSL.
- (d) Exclusionary intent.
- (e) Effect on competition.
- (f) The implications of a finding of price discrimination.

### **(a) Price discrimination and equivalence of transactions**

B103 Coal haulage by rail provided to one customer and coal haulage by rail provided to another customer in respect of the same flows constitute comparable transactions. This is especially, but not exclusively, so where the coal haulage is provided on the same origin-destination pair.

---

<sup>231</sup> EWS Response, §7.1.

B104 EWS maintained that in order for ORR to compare prices, those prices must be for equivalent transactions, and it argued that ORR had not compared equivalent transactions. EWS stated in a response of 19 October 2001:

“[...] for price discrimination to have occurred EWS must have charged different prices to ECSL for equivalent transactions. EWS submits that ORR has not in the Third Notice made comparisons between equivalent transactions, and that there are legitimate reasons why quotations to different companies may differ for what appear to be similar routes.”

B105 In the same response, EWS also stated:

“Comparisons cannot be made between prices under agreements which offer long term, predicable [sic] and committed commitments from the customers concerned and requests for spot rates from new customers that are made several years later.”

B106 In a later response dated 20 December 2001, EWS stated:

“3.4. In conducting an investigation into discriminatory pricing pursuant to section 18(2)(c) [of the Competition Act 1998], the initial focus must be on the equivalency of the *transactions*, not merely identity or similarity of the *route* [...].

**3.5 Two given coal haulage transactions are equivalent only if it is practicable to compare them (for the purpose of deciding whether the rates quoted are discriminatory) having regard to the terms on which EWS is to provide the coal haulage services and to the circumstances of provision.”** (Emphasis added.)

B107 In its Response, EWS submitted that (paragraph 7.16):

“The correct approach is that, even where two rates have been quoted in respect of the same route – the transactions in question must be “equivalent” in all other material respects if they are to be treated as comparable for the purposes of assessing whether anti-competitive price discrimination has occurred.”

B108 EWS’s extreme contention set out in the paragraph above cannot be accepted:

- (a) As EWS itself correctly pointed out in the response dated 20 December 2001 (see above), two given transactions can be treated as “equivalent” if it is practicable to compare them for the purpose of deciding whether the rates quoted are discriminatory. The issue is then whether any differences between the two situations are capable of justifying the disparity in treatment.
- (b) From an economic perspective, price discrimination depends on the price-cost margin for different customers not reflecting differences in the underlying costs of supplying those two customers. In the case where price-cost margins do not reflect the costs of supply, the

differences in price must, by definition, reflect differences in demand-side characteristics. If, as was EWS's view, differences in demand-side characteristics are sufficient in themselves to render transactions dissimilar, this effectively means that few, if any, transactions could fall to be considered as price discrimination. Clearly such a position is not tenable and would effectively mean that almost all transactions would be free from competition law scrutiny. Therefore, in order for the term 'equivalent transaction' to be meaningful, it must relate only to the supply-side of two or more transactions being equivalent.

B109 Therefore, where the supply-side of two transactions is the same, that is, the supply is of the same product (i.e. coal haulage), using the same technology (i.e. haulage by rail), by the same undertaking (here, EWS), over at least the same origin-destination pair, such transactions are equivalent for the purposes of assessing price discrimination under competition law. Nonetheless, as recognised below, differences in the prices set for such transactions may be objectively justified, and would not constitute an abuse if they were incapable of placing a trading partner at a competitive disadvantage.

B110 EWS further maintained in its Response that transactions are unlikely to be sufficiently comparable where:

(paragraph 7.17(a))

"Quotes in the course of negotiations – which were not ultimately embodied in a concluded contract – are compared with agreed rates in final contracts. As EWS has explained in its previous submissions to the ORR<sup>232</sup>, quotes given in the course of negotiations will necessarily have been made before all relevant terms and conditions have been finalised; this lack of specificity will naturally impact on the price level that EWS is able to offer at that stage of the negotiations."

(And paragraph 7.17(e))

"Rates offered by EWS at varying stages of a tender process operated by a customer, where EWS has been informed that it must improve upon its 'first round' bid in order to be successful. Subsequent lower rates offered in these circumstances constitute [...] legitimate and pro-competitive price competition by EWS, provided that the lower rates offered were not predatory."

B111 *Aéroports de Paris*<sup>233</sup>, however, shows that discrimination can hold when transactions are based on individual negotiations with customers. This is entirely appropriate.

B112 Whether prices are individually negotiated or not is irrelevant as to whether price discrimination has occurred. What matters is that the supply-side of the transactions is the same. The prices offered to ECSL, as part of commercial

---

<sup>232</sup> Letters from EWS to the ORR dated 19 October 2001 and 20 December 2001.

<sup>233</sup> Case T-128/98 [2000] ECR II-3929.

negotiations between ECSL and EWS, cannot be justified on the basis that they were simply an offer and not a final agreed price. Indeed, it cannot be correct that a price offered by a dominant undertaking to a customer could form part of a discriminatory abuse were the customer to accept the offer but would not do so were the customer to decline the offer.

B113 EWS also took issue with ORR's interpretation of internal documents comparing ECSL's rates with those under other contracts<sup>234</sup>. It maintained in its Response that such transactions are unlikely to be sufficiently comparable when:

"Rates under the Legacy Contracts – negotiated with customers as part of a 'package' of rates involving 'give and take' as between rates on particular routes within the overall package (with a lower rate on one route being compensated for by a higher rate on another) – are compared to rates quoted or agreed on a 'standalone' basis. The 'legacy' contracts were concluded between 1996 and 1998 in fundamentally different market conditions to the later non-legacy contracts." (Paragraph 7.17c.)

B114 Legacy contract prices and more recent prices can be compared where these are for flows with the same supply-side characteristics. If such prices were to differ materially, this could provide evidence of price discrimination. But, particularly where there is a significant time lag between two quotes, it might also be appropriate to take account of the possibility that differences in prices are better explained by changes in general market conditions (e.g. input prices), rather than by discriminatory treatment of a particular customer or set of customers.

B115 The price comparisons shown in the tables above are not comparisons with legacy rates. In light of the focus of ORR's price comparisons, EWS's point on legacy rates does not apply to the figures in these tables.

B116 Internal EWS documents leave no doubt that EWS's representatives themselves viewed the rates charged to ECSL as directly comparable to the rates charged to the generators directly, and that EWS's representatives were, moreover, fully aware that they were engaging in discriminatory treatment: see, in particular, the section above *Evidence of exclusionary intent*.

B117 EWS also submitted at paragraph 7.17(d) that transactions are unlikely to be sufficiently comparable when:

"Rates are compared, which relate to transactions involving different terms and conditions (such as performance regimes), which affect anticipated underlying costs and therefore the price quoted."

B118 Differences in performance regimes might potentially account for some or all of the differences in price to different customers. In particular, the May 2000 prices to ECSL would have been subject to performance payments whereas ECSL's December 1999 contract was not. However, performance payments would not be sufficient to explain the differences in prices. The reason for this is set out below.

---

<sup>234</sup> EWS Response, §§7.22-7.25.

B119 There is evidence that EWS calculated the additional cost associated with the performance-based contract, offered to ECSL in May 2000<sup>235</sup>. These calculations saw EWS identify all the payments that it might expect to make to ECSL, and all the payments ECSL might make to EWS, depending on performance. EWS then added all these potential payments together and concluded that the additional cost of the performance regime in the May 2000 contract was £0.75 per tonne. EWS's calculations are set out in the Table below.

**Table 19. Penalties payable by EWS to ECSL under May 2000 proposals**

Incentive payment	Amount (£ per tonne)
Base train plan incentive: Paid if EWS reduces the number of trains in any week from the Base Train Plan	[ ... ]
Balancing period volume delivery incentive: Paid if at the end of each 13 week balancing period EWS has not made up for the number of trains it has not operated within that period	[ ... ]
Seasonal discount: Paid to encourage ECSL to spread movement of coal through the year <sup>236</sup>	[ ... ]
Discharge incentive penalty: Paid if the power station unloads the train within the discharge time	[ ... ]
Total possible payment by EWS to ECSL	[ ... ]

B120 EWS's calculations of these additional performance costs are flawed. Rather than being based on EWS's expected net payments to ECSL under the proposed performance arrangement, it is based on simple addition of all possible penalty payments by EWS. The implicit assumption in EWS's calculation that the full value of penalty payments is certain, i.e. that the probability of all possible penalty payments being made is unity, is not correct.

B121 EWS itself realised that the calculation set out above would overstate the actual cost of these performance payments. An internal internal memoranda<sup>237</sup> dated 26 May 2000 provides an illustration of the level of future performance required in order to maintain the same contributions to costs as those which to date had resulted from the non-performance based contract with ECSL. This calculation shows that a performance standard of between [ ... ]% and [ ... ]% would maintain current contributions and moreover David Simons (Market Planning) confirms in the covering memorandum,

<sup>235</sup> Documents 7/8 of file 6 of documents provided in response to a section 26 notice of 11 May 2001.

<sup>236</sup> In EWS's internal memo (provided in the Complaint) it is written, "[t]he tabled proposal is for Enron to spread volumes in its Base Train Plan by 1/12th annual tonnage for each month. To encourage this EWS will pay Enron 15 pence per tonne." It is therefore not clear what exactly would trigger this incentive payment to ECSL. The same memo is provided by EWS at documents 283/284 of file 2 to documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>237</sup> Document 12 of file 6 of documents provided by EWS in response to a section 26 notice of 11 May 2001 is an internal memo from David Simons (Market Planning) to David Griffiths reporting that Allen [Johnson] had been briefed on net contributions arising from the May 2000 quotes to ECSL.

“Provided the base plan is reasonable there should be no question of us failing to achieve better than current levels of contribution.”

B122 A previous briefing e-mail dated 22 November 1999 from Nigel Jones<sup>238</sup> to colleagues and directors including Ian Braybrook and Graham Smith seems to support the view that, although each performance regime is negotiated on its merits, a level of performance target of [ ... ] tends to be the contract standard for EWS. On this basis he asked for Executive agreement, in the context of his continuing negotiations with ECSL, on:

“the principle of agreeing a performance regime against target arrival of [ ... ]. Frankly as this is the EWS contract standard I think we have no choice, especially in the light of the prices.”

B123 Moreover, a handwritten note<sup>239</sup> dated 31 May 2000 which appears to record a briefing conversation with Allen Johnson suggests [at document 19] that at a performance level of below [ ... ]%, EWS would expect to pay to ECSL just £[ ... ] per tonne. In light of this evidence, the price increases to ECSL (which in three cases were rises of £[ ... ] per tonne) cannot be explained by performance regimes.

#### **(b) Objective justification for prices**

B124 EWS submitted at paragraph 7.42 of its Response:

“Even if, contrary to EWS submissions, the ORR continues to consider that it has compared equivalent transactions and that EWS’s rates to Enron were based on the application of discriminatory criteria [...] EWS considers that any differentials in rates quoted to Enron were objectively justified by legitimate commercial considerations.”

B125 EWS listed at paragraph 7.45 of the Response, the following factors which it considered to provide objective justification for its pricing to ECSL:

- (a) That Enron’s rate requests were typically speculative and devoid of the level of specificity of details (notably the volumes to be hauled) required by EWS in order to give anything other than an indicative quote.
- (b) Enron’s rate requests were, in some cases, for “spot” business rather than for a term contract including committed volumes. Even when seeking rates for a longer-term contract with EWS, Enron was unable to give any indication of key factors such as volumes. Unsurprisingly, EWS was not therefore able to quote rates that reflected cost and

---

<sup>238</sup> Page 1 of document 321 of volume 3 of documents provided by EWS in response to a section 26 notice dated 19 March 2002.

<sup>239</sup> Documents 17 to 19 of file 6 of documents provided by EWS in response to a section 26 notice of 11 May 2001 is an handwritten note dated 31 May 2000 which appears to record a briefing [telephone] conversation with Allen Johnson.

resource planning-related efficiency benefits to EWS of predictable volumes.

- (c) That the market for coal haulage by rail is characterised by derived demand from the commodity market for coal for use in electricity generation. It is therefore to be expected that market circumstances will fluctuate over time and that EWS's rates would legitimately reflect those fluctuations. Such objective factors, rather than any discrimination against Enron or other parties, underlie any differences in rates quoted over time.
- (d) That EWS had reservations about quoting to customers like Enron in light of the significant operational difficulties they could and had caused to EWS.

B126 EWS asserted that it did not have to account precisely, down to the last penny, for any differences in rates quoted<sup>240</sup>. However, the burden of proof rests on EWS to demonstrate, on the balance of probabilities, its objective justification for the extent of the disparity in the prices it charged ECSL and EME and BE between May 2000 and November 2000<sup>241</sup>. Such defence would need to be substantiated with convincing evidence. EWS has not discharged that burden.

B127 In particular, the points raised at (a) and (b), do not correctly characterise the nature of the ECSL approach. In February 2000, for example, ECSL e-mailed Nigel Jones at EWS regarding proposed contractual terms for the period 1 July 2000 to 30 June 2001<sup>242</sup>. ECSL provided the following principles, under which it sought to enter into a contract with EWS:

“It is Enron?s [sic] goal to provide EWS with clear, consistent, and advance notification of its rail transport needs to EWS;

Enron is committed to transport as much coal by rail as EWS is willing to commit to for the period from July 1, 2000 to June 30, 2001;

Enron is prepared to provide EWS with year-ahead, 90 day-ahead, 30 day-ahead schedules to facilitate EWS?s [sic] scheduling of its trains;

Enron is prepared to structure shipments and deliveries in quantities and at times that would optimise EWS operations;

Enron is prepared to commit to mutually-agreed performance criteria and will pay EWS when we do not perform [...]”.

---

<sup>240</sup> EWS Response, §7.43.

<sup>241</sup> Regulation 1/2003 EC, recital 5.

<sup>242</sup> E-mail dated 21 February 2000 provided at document 273 of file 2 of documents submitted by EWS in response to a section 26 notice of 11 May 2001.

B128 In a follow on e-mail dated 10 March 2000<sup>243</sup>, ECSL provides further proposed terms over a two-year period 2000-2002 (extendable for a third year at ECSL's option) and provides indicative annual tonnage from LBT and Hunterston to Fiddler's Ferry, and from Hunterston, Redcar, Hull and Immingham to the Aire Valley and from Redcar to Wilton. The May 2000 prices provided by EWS to ECSL (see discussion on *Haulage to EME power stations at Fiddler's Ferry and Ferrybridge* above) were provided in that context and in response to that approach. A further quote provided by EWS to ECSL on 13 April 2000<sup>244</sup> for haulage of coal from Gascoigne Wood, discussed above in relation to *Flows to Eggborough* was in relation to a committed volume of 100,000 tonnes over 12 months.

B129 Although the general premise made at point (c) that market circumstances which fluctuate over time may legitimately be reflected in prices offered is valid, this point is not persuasive when applied to the specific pricing behaviour and pattern identified and discussed above. Here the concern is the prices offered by EWS to its customers over a seven-month period (May 2000 to November 2000), where there is no evidence from EWS, contemporaneous or otherwise, that would substantiate the claim that during that period there were differences in market conditions that would lead to justifiable differences in price.

B130 Moreover, the prices in May 2000 were offered in the context of a 2-year proposal, for which one might have expected to see a discount from those offered in December 1999.

B131 Neither is the point made by EWS at (d) which it repeats at paragraph 7.46(c) of its Response persuasive:

“EWS's concerns regarding the operational difficulties that could (and did) arise as a result of dealing with E2E suppliers such as Enron which had no control over access to, or the operation of, the power station infrastructure to which EWS was required to deliver coal on its behalf.”

B132 EWS provides haulage for a number of E2E suppliers notably E.ON, RWE and other generators who trade-on coal from time to time. The operational difficulties experienced at Fiddler's Ferry to which EWS referred at paragraph 7.49 of its Response were apparently as a result of EME contracting with two E2E suppliers, E.ON (then Powergen) and ECSL. In an e-mail from Nigel Jones to Tom Kearney of ECSL of 2 March 2000<sup>245</sup>, Nigel Jones states:

“We continue to be faced by combined weekly requests for trains from Enron and Powergen that vastly exceed the power station's ability to cope. Only this

---

<sup>243</sup> E-mail dated 10 March 2000 provided by EWS at document 430 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

<sup>244</sup> The rate provided to ECSL on 13 April 2000 for traffic from Gascoigne Wood to Eggborough is apparently provided by telephone and recorded in an internal e-mail provided at document 184 of file 6 of documents provided in response to a section 26 notice of 11 May 2001 and is in relation to a rate request by ECSL for a volume of 100,000 tonnes over 12 months.

<sup>245</sup> Document 324 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001.

Monday power station management admitted that they could only handle 70-80 trains a week. However in the light of combined weekly orders of up to 60% more than this, Edison Mission continue to decline to common-sense their supplies. You will appreciate the difficult position we are continually placed in.”

B133 EWS also referred in sections 2 and 7 of the Response<sup>246</sup> to the operational difficulties arising at Fiddler’s Ferry from October 1999 onwards which it says arose from the decision by EME, at that time, of contracting direct with two E2E suppliers of coal (E.ON and ECSL) rather than by having a direct contractual relationship for haulage with EWS. It submitted at paragraph 2.59 that:

“By November 1999, EWS therefore found itself in a novel and extremely difficult position from an operational perspective, where it was forced to attempt to reconcile conflicting orders for trains into Fiddler’s Ferry placed by two intermediate E2E suppliers in circumstances where it had no direct contractual relationship with the power station owner. This experience resulted in a preference from an operational perspective for dealing with the owners of power stations”.

B134 The operational difficulties experienced at Fiddler’s Ferry cannot be said to be purely the fault of ECSL and cannot provide objective justification for discriminatory pricing. It is hard to see how operational problems needed to be resolved by imposing higher prices rather than by negotiating appropriate contractual arrangements. Even if EWS had been concerned about ECSL’s involvement in the operational difficulties at Fiddler’s Ferry, setting higher prices to ECSL than to EME would not have represented a proportionate response.

### **(c) Overall pattern of discrimination against ECSL**

B135 At paragraph 7.269 (b) of EWS’s response, EWS submitted that prices to ECSL were not generally higher than those to other customers but in some cases they were lower. Figure 5 of the Response showed a chart that was described as providing a comparison, for a series of different routes, of average rates to ECSL against average rates to other customers on the same routes.

B136 Whilst the chart shows several flows for which rates average to ECSL were considerably higher than average rates to other customers, it also shows cases where average rates to ECSL were lower. EWS argued that this demonstrates that there is no clear pattern of differences between average quotes to ECSL and average quotes given to others on those routes (paragraph 7.51).

B137 This evidence does not undermine the findings set out above.

B138 First, the finding of discriminatory abuse is confined to flows to Fiddler’s Ferry, Ferrybridge and Eggborough. Taking Figure 5 of the Response at face value, it seems that flows to these destinations tend to have been flows for which EWS’s calculations show a higher price to ECSL.

---

<sup>246</sup> In particular paragraphs 2.58-2.59 and paragraph 7.49.

B139 Second, EWS's calculations seem to compare average ECSL prices against average prices to other customers. However, the discrimination identified in this Decision is not discrimination against ECSL overall, but discrimination against ECSL during a particular time period. This is the time period when ECSL was seeking general terms for haulage that would allow it to then bid for direct contracts with the generators including on an E2E basis.

B140 This time period was also after EWS had become concerned about the threat posed by ECSL as a potential facilitator of the entry of a new freight train competitor to EWS. This time period excludes the time of ECSL's initial operation as an E2E supplier, as well as the subsequent time period from 2001 when ECSL had won the BE contract and had the opportunity to use FHH for at least some of its coal haulage. Because of this, ORR could not rely on evidence that there was no discrimination against ECSL on average (say across 1999, 2000 and 2001) to reject the hypothesis that there had been discrimination against ECSL between May 2000 and November 2000. Thus, calculations showing average quotes to ECSL are of limited value. (Similarly, calculations of average quotes to other customers could be misleading if the quotes were provided at different points in time and under quite different conditions from the ECSL quotes.)

#### **(d) Exclusionary intent**

##### *Interpretation of the documentary evidence*

B141 At paragraph 7.46 of its Response EWS argued that ORR has mischaracterised the material cited, which, in EWS's view, reflected no more than:

- (a) EWS's desire properly to understand the basis upon which Enron was proposing to contract with it and to ensure that any contractual arrangements it entered into with Enron were negotiated and agreed on terms that were commercially acceptable to it.
- (b) Enron's attempts to impose novel and commercially unacceptable contractual terms on EWS which were more far reaching and favourable to Enron than the terms upon which EWS had contracted with existing long term customers.
- (c) EWS's concerns regarding the operational difficulties that could (and did) arise as a result of dealing with E2E suppliers such as Enron which had no control over access to, or the operation of, the power station infrastructure to which EWS was required to deliver coal on its behalf.
- (d) EWS's concerns regarding constraints on its capacity and the impact that accepting new business from Enron might have on its existing contractual obligations and relationships with other customers.
- (e) EWS's concerns regarding Enron's commercial reputation for sharp practice and its attempts to acquire and effectively commoditise EWS's services.

B142 Most of these points have been dealt with previously in the section entitled *Objective justification for prices*. With regard to points (a) and (b), exchanges of correspondence have been identified between ECSL and EWS which show more specificity articulated in ECSL's approach than characterised by EWS. The "*novel and commercially unacceptable terms*" referred to at some length at paragraphs 7.50 et sequitur of the Response appear to be primarily ECSL's proposal to link "[...] *rates to performance, rather than merely imposing penalties in the form of liquidated damages for underperformance [...]*" (paragraph 7.51). In the section *Price discrimination and equivalence of transactions* above there is an assessment of how the proposed performance regimes impact on the prices offered. With regard to point (c) it is explained above why the submission that operational difficulties at power stations would not provide, in the circumstances described in contemporaneous documents, any form of objective justification for deliberately setting higher prices to ECSL.

B143 The point EWS raised at (d) regarding capacity seems to concern a perception attributed to the originator of the documents (paragraph 7.60 of the Response) that ECSL wished to purchase all or a considerable proportion of EWS's capacity on Anglo-Scottish flows, which it submitted would have undermined its ability to service its existing customers. In support of this EWS cited the Heads of Terms proposed by ECSL in 11 November 1999 which EWS submitted represented volumes significantly greater than ECSL required on its own account at that time and a proposal made by ECSL in January 2000<sup>247</sup> for a joint venture between ECSL and EWS<sup>248</sup>.

B144 The documents cited (in the section entitled *Exchanges between the General Manager Coal and the Managing Director*) are all dated November 1999, thus the joint venture proposed in January 2000 would not have been in the mind of the originators of those November 1999 documents. Furthermore, the January proposal never made it further than the presentation and certainly cannot be submitted as an objective justification for the prices subsequently offered to ECSL in a different contractual context. Secondly, there is no other contemporaneous evidence either inter se or between EWS and ECSL which suggested that the Heads of Terms, proposed in November 1999, would have caused the capacity constraints that EWS now alleges and moreover such concerns did not prevent EWS entering into a contract with ECSL in December 1999.

B145 The material relied on to demonstrate EWS's exclusionary intent may well reflect commercial considerations and some apprehension about EWS moving towards greater involvement with intermediaries and away from the familiar territory to EWS of contracting with a small number of large generating companies. For precisely this reason, however, the material validly demonstrates how EWS had the intention from the outset of preventing ECSL becoming the principal in the relationship with generators, thereby, as stated in paragraph 7.60(b) of the

---

<sup>247</sup> Slides of a presentation from ECSL to EWS on 26 January 2000. Document 368 of file 4 of documents provided by EWS in response to a section 26 notice dated 19 March 2002.

<sup>248</sup> Which contained two options the first to form a coal marketing joint venture with exclusive rights to market all imported coal and the second that ECSL would buy all of EWS's coal rail capacity and associated marketing rights.

Response, commoditising EWS's capacity and trading it on the market and, moreover, moving into a position from whence it could facilitate the entry of an alternative rail haulier (Mr Jones' handwritten note to Mr Braybrook (at that time Managing Director, EWS)<sup>249</sup>, cited also at paragraph 7.60(b) of the Response: "*Enron want a long term role and see themselves as developing a similar role controlling supply and logistics for all major coal users*".

B146 It is not accepted, therefore, that the material relied on *only* reflects legitimate commercial considerations, nor, on the contrary, that it reveals objective justification for higher prices to ECSL. The material reveals not only that the exclusionary intent and strategy was discussed among various members of EWS's senior managers, but also viewed in the round, reveals that more than just legitimate commercial considerations lay behind EWS's dealings with ECSL.

#### *March 2000 Board paper*

B147 At paragraph 7.62 of its Response, EWS stated that the March 2000 Board paper:

"[...] was prepared by the Coal Team for the information of the Board only and does not reflect any agreement or endorsement by the Board of any of the matters set out therein [...] The only reference to the presentations in the Minutes stated that "there was a discussion about the previous day's presentations. It was felt that a commercial strategy on coal was lacking."

The position is repeated in EWS's Supplementary Response.<sup>250</sup>

B148 As discussed earlier in the section **Contemporaneous evidence of EWS's exclusionary strategy**, the formal record of the Board meeting does not record that the Board endorsed such a strategy and therefore there is no persuasive evidence to suggest positive endorsement by the Board of any such matters. The recommended approach of *controlling the market* and *forestalling ECSL's Open Access threats* remains, however, entirely consistent with the tenor of the rest of the evidence presented in respect of the approach prevalent throughout EWS.

B149 At paragraph 7.15 of its Supplementary Response EWS further argued that the reference to its desire to "*handle Enron [...]*" is selectively quoted and that ORR has turned a perfectly legitimate strategic question for the Board as to how EWS should seek to deal with third party intermediaries into a statement of intent against ECSL. ORR considers its interpretation to be more plausible given that on the same slide EWS asks the further question "*How can EWS maintain market control and deter the threat of an Open Access Operator*" and in the next slide it states that it is currently addressing these developments in the market by "*Working with the Generators to reach direct commercial agreements [...]*" and "*Working with Enron for a further one year deal to cover their supplies to Edison Mission and any other*

---

<sup>249</sup> Document 272 of file 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>250</sup> At paragraphs 3.7, 7.14 and 7.16.

*business they succeed in winning and to forestall their Open Access threats*". The context and juxtaposition of these quotes tend to show that EWS wished to limit ECSL's presence in the market.

#### *Involvement of the Board and senior management in pricing strategy*

B150 At paragraphs 7.94-7.107 of its Response, EWS sought to dismiss generally the proposition that its Board attempted to:

"[...] develop any strategic directions or issue any instructions to senior management or the Coal Team in relation to the manner in which EWS should approach pricing to particular customers."

B151 Documentary evidence of specific directions from the Board of this exclusionary strategy has not been discovered by ORR. While EWS have not presented evidence that demonstrates that the Board rejected the strategy effectively recommended by senior staff within EWS, ORR's view is that there is no persuasive evidence of any Board endorsement of any anti-competitive pricing strategy.

B152 At paragraph 7.96 of its Response EWS also argued that:

"In relation to the involvement of senior management (the Chief Executive Officer, the Chief Operating Officer and the Finance Director) in pricing during the period of the investigation, it is important to note that in the period between late 1999 and early 2000, there was a complete changeover in EWS' senior management team with little overlap between the tenure of the outgoing and incoming management teams. The personnel involved and the timing of this change in management is set out in detail in Section 2 above. In the circumstances, any allegation to the effect that there was a continuing strategy pursued by senior management over the period of the investigation, notwithstanding this complete management change over, is not credible, particularly given that, in many cases, incoming members of senior management never met the predecessor in their role."

B153 It further clarified at paragraph 7.17 of its Supplementary Response that its point is that it is implausible to suggest that even if an exclusionary strategy had existed prior to new management coming into place, this continued *"in circumstances where an entirely new team was in place and where many incoming team members had never even met their predecessors in the role"*.

B154 The emphasis that EWS placed on there having been a complete changeover in the senior management team is not accepted on two counts. While it is true to say that the senior roles of CEO, COO/Operations Director and Finance Director were all different, four members of the management team remained. Thus it cannot be accepted that there was no continuity as between the old team and the new team. Further David Israel in a meeting with ORR on 2 September 2005<sup>251</sup> confirmed that marketing managers were certainly not made aware of any change of company

---

<sup>251</sup> Access to file number -29/360.

policy or strategy at that time (e.g. via internal policy papers or directions), neither has ORR been provided with such documents. Mr Israel did recollect, however, that Philip Mengel was appointed CEO in January 2000 with the objective of preparing the company for flotation by a strategy of increasing prices/revenues and reducing costs. This confirms the explanation by EWS at paragraph 2.48 of its response that, “[t]he new management team under Philip Mengel was more focused in seeking to understand the costs of the business in general than had previously been the case”.

B155 Although the new management team may have had, from David Israel’s recollection, an entirely legitimate focus on properly understanding the costs of the business, ORR has found no evidence to support an assertion that the new management team had led to a change in EWS’s behaviour such that an exclusionary strategy was no longer pursued (ORR relies, for example in this part II B, on a document from Nigel Jones to Philip Mengel (the new CEO) dated 4 February 2000). However, as indicated above, ORR has concluded that there is no persuasive evidence that any anti-competitive strategy was endorsed by the EWS Board.

#### *EWS-ECSL March 2000 telephone conversation*

B156 In EWS’s Response<sup>252</sup> EWS considered that the recording of the telephone conversation between Nigel Jones and Tom Kearney was potentially unlawfully obtained and did not accept that the transcript is necessarily accurate and requested the original. ORR does not possess the original tape recording. ORR notes, however, that EWS has not denied that the conversation took place and in light of the consequences of providing false information to ORR, ORR has no reason to suspect that the transcript is false

B157 At paragraph 7.70 of its Response, EWS argued that:

“Mr Jones considered that, had Enron intended to either enter on its own account or sponsor another operator at the end of a two year contract, there would have been little to no potential for an ongoing relationship with EWS and therefore a longer contractual term. Had a longer-term arrangement been a possibility, EWS may have been in a position to offer Enron better contractual rates.”

B158 At paragraph 7.72 EWS added:

“EWS’s preference for longer term arrangements is expressed in Mr Jones’s earlier letter to Tom Kearney dated 17 June 1999 where, at page 2, Mr Jones states “we have contracts varying in length from six to fifteen years depending on circumstance. Our preference is for a long term contract to give our customers certainty of supply and us certainty of planning provided there is an

---

<sup>252</sup> At paragraph 7.66.

appropriate set of safeguards for both parties to cater for unexpected changes in circumstances.<sup>253</sup>

“This preference and EWS’s ability to offer better rates in return for a contract of longer duration is also referred to in Nigel Jones’s letter to Tom Kearney dated 29 July 1999 where, at page 2, Mr Jones states “another factor that is important to us is term of contract. Generally speaking, the longer the commitment, the better the overall deal is likely to be...It is self evident that we will apply different arrangements to a nine-month deal than we would to a [e.g.] five or ten year deal<sup>254</sup>.””

B159 While a longer-term contract might be more attractive to a supplier by providing greater certainty over cash-flow, such certainty will critically depend on the precise terms agreed. For example, the longer the period over which prices are agreed and held fixed, the greater the risk that cost shocks or changes in volumes (e.g. to lower margin routes) can render the overall contract less profitable. Indeed, the long-term legacy contracts appeared to have caused EWS precisely these problems as the lower prices for Anglo-Scottish flows caused EWS to suffer significantly reduced profitability as volumes on these flows increased markedly from 1997 (see section 2 of the Response). In this regard there is no need, as EWS implied at paragraph 7.22 of its Supplementary Response, for the term of any contract with Enron to have been the same as the legacy contracts for their example to be instructive; *any long-term* contract carries such a risk.

B160 Moreover, while the Response at paragraph 7.72 suggested that a longer-term contract would be accompanied by more attractive terms for the customer, this is not consistent with EWS’s actual pricing to ECSL on the flows analysed below. For example, as noted below, the November 1999 prices quoted for flows to Fiddler’s Ferry and Ferrybridge are systematically lower than prices quoted in May 2000 on the same flows, in spite of the fact that the November 1999 prices were applicable for 7 months whereas the May 2000 prices were given in the context of a 1-year deal.

B161 At paragraph 7.246 of its Response, EWS submitted that the comments about Enron being “*off our hands*” and “*out of Fiddler’s Ferry and Ferrybridge*” refer to the operational difficulties experienced on those flows with ECSL being at an end. As noted above at paragraph A39, EWS did not provide evidence to support a causal link between the operational difficulties experienced at those stations and the mere presence of ECSL alone and, by extension, those statements can not be taken to refer only to the elimination of operational difficulties arising merely from the exit of ECSL from those stations. In the light of this and the overall documentary evidence providing evidence of EWS’s intent to stop ECSL from providing indirect supplies to EME, ORR views these statements as a further expression of an exclusionary intent. In that context, the interpretation of the further references to the situation on

---

<sup>253</sup> Document 215 of file 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>254</sup> Document 246 of file 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

Eggborough flows advocated at paragraph 7.24 of EWS's Supplementary Response is also implausible.

B162 In addition, the fact that, as contended by EWS at paragraph 7.247 of its Response, the rate quoted to EME in this e-mail may have been above others offered to ECSL for the Liverpool-Fiddler's Ferry flow is immaterial to ORR's findings on EWS's discriminatory practices and intent. The discrimination identified by ORR applies to particular flows and particular time periods, the fact that ECSL may, on other flows, have been offered lower rates than other customers does not affect this position.

B163 At paragraphs 7.229 to 7.233 of its Response, EWS contended that the extract from the e-mail dated 23 November 2000 is incorrectly relied upon [at B76] as evidencing an exclusionary intent. It argued that the suggestion that low prices be used to "snooker" FHH was subject to the caveat that such prices be above total costs and that, in order to achieve this, prices that were equal to or slightly higher than those EWS believed FHH to be offering on flows to Eggborough were, in general, offered by EWS. Accordingly, EWS were simply engaging in legitimate price competition.

B164 ORR does not accept that these considerations can negate the finding of exclusionary intent it draws from this document. EWS's statement that it wished to "snooker" FHH is a clear expression of a desire to exclude competitors from the market and to secure the Eggborough flows for itself. It is therefore plausible to infer from this that, regardless of EWS's exact strategy taken in respect of FHH itself, its refusal to offer ECSL equivalent prices would have been driven by such considerations.

#### *No intent to exclude FHH*

B165 EWS in its Response (paragraphs 7.267-7.268) "*rejected the suggestion that above cost pricing to Enron would have any adverse impact on Freightliner's entry or competitive success.*" It cited, in support of this rejection, its submission that there are no significant barriers to entry into coal rail freight (which ORR refutes in the discussion on barriers to entry in part I, *Market definition and Assessment of Dominance*) and its submission that the relevant market can be characterised as a bidding market means that intensive competition is likely when there are two bidders for a contract (which again ORR refutes in the present context, see part I *Assessment of dominance*). In summary EWS submitted that Freightliner's entry did not require the existence of an intermediary in coal rail freight (such as ECSL) and that ECSL was in no better position to be a potential facilitator of competition in the market for the carriage of coal by rail than any of the generators.

B166 As part of its analysis of abuse, ORR has taken account of relevant market factors, including the potential role of an intermediary such as an E2E supplier in facilitating entry to the supply of coal haulage by rail. ORR has also taken account of the evidence showing the development of a strategy by EWS to treat ECSL in such a way as to forestall an "open access threat". It is not necessary to demonstrate that EWS's conduct towards ECSL actually had an adverse effect on FHH in order to find that EWS discriminated against ECSL and placed ECSL at a competitive disadvantage. However, this aspect of the market context is still relevant: it not only

helps explain the motivations of EWS when dealing with ECSL during the period May 2000 to November 2000, but it also suggests that the distortion to competition arising from the discrimination against ECSL might have distorted competition additionally through effects on FHH's entry to the market. Therefore, the following points are raised in response to the submissions of EWS.

B167 The hurdles to entering the coal haulage by rail market are [...] <sup>255</sup>:

“[...]”

B168 [...] Freightliner approached Eastern Power and Trading (latterly TXU) in January 2000 stating <sup>256</sup>:

“We have realised that entering the heavy haul market will be much easier for Freightliner if we can be seen to acquire some equipment etc ahead of full contractual commitment from customers. Our financiers have supported this in the case of locomotives, and we will soon be announcing the acquisition of further heavy haul capability; of course it will be possible to use the locos in mainstream business if the other prospects do not materialise. We would now like to try to do something similar with coal wagons, but we don't have an existing use for them [...]”

B169 Freightliner then went on to propose a committed asset model whereby TXU would essentially secure Freightliner capacity and avoid the need for Freightliner to make speculative purchase. TXU recorded that earlier exchange in a document dated 4 April 2002 in which it stated <sup>257</sup>:

“After a number of meetings we halted discussions because the rates per tonne at that time were not attractive enough for us to go ahead. [...]”

B170 TXU only reopened discussions when FHH entered into the joint venture with ECSL and had been awarded the contract with AES Drax. In the same April 2002 document, TXU stated:

“Further discussions took place in early 2001 when Freightliner had already entered the market for another customer and had some spare capacity available [...]”

B171 The unattractiveness of the earlier offer by Freightliner was also recorded in the minutes of the meeting between TXU and ORR on 18 April 2002 <sup>258</sup>. At that meeting TXU explained that although discussions with Freightliner commenced in late 1999, those early proposals were not favourable to TXU [...].

---

<sup>255</sup> [...]

<sup>256</sup> Provided by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002. [385/192.1]

<sup>257</sup> Provided by TXU in its response of 25 April 2002 to a section 26 notice of 20 March 2002, in section entitled “*Recent documents prepared for Middle Office on Freightliner as an alternative to EWS*”. [385/197.2]

<sup>258</sup> Meeting with TXU on 18 April 2002. [17/1629.5]

B172 The above evidence highlights the importance of an entrant establishing customer contracts in order for entry to be viable. Of particular importance in this regard is the role played by ECSL in establishing relationships with end customers and facilitating the route to market for the new entrant in coal haulage by rail, FHH.

B173 The potential importance of intermediaries in facilitating entry into coal haulage by rail is illustrated by the attempts of Fastline to enter the relevant market. Indeed, Fastline attempted to negotiate a joint venture with [a coal supplier] which, like ECSL, had established relationships with generating companies. [...] <sup>259</sup>. As explained in part I of this Decision, in *Assessment of Dominance*, the heads of terms with [...] have now expired as a result of [...] suspending talks due to concerns over Jarvis group's (Fastline's parent company) financial position <sup>260</sup>. As a result, Fastline has advised that it is unlikely to '*envisage considering*' entry into coal haulage by rail until at least two years after its entry into rail freight haulage, itself not expected until April 2006.

B174 The experience of FHH, the entry considerations of Fastline and the more detailed discussion of barriers to entry in part I of this Decision – *Assessment of dominance*, all serve to illustrate the extent to which EWS's submissions significantly underestimate the barriers to entering coal haulage by rail. EWS's position also seems to ignore the fact that there has been no generator sponsored entry or self-supply since the exit of National Power (RWE) in 1998.

#### **(e) Effect on competition**

B175 At paragraph 7.35 of the Response, EWS summarised its objections to the view that its pricing behaviour could have imposed a material competitive disadvantage on ECSL:

“At a minimum, each of the following conditions must be proven, to the Napp standard, in order for Enron to be found to have suffered a material competitive disadvantage <sup>261</sup>:

- (a) Enron must have had no alternative supplier at the relevant time (i.e. it was captive to EWS).
- (b) Enron must have been in competition with other customers of EWS who benefited from preferential EWS rates at the same point in time.
- (c) Coal haulage prices must have formed a material percentage of the input costs - the overall 'delivered price' of coal - of the power generators active in the downstream electricity generation market.

---

<sup>259</sup> Fastline response dated 19 June 2003 to a section 26 notice of 8 May 2003. [16/1538/4.7]

<sup>260</sup> Fastline response dated 23 June 2005 to an ORR information request dated 27 May 2005. [27/266.1]

<sup>261</sup> For the methodology of this analysis, see John Temple Lang, Robert O-Donoghue, *Defining Legitimate Competition: How to clarify pricing abuses under Article 82 EC*, Fordham International Law Journal [2002] Vol. 26.

- (d) The differential in the rates charged by EWS to Enron as opposed to other customers must have been large enough to result in Enron suffering a material competitive handicap in winning coal supply contracts with electricity generators.”

B176 Turning first to point (a) above, at the time of the discriminatory abuse, ECSL was dependent upon EWS for its rail haulage. EWS was the only company providing rail haulage of coal in 2000. FHH did not haul coal by rail until January 2001. Furthermore, even though FHH participated in tenders before January 2001, ORR does not consider this sufficient to remove the position of economic dependency on EWS that ECSL was in when it sought the performance-based contract in May 2000. Not only was it another six months before FHH hauled any coal, and not only was FHH an untested operator in the coal haulage market, but also, as discussed in part I – *Assessment of dominance*, FHH faced capacity constraints when it began to operate on the market.

B177 Leaving point (a) aside, ORR does not accept that the above list represents the minimum conditions necessary to support a finding that EWS had discriminated against ECSL. For the following reasons, the approach reflected under (b) to (d) above is not accepted.

B178 ECSL was a customer of EWS. However, the power generators were willing to consider contracting for coal haulage either indirectly through an intermediary (including the E2E option) or directly with the rail operator. This meant that ECSL also competed against EWS to win contracts with the power generator (as well as competing against other suppliers of coal to the generator). As a result, the competitive disadvantage that ECSL faced was not primarily a disadvantage compared to other customers of EWS. Rather, ECSL was at a competitive disadvantage vis-a-vis other actual and potential competing suppliers to BE and EME. These parties included EWS as well as other suppliers of coal, whether on an E2E basis or not.

B179 Given this structure, neither EWS’s assertion that, for ECSL to have faced competitive disadvantage, ECSL “*must have been in competition with other customers of EWS who benefited from preferential EWS rates at the same point in time*” nor its assertion that “*coal haulage prices must have formed a material percentage of the [...] overall ‘delivered price’ of coal [...] of the power generators active in the downstream electricity generation market*” is valid. The competitive disadvantage faced by ECSL was in relation to EWS and also to other suppliers of coal.

B180 Moreover, to reject the prospect of *material* competitive disadvantage under (c) and (d), EWS seems to rely on calculations that imply that the higher coal haulage rates faced by ECSL would only have made a 1% difference to the delivered price of coal for a £0.25 difference in road haulage prices, because coal cost much more per tonne than haulage (Response, paragraph 7.40). This approach is misleading.

B181 EWS’s alleged immateriality of differences in haulage price seems to rest on a falsehood: that when a customer buys a low-priced item and a high-priced item at the same time, the customer will not be concerned about differences in the price of the low-priced item. Although differences in low-priced goods are

sometimes overlooked on transaction costs grounds, there is no evidence that generating companies were unconcerned about the price of coal haulage. To the contrary, there is evidence that generating companies would have been influenced by coal haulage rates:

- (a) The fact that EME and BE ran tenders for coal haulage indicates that coal haulage prices were important enough to warrant the effort of getting the best deal.
- (b) Before the period of EWS's attempts to undermine ECSL, EWS had observed to ECSL that rates for coal haulage could provide generating companies with a competitive advantage over their rivals. In a letter to Tom Kearney of ECSL of 29 July 1999<sup>262</sup>, Nigel Jones observes that prices offered that month were "*very significantly below current coal delivered prices and [...] at a level that will give [EME] a significant price advantage over the sort of generator they can hope to compete with*".
- (c) It would have been in the clear financial interests of a generating company to react to differences in coal haulage rates. Because of large volumes of traffic, even small differences in rates per tonne could have significant financial impacts on its expenditure. For instance, the BE response indicates that in the year 2000, over 2 million tonnes were hauled to Eggborough by rail<sup>263</sup>. For price differences of the order of £0.25 on each flow, BE would have been able to save £500,000 per annum by ensuring that it was getting the best deal for coal haulage.

B182 For these reasons, EWS's assertion that the price differences were insufficient to place ECSL at a "*material competitive handicap*" must be rejected.

B183 Furthermore, one important aspect of the competitive disadvantage that ECSL faced was that it went into tender negotiations in 2000 having failed to agree with EWS the performance-related deal for coal haulage that it had sought. As an intermediary and E2E supplier, this would have placed ECSL in a difficult position. In submitting a bid to a power generator, ECSL would have been forced to bear business risks that it would have avoided had it been treated in a non-discriminatory manner such that it was able to secure a suitable coal haulage contract with EWS.

B184 Somewhat differently, at paragraphs 7.253 and 7.254 of its Response, EWS rejected the prospect of competitive disadvantage to ECSL on the basis that ECSL's principal activity was as a coal trader and the viability of its coal trading business would not be undermined by EWS because ECSL could sell coal to power generators on an un-delivered basis. In effect, EWS was saying that ECSL could choose not to be an E2E supplier and avoid the effect of high coal haulage rates.

---

<sup>262</sup> Document 246 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002.

<sup>263</sup> BE response to a section 26 Notice of 20 March 2002. [5A/329/1.1]

B185 This argument is rejected. As described in the *Introduction* to this part above, ECSL provided a number of services to the owners of power stations including sourcing and trading on coal and providing straight to stock-pile deals (sourcing coal and arranging its transport from source to stockpile as part of an E2E deal). It is not compatible with the Chapter II prohibition or Article 82 EC for EWS to have then used a dominant position to force ECSL to trade under a different business model. The relevant competitive disadvantage includes consideration of ECSL's operations in its legitimate and established capacity as a supplier and, more generally, as an intermediary between generating companies and EWS.

B186 The positive role that ECSL had played in the market is illustrated by BE's attitude towards coal haulage when it first agreed to use ECSL. In a meeting with ORR on 19 April 2002, David Love of BE noted (paragraph 5):

"[...] before the contract with Enron was entered into BE had considered (in early 2000) different contractual structures, including the DIY option of sourcing its own coal and entering into a coal carriage agreement, however, the E2E deal was chosen as a short term option which took account of BE's early inexperience of coal procurement."<sup>264</sup>

B187 Finally, with respect to ECSL suffering competitive disadvantage, the intent of EWS is also relevant. ORR's primary concern is that:

- (a) EWS recognised the competitive threat that ECSL posed to EWS by establishing customer relationships with generating companies and, off the back of these relationships, seeking to facilitate entry into coal haulage by rail; and
- (b) EWS feared that this would therefore diminish its ability to "*control the market*" (see EWS March 2000 Board paper discussed in the discussion on contractual restraints above).

#### **(f) The implications of a finding of price discrimination**

B188 In Part D of Section 7 of the Response, EWS criticised the findings in the Notice by seeking to draw out the possible future implications of ORR's findings. At paragraph 7.279, EWS argued that ORR's approach to price discrimination in the Notice failed "*to recognise the likely implications [...] for price competition in the market for coal haulage by rail and how it would undermine normal commercial behaviour to the detriment of customers*".

B189 It should be noted that partly in light of the Response, ORR's analysis is focused on particular flows, over a shorter time period for price comparisons than the period addressed in the Notice, and on circumstances where there is strong and compelling evidence of anti-competitive intent on the part of EWS as the reason for the discriminatory treatment accorded to ECSL. The following addresses what seems to be the main arguments made by EWS in the Response.

---

<sup>264</sup> Minutes of meeting between ORR and BE, 19 April 2002. [20/1868c]

### *Freedom to negotiate and change prices*

B190 At paragraphs 7.284 to 7.288 of its Response, EWS set out how a finding of discriminatory abuse would detract from EWS's ability to negotiate rates individually with customers and to change its prices.

B191 Although it is possible that EWS's freedom to alter the prices it imposes on an individual customer is diminished as a result of the existence of Chapter II of the Act and Article 82 EC, this possibility cannot, on its own, preclude the effective enforcement of the law.

B192 Under Chapter II of the Act and Article 82 EC, limitations are placed on the freedom of a dominant undertaking in order to protect competition as an institution. Dominant undertakings have a "special responsibility" to avoid impairing competition, which does not apply to undertakings that are not dominant. The legislation itself states that it is an abuse for a dominant firm to apply "*dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*". Some limitations on a dominant undertaking's commercial freedom are therefore envisaged under UK and EC legislation.

B193 Even so, a finding of discriminatory abuse does not remove EWS's ability to change prices according to variations in market conditions. In the analysis above, ORR has objected to the discriminatory treatment of ECSL (once EWS had developed concerns that ECSL could bring a competitive threat to EWS's position in rail haulage) not to any more general variations in prices between customers. Because EWS contracts with different customers at different times, inevitably there will be some differences between the rates that are offered or agreed at different points in time. This might mean that allegedly abusive prices are in fact objectively justified.

### *Legitimate competition*

B194 EWS gave particular emphasis to the risk that a finding of discriminatory abuse would mean that EWS would be severely constrained in how it could respond to competition. For instance, EWS was concerned that in order to comply with the Act, EWS would need to adopt a "rate card" to ensure that it priced equivalently to all customers and that this would undermine competition between EWS and FHH. (Paragraphs 7.291 to 7.294, and paragraphs 7.304 to 7.307 of the Response.)

B195 Competition would not, however, be undermined in this way. The period of time relevant to the ORR's finding of the discriminatory abuse relates to a period in which EWS was the only supplier of coal haulage by rail in Great Britain, with a 100% share of the relevant market. In particular, this was a period before FHH had ever hauled coal by rail. The discriminatory treatment accorded to ECSL was the result of anti-competitive intent on the part of EWS. It is, therefore, not possible to infer from a finding of a discriminatory abuse in these circumstances, that EWS would be unduly constrained from competing against FHH at a point in time when market conditions are different, and when its actions were not actuated by an anti-competitive intent as in the present case.

### *Efficient pricing*

B196 At paragraphs 7.295 to 7.303 of the Response, EWS argued that it would be economically inefficient for EWS to be obliged to set prices that achieve a “*fixed allocation of overheads and a compulsory return on assets on each origin-destination pair*” (paragraph 7.295). EWS’s argument seemed to rest on the view that customers “*preferred pricing packages that recovered a greater proportion of overheads and capital costs from shorter routes*” (paragraph 7.300). Regardless of whether this is the case, it is not relevant to the analysis of discrimination set out above.

B197 The finding of discriminatory abuse does not rely on a consideration of whether EWS has engaged in a discriminatory abuse by setting prices for *different* flows that allow EWS a different “mark-up” over marginal costs. The comparison of prices relates to prices set for different customers, for the *same* flows. The abuse is that EWS discriminated against ECSL by imposing higher rates on ECSL than it set for other customers (and higher than it had previously set for ECSL) for coal haulage on the same flows, and did so with the aim of impairing the development of competition in the market for coal haulage by rail. As a result, EWS’s arguments relating to efficient pricing are not considered as part of the decision.

## **Conclusion**

B198 For all of the above reasons, it is found that between May 2000 and November 2000, EWS pursued, without objective justification, selective and discriminatory pricing practices that placed ECSL at a competitive disadvantage in its contractual negotiations with two power generators, EME and BE. By impeding the competitive position of ECSL as a customer and a competitor, EWS’s actions were capable of distorting the structure of competition in the relevant market. This conduct was contrary to both the Chapter II prohibition of the Act and Article 82 EC.

# Part II C: Assessment of abuse of dominance – Predatory pricing on flows to Cottam and West Burton

---

## Introduction

C1 In a letter dated 19 August 2002<sup>265</sup>, FHH, EWS's only direct competitor, complained that EWS had engaged in predatory pricing in respect of prices offered to LEG for flows to Cottam and West Burton. The existing investigation into EWS's pricing following ECSL's complaint (in February 2001) was therefore widened to incorporate FHH's pricing complaint.

## Applicable legal principles

C2 This section sets out EC and UK case law relating to abusive and predatory pricing under Article 82 and the Chapter II prohibition.

C3 In *AKZO*, the Commission found that AKZO had adopted various pricing practices contrary to Article 82. AKZO appealed to the ECJ. The ECJ upheld various aspects of the Commission's decision including its findings that AKZO had adopted unreasonably low prices, artificially low prices over a prolonged period, selective prices and bait prices (low prices for some products in order to obtain orders for a broader range of products). The ECJ stated materially:<sup>266</sup>

"70. It follows that Article [82] prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality. From that point of view, however, not all competition by means of price can be regarded as legitimate.

71. Prices below average variable costs (that is to say, those which vary depending on the quantities produced) by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss, namely the total amount of the fixed costs (that is to say, those which remain constant regardless of the quantities produced) and, at least, part of the variable costs relating to the unit produced.

---

<sup>265</sup> Letter from Douglas Downie (FHH) to Neil Roberts (ORR) dated 19 August 2002 [7/462.1-7/462.5].

<sup>266</sup> Case C-62/86 *AKZO Chemie BV v Commission* [1991] ECR I-3359, [1993] 5 CMLR 215.

72. Moreover, prices below average total costs, that is to say, fixed costs plus variable costs, but above average variable costs, must be regarded as abusive if they are determined as part of a plan for eliminating a competitor. Such prices can drive from the market undertakings which are perhaps as efficient as the dominant undertaking but which, because of their smaller financial resources, are incapable of withstanding the competition waged against them.

[...]

(iii) Selective prices

110. The Commission further accuses AKZO of having made selective quotations to customers of ECS while maintaining the substantially higher prices that it charged to comparable buyers who were already their own regular customers [...]

113. AKZO has not denied that it charged differing prices to buyers of comparable size. It has, furthermore, not advanced arguments to show that these differences related to the quality of the products sold or to special production costs.

114. The prices charged by AKZO to its own customers were above its average total costs, whereas those offered to customers of ECS were below its average total costs.

115. AKZO is thus able, at least partly, to set off losses resulting from the sales to customers of ECS against profits made on the sales to the "large independents" which were among its own customers. This behaviour shows that AKZO's intention was not to pursue a general policy of favourable prices, but to adopt a strategy that could damage ECS. The complaint is therefore substantiated."

C4 In *Tetra Pak II* the CFI stated materially:<sup>267</sup>

"147. As a preliminary point, although it may be acceptable for an undertaking in a dominant position to sell at a loss in certain circumstances, that would clearly not be the case where such selling was predatory. Although Community competition law recognizes that an undertaking in a dominant position has the right to take reasonable steps to protect its commercial interests, it does not countenance acts whose actual purpose is to strengthen that dominant position and abuse it (judgment in *United Brands v Commission*, cited above, paragraph 189).

[...]

150. In this case [...] [b]y their scale and their very nature, the purpose of such losses, which cannot reflect any economic rationale other than ousting

---

<sup>267</sup> Case T-83/91 *Tetra Pak International SA v Commission* [1994] ECR II-755, [1997] 4 CMLR 726.

Elopak, was unquestionably to strengthen Tetra Pak's position on the markets in non-aseptic cartons where it already had a leading position [...], thereby weakening competition on those markets. Contrary to the applicant's allegation, such conduct thus constituted abuse within the meaning of Article [82] of the Treaty, in accordance with settled case law (see above, paragraph 114), and it is not necessary to demonstrate specifically that the undertaking in question had a reasonable prospect of recouping losses so incurred.

151. The same applies to 1982 [...]. A whole series of important and convergent factors provides evidence of the existence of an eliminatory intent. Such intent is apparent in particular from the duration, the continuity and the scale of the sales at a loss made throughout the period from 1976 to 1982."

C5 On appeal the ECJ rejected Tetra Pak's plea that it was wrong for the CFI to characterize Tetra Pak's prices as predatory without accepting that it was necessary for that purpose to establish that it had a reasonable prospect of recouping the losses so incurred. The ECJ stated in particular:<sup>268</sup>

"44. Furthermore, it would not be appropriate, in the circumstances of the present case, to require in addition proof that Tetra Pak had a realistic chance of recouping its losses. It must be possible to penalize predatory pricing whenever there is a risk that competitors will be eliminated. The Court of First Instance found, at paragraphs 151 and 191 of its judgment, that there was such a risk in this case. The aim pursued, which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competition."

C6 In *Compagnie Maritime Belge (CMB)* the Commission found that the members of the CEWAL conference had committed an abuse within the meaning of Article 82 by, among other things, "*altering the conference's freight rates with respect to the rates in force so as to obtain rates identical to or lower than those charged by the main independent competitor for ships sailing on the same or similar dates (a practice known as 'fighting ships')*".<sup>269</sup> On review the CFI stated materially:<sup>270</sup>

"139. The Court observes that, in points 73 and 74 of the Decision, the Commission identified three factors constituting the practice of fighting ships used by members of Cewal to drive out its competitor [...], namely: [i] designating as fighting ships those Cewal vessels whose sailing dates were closest to the sailings of [its competitor] without altering its schedule timetables; [ii] jointly fixing fighting rates different from the rates normally charged by Cewal members so that they were the same or lower than [its competitor's] advertised prices; and [iii] the resulting decrease in earnings, which was borne by Cewal's members. It is stated in point 80 of the Decision that this practice differs from predatory pricing [...]

---

<sup>268</sup> Case C-333/94 P Tetra Pak International SA v Commission [1996] ECR I-5951, [1997] 4 CMLR 662.

<sup>269</sup> As summarised in paragraph 15 of the judgment of the CFI. Cases T-24-26 and 28/93 *Compagnie Maritime Belge v Commission* [1996] ECR II-1201.

<sup>270</sup> *Ibid.*

[...]

143. In reality, the applicants' argument seeks to show that the practice, as so defined, does not constitute an abuse of a dominant position within the meaning of Article 82 of the Treaty.

144. In the first place, they assert to that end that the practice of which the Commission accuses them does not correspond with the definition which, in their view, is generally employed when the practice in question is penalized as anti-competitive. That argument cannot be accepted. The Court considers that it is not necessary to decide whether or not the definition employed by the Commission corresponds with other definitions put forward by the applicants. The only question is whether the practice as the Commission defined it in its decision, without being contradicted by the citations of learned writings and legislation embodied in the Decision, constitutes an abuse of dominant position within the meaning of Article [82] of the Treaty.

145. Secondly, the applicants maintain that the Commission has failed to prove that they exceeded what is normal in competition in implementing the practice complained of.

146. As has already been pointed out, it has been consistently held that whilst the fact that an undertaking is in a dominant position cannot deprive it of entitlement to protect its own commercial interests if they are attacked; and whilst such an undertaking must be allowed the right to take such reasonable steps as it deems appropriate to protect those interests, such behaviour cannot be allowed if its real purpose is to strengthen this dominant position and thereby abuse it (in particular, *BPB Industries and British Gypsum v Commission*, paragraph 69).

[...]

149. Thirdly, the applicants rely on the increase in [their competitor's] market share in order to maintain that the practice complained of had no effect and hence that there was no abuse of a dominant position. The Court however considers that, where one or more undertakings in a dominant position actually implement a practice whose aim is to remove a competitor, the fact that the result sought is not achieved is not enough to avoid the practice being characterized as an abuse of a dominant position within the meaning of Article [82] of the Treaty. Besides, contrary to the applicants' assertions, the fact that [the competitor's] market share increased does not mean that the practice was without any effect, given that, if the practice had not been implemented, [its] market share might have increased more significantly."

C7 On appeal the ECJ stated materially:<sup>271</sup>

"109. As to the appellants' second ground of appeal relating to the interpretation by the Court of First Instance of the contested decision, it must

---

<sup>271</sup> Cases C-395 and 396/96P *Compagnie Maritime Belge v Commission* [2000] ECR I-1365

be recalled that the Commission stated in its defence that it was unnecessary for a fighting ship to have been specially placed on berth, for the prices to be lower than those of the competitor or for the operation to result in actual losses.

[...]

111. The third ground of appeal concerns the question whether the alleged abuse, as defined in the contested decision and the defence, can properly be so characterised.

112. It is settled case-law that the list of abusive practices contained in Article [82] of the Treaty is not an exhaustive enumeration of the abuses of a dominant position prohibited by the Treaty (Case 6/72 *Euroemballage and Continental Can v Commission* [1973] ECR 215, paragraph 26).

113. It is, moreover, established that, in certain circumstances, abuse may occur if an undertaking in a dominant position strengthens that position in such a way that the degree of dominance reached substantially fetters competition (*Euroemballage and Continental Can*, paragraph 26).

114. Furthermore, the actual scope of the special responsibility imposed on a dominant undertaking must be considered in the light of the specific circumstances of each case which show that competition has been weakened (Case C-333/94 *P Tetra Pak v Commission* [1996] ECR I 5951, paragraph 24).

[...]

118. It is not necessary, in the present case, to rule generally on the circumstances in which a liner conference may legitimately, on a case by case basis, adopt lower prices than those of its advertised tariff in order to compete with a competitor who quotes lower prices [...]

119. It is sufficient to recall that the conduct at issue here is that of a conference having a share of over 90% of the market in question and only one competitor. The appellants have, moreover, never seriously disputed, and indeed admitted at the hearing, that the purpose of the conduct complained of was to eliminate [the competitor] from the market.

120. The Court of First Instance did not, therefore, err in law, in holding that the Commission's objections to the effect that the practice known as fighting ships, as applied against [the competitor], constituted an abuse of a dominant position were justified. It should be noted that there is no question at all in this case of there having been a new definition of an abusive practice."

C8 The issue of abusive and predatory pricing, and the relevant case law, have been considered by the Tribunal in the three cases of *Napp*<sup>272</sup>, *Aberdeen Journals*<sup>273</sup> and *Claymore*.<sup>274</sup>

C9 In *Napp* the Tribunal stated materially:

“219 [...] We for our part accept and follow the opinion of Mr Advocate General Fennelly in *Compagnie Maritime Belge*, cited above, that the special responsibility of a dominant undertaking is particularly onerous where it is a case of a quasi-monopolist enjoying “dominance approaching monopoly”, “superdominance” or “overwhelming dominance verging on monopoly [...]”

[...]

337 [...] in *Compagnie Maritime Belge*. As appears from the Court’s judgment in that case, a dominant enterprise with over 90 per cent of the market may commit an abuse if it selectively cuts prices deliberately to match those of a competitor, even if it is not shown that the undertaking has priced below total costs [...]

[...]

344. As *Tetra Pak II* and *Compagnie Maritime Belge* make clear, the freedom of action of a dominant undertaking, particularly a superdominant undertaking is still constrained, even where prices remain above average variable costs, or even above average total costs, if the price cutting is carried out on a selective basis, with the purpose of eliminating a competitor. If that purpose can be achieved simply by matching the competitor’s prices, it is no answer to say that there was no undercutting: see *Compagnie Maritime Belge*, at paragraphs 113 to 119 of the judgment, and Mr Fennelly’s opinion in that case, especially at paragraph 137.”

C10 In *Aberdeen Journals* the Tribunal stated materially:

“350. The cases cited above demonstrate, in our view, that the question whether a certain pricing practice by a dominant undertaking is to be regarded as abusive for the purposes of the Chapter II prohibition is a matter to be looked at in the round, taking particularly into account (i) whether the dominant undertaking has had “recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators” (*Hoffman-La Roche*, cited above, at paragraph 91); and (ii) whether such conduct has the effect of weakening or distorting competition in the relevant market, having regard to the special

---

<sup>272</sup> Napp Pharmaceutical Holdings Limited and Subsidiaries and the Office of Fair Trading, Case No. 1001/1/1/01, 15 January 2002.

<sup>273</sup> Aberdeen Journals Limited and the Office of Fair Trading, Case No: 1009/1/1/02, 23 January 2003.

<sup>274</sup> Claymore Dairies Limited and Arla Foods UK plc (formerly Express Dairies plc) v Office of Fair Trading, Case No: 1008/2/1/02, 2 September 2005.

responsibility of a dominant firm not to impair genuine undistorted competition. In our view, these principles apply particularly to the case of a dominant firm facing new entry, where retaliatory measures going beyond what is reasonable and proportionate are likely to require close scrutiny under the Chapter II prohibition.

[...]

352. [...] In our view, pricing between average variable cost and average total cost is likely to be abusive when undertaken in anticipation of competitive entry or in order to undercut a new entrant.

[...]

356. [...] the longer the prices of a dominant undertaking remain below total costs the easier it is likely to be to infer an intent to eliminate competition, in accordance with the *AKZO* test, absent special circumstances such as recessionary conditions. Such an intention may be inferred, of course, from other circumstances, such as selective price cutting.

[...]

358. However, in our view the presumption of abuse will rarely, if ever, be rebutted if the pricing policy under scrutiny originates as an aggressive response to market entry by a competitor, or is directed towards eliminating a competitor. An objective justification will normally be particularly difficult to establish if there is evidence of selective price cutting by a dominant undertaking that is targeted specifically towards the customers or potential customers of a competitor. Indeed, *Compagnie Maritime Belge* and *Irish Sugar* show that price discrimination of that kind by a dominant undertaking may be an independent head of abuse, even if the targeted price cuts do not fall below average total cost.

[...]

370. Although the Director has approached this case on the basis of pricing below average variable costs, we have already pointed out (at paragraph 355 above) that, in order to survive in the market, a competitor to a dominant firm must normally cover its total costs (including overheads) and earn a return on its investment. Moreover, in our view, in normal commercial business, each product line is expected not merely to cover its variable costs, but to make an appropriate contribution to general overheads. If a dominant firm prices below average total costs, including a proportionate share of general overheads, for a prolonged period, sooner or later an equally efficient competitor will be forced out of the market

371. Thus, where prices of a dominant undertaking are above average variable costs but below average total costs, and there is evidence that those prices result from, or originate in, an aggressive response by the dominant firm to competition, we would expect such conduct to be closely scrutinised from the point of view of the Chapter II prohibition [...]. We do not ourselves regard pricing by a dominant firm that is below total cost but on some

measure above average variable costs as necessarily a “safe haven” as far as the Chapter II prohibition is concerned, depending of course on the timescale and circumstances involved.

[...]

378 [...] the argument presented by Aberdeen Journals is, in effect, that a dominant firm, using its spare capacity, is entitled to price against a competitor on a marginal basis and that, so long as its marginal revenues exceed its marginal costs (for which average variable costs are a proxy) it is acting lawfully, and does not need to allocate any costs, other than marginal costs, to the particular activity in question.

379. This argument has not, as far as we know, yet been considered by the Court of Justice, or the Court of First Instance. The Tribunal has not heard submissions on this issue, and it is not necessary for the Tribunal to rule on it for the purpose of deciding the present case. Nonetheless, it does seem to us that if a dominant undertaking is able to exclude from its computations significant elements of cost which have to be borne one way or another, and which any equally efficient competitor would have to bear, there is a risk that the dominant firm will always be able, sooner or later, to undercut an equally efficient competitor and drive it from the market. That, in our view, is a particular risk where the marginal cost of a particular strategy, such as the use of a “fighting title” (as in this case) or a “fighting ship” (as in *Compagnie Maritime Belge*, cited above) may well be very low.

380. In our view, the cost-based rules set out in *AKZO* and *Tetra Pak II*, while providing guidance, are not an end in themselves and should not be applied mechanistically. The ultimate aim of the 1998 Act is to secure conditions of undistorted and effective competition. With that primary aim in view, a principal role of the Chapter II prohibition is to prevent dominant firms from defending or strengthening their dominant position in ways that are unreasonable and disproportionate, particularly by using methods different from those found under normal competitive conditions. In our view, the decision of the Court of Justice in *Compagnie Maritime Belge* itself shows that the guidance available in *AKZO* and *Tetra Pak II* is open to further development.

[...]

434. We have already held above that during March 2000 Aberdeen Journals knowingly allowed the *Herald & Post* to continue with a strategy of pricing below cost that had been originally designed for the purpose of eliminating the *Independent*. Although, in the event, the *Independent* did not go out of business, it is not necessary to show that a competitor has actually gone out of business in order to establish the abuse of predatory pricing (see: *Tetra Pak II*, cited above, at paragraph 44). In this case it does not seem to us that one can discount the risk that the *Independent* might have ceased publication during March 2000, faced as it had been with predatory pricing for nearly four years.

435. In any event, by continuing to price in a predatory way in March

2000, in our view Aberdeen Journals was distorting competition, hindering the maintenance of effective competitive structure and hindering the growth of competition, by forcing the *Independent* to incur losses, and denying it business that it could otherwise have been expected to obtain. The purpose, or at least the effect, of that strategy was to continue to protect Aberdeen Journal's dominant position in the market for local newspapers in Aberdeen during March 2000. In our view, those effects on competition are amply sufficient to engage the Chapter II prohibition in accordance with the principles of *Hoffman-La Roche* and the subsequent case-law set out above.

[...]

443. We do not read Mr Fennelly's opinion in *Compagnie Maritime Belge* as throwing any doubt on the Court's judgment in *Tetra Pak II*, at paragraph 44, that there is no need to prove the possibility of recoupment whenever there is a risk that competitors will be eliminated."

C11 In *Claymore* the CAT stated materially:

"188. Thus, [in relation to abusive pricing] among the relevant considerations are (i) whether the actions of the dominant firm go beyond what may be considered "normal" competition in a market where competition is already weak as a result of the presence of the dominant firm; (ii) whether the dominant firm's conduct was reasonable and proportionate; and (iii) whether the conduct was intended or likely to affect the structure of the market, by preserving or strengthening its dominant position.

[...]

269. As already seen, the *AKZO* test presumes predation if prices are below AVC, but if the prices are between AVC and ATC an "intention to eliminate a competitor" must be shown [...]

270. The phrase "intention to eliminate a competitor" is not entirely straightforward to interpret, since in one sense any competitor, competing in the market, is striving to eliminate – i.e. to drive out – a less efficient rival competitor. What is meant in our view is conduct on the part of the dominant firm which (i) has the reasonably foreseeable result of driving a rival from the market; (ii) goes beyond a normal competitive response and is disproportionate to the threat; and (iii) has the object or effect of preserving or strengthening a dominant position.

271. As to the evidence necessary to establish the necessary intention, the OFT accepts that it is unnecessary to produce a document showing an intention to eliminate: intention can be inferred from all the circumstances. Among the relevant elements may be the circumstances in which the alleged price cutting takes place [...]

[...]

273 [...] events before 1 March 2000 may be relevant to establishing the existence of intent after that date, particularly if there is no reason to suppose

any change of intent.”

### **The pricing practices under consideration: flows to Cottam and West Burton**

C12 This part of the Decision is concerned with prices quoted by EWS in respect of various flows to LEG’s power stations at Cottam and West Burton. The prices were offered by EWS to both LEG directly and also to UK Coal, for the purpose of UK Coal making an offer to LEG to supply on an E2E basis (for which it would have used EWS for haulage). The quotes were all provided in August 2002.

#### *Quotes to LEG*

C13 EWS reports that between August 2001 and July 2002 it had been in negotiations with LEG for a 12-month contract to haul coal to its power stations at Cottam and West Burton<sup>275</sup>. Draft contracts had been exchanged, containing the following rates:<sup>276</sup>

- (a) Immingham to Cottam: £[ ... ] per tonne
- (b) Immingham to West Burton: £[ ... ] per tonne
- (c) Redcar to Cottam: £[ ... ] per tonne
- (d) Redcar to West Burton: £[ ... ] per tonne

C14 No agreement for a 12-month contract was reached at these rates, but EWS did agree in April 2002 to haul one shipment of coal from Redcar to Cottam in October or November 2002 at the £[ ... ] rate<sup>277</sup>.

C15 On 19 July 2002, EWS was contacted by LEG asking for spot rates for the following specific shipments: one cape-sized shipment from Redcar and two panamax-sized shipments from Immingham (approximately 400,000 tonnes in total)<sup>278</sup>. LEG sought quotes from each of these source points to each of the two power stations, namely Cottam and West Burton<sup>279</sup>.

C16 Rates for these routes were discussed at a meeting between EWS and LEG on 25 July 2002<sup>280</sup>. A further meeting took place on 9 August 2002, at which EWS offered LEG the following rates:<sup>281</sup>

- (a) Immingham to Cottam: £[ ... ] per tonne

---

<sup>275</sup> EWS Response at paragraph 8.120.

<sup>276</sup> EWS Response at paragraph 8.120.

<sup>277</sup> EWS Response at paragraph 8.122.

<sup>278</sup> EWS Response at paragraph 8.123.

<sup>279</sup> EWS Response at paragraph 8.123.

<sup>280</sup> EWS Response at paragraph 8.132.

<sup>281</sup> EWS Response at paragraph 8.138.

- (b) Immingham to West Burton: £[ ... ] per tonne
- (c) Redcar to Cottam: £[ ... ] per tonne
- (d) Redcar to West Burton: £[ ... ] per tonne

C17 EWS reports that on or about 12 August 2002, EWS was contacted by LEG to ask whether the rates offered on 9 August 2002 would apply for the following calendar year, i.e. the year 2003<sup>282</sup>. LEG informed EWS that LEG anticipated offering EWS, during 2003, a minimum of [ ... ] tonnes of coal to be hauled from Immingham and four cape-sized shipments (approximately 600,000 tonnes) to be hauled from Redcar<sup>283</sup>.

C18 On 13 August 2002, EWS “formally quoted”<sup>284</sup> the prices to LEG and confirmed that, on the basis of these minimum volumes, the rates offered on 9 August 2002 would apply for the calendar year 2003<sup>285</sup>.

C19 The prices that EWS confirmed on 13 August 2002 applied both to coal hauled during the calendar year 2003 and to specific shipments of coal in the latter half of 2002<sup>286</sup>. The Table below summarises these prices and compares them to the corresponding quotes previously offered by EWS<sup>287</sup>.

**Table 20. EWS price reductions to LEG**

Source point	Immingham			Redcar		
	Initial price	Revised price (August 2002)	Price reduction	Initial price	Revised price (August 2002)	Price reduction
Cottam	[ ... ]	[ ... ]	14.6%	[ ... ]	[ ... ]	14.0%
West Burton	[ ... ]	[ ... ]	17.4%	[ ... ]	[ ... ]	26.0%

*Quotes to UK Coal*

C20 EWS reports that on 22 August 2002 it received an unsolicited telephone call from UK Coal informing EWS that UK Coal had won a contract to supply approximately [ ... ] tonnes of coal from UK Coal’s collieries at Maltby, Thoresby and

282 EWS Response at paragraph 8.140.

283 EWS Response at paragraph 8.140.

284 Page 3 of document 70 of documents provided by EWS at the site visit.

285 EWS Response at paragraph 8.140.

286 Document 70 of documents provided by EWS at the site visit.

287 The data in the table is based on the information set out above, where prices have been cross-referenced to relevant parts of the EWS Response. This price information is consistent with the undated note headed ‘Coal Pricing’ attached to an e-mail from David White (Business Manager – Coal) to David Purves and Jim Wilson (General Manager – Coal) dated 27 August 2002 (Pages 2-3) of document 70 of documents provided by EWS at the site visit. EWS advises in its Response (paragraphs 7.103 and 8.112) that this note was drafted on behalf of Mr Purves by David White, for the purpose of briefing the Chief Operating Officer, EWS. Note that in the ‘Coal Pricing’ paper, EWS describes the two sets of rates as “current prices” and “reduced prices”.

Welbeck to LEG's power stations at Cottam and West Burton<sup>288</sup>. UK Coal expected the coal to be delivered over a period of between six and eight weeks in September and October 2002<sup>289</sup>. EWS was asked to prepare a quotation for haulage of this coal. This quote was to be offered on a 'blind tender basis', which EWS explains to mean that UK Coal did not indicate the price it was seeking and would not enter into negotiation on prices following the submission of the quote.

C21 This was confirmed in an e-mail from Martin Higgins of UK Coal to David White of EWS, dated 22 August 2002, in which EWS is asked to quote for [ ... ] tonnes of coal to be delivered over the following 6-8 weeks commencing 27 August 2002, split as follows: [ ... ]kt from Maltby, [ ... ]kt from Thoresby and [ ... ]kt from Welbeck<sup>290</sup>.

C22 David White quoted a rate of £[ ... ] by e-mail the same day (22 August 2002)<sup>291</sup>.

C23 EWS applied this price when quoting for three tranches of business for UK Coal. First, [ ... ] tonnes over a maximum eight-week period commencing 2 September 2002<sup>292</sup>. (While EWS's prices were initially a bid for [ ... ] tonnes an internal e-mail exchange between David White, James Wilson and David Purves of 23 August 2002<sup>293</sup> suggest that this tranche was settled at [ ... ] tonnes.) Second, [ ... ] tonnes due to commence late September<sup>294</sup>. Third, [ ... ] tonnes taking the total haulage for UK Coal to around [ ... ] tonnes to be delivered by the end of December 2002<sup>295 296</sup>.

C24 The price quoted to UK Coal in August 2002 is set out in the Tables below. The price was considerably less than the prices previously quoted by EWS to LEG on 5 July 2002 and to ECSL on 27 April 2001<sup>297</sup> for the same or comparable routes.

---

288 EWS Response at paragraph 8.144.

289 EWS Response at paragraph 8.144.

290 Document 61 of documents provided by EWS at the site visit.

291 Document 63 of documents provided by EWS at the site visit.

292 Commencement date taken from an e-mail from UK Coal of 22 August 2002, which confirms that EWS's tender had been successful (document 64 of documents provided by EWS at the site visit).

293 Document 67 of documents provided by EWS at the site visit. "[The quote of £[ ... ]] is a price for a specific tranche of [ ... ] tonnes over a maximum of 8 weeks in autumn – and extended [sic] to a second discrete tranche of [ ... ] tonnes to commence late September".

294 Ibid.

295 See e-mail exchange between Mr White, EWS, and Martin Higgins of UK Coal of 12 September 2002 (document 99 of documents provided by EWS at the site visit); e-mail from Phil Cairns of UK Coal to Mr White dated 17 September 2002 (document 105 of documents provided by EWS at the site visit; and e-mail from Mr White to Mr Purves of 18 September 2002 (document 108 of documents provided by EWS at the site visit).

296 Paragraph 8.161 of the EWS Response suggests that only [ ... ] tonnes or so were actually hauled.

297 Document 51 of file 6 of documents provided in response to a section 26 notice of 11 May 2001.

The Tables below show the percentage price reduction on the flows to UK Coal (on both occasions an equivalent price was quoted for each of the six possible flow combinations).

**Table 21. EWS price reductions to UK Coal**

Flow	Price quoted to LEG 5 July 2002 <sup>298</sup>	Flow	Revised price (22 August 2002)	Implied price reduction
Oxcroft to West Burton/Cottam	£[ ... ]	Maltby, Thoresby and Welbeck to Cottam/West Burton	£[ ... ]	31.4%

**Table 22. Comparison of price reductions to UK against ECSL price**

Flow	Price to ECSL 27 April 2001	Revised price to UK Coal (22 August 2002)	Implied price reduction
Thoresby, Welbeck and Oxcroft to West Burton	£[ ... ]	£[ ... ]	42.4%

### **The nature of the abuse: predatory and selective pricing as aspects of the abusive conduct**

C25 There is no exhaustive list of the different possible types of abuse under Article 82 EC and Chapter II of the Act, and the actual scope of the special responsibility of a dominant undertaking (and therefore what conduct is, and is not, abusive) must be considered in the light of the specific circumstances of each case (*CMB*, at paragraphs 112 and 114 of the ECJ's judgment). It is therefore not possible precisely to identify what is required in order to establish a particular type of abuse in the abstract, as certain conduct may not be abusive for a firm operating in one set of market conditions, but would be abusive for a firm operating in a different set of market conditions.

C26 The correct approach when considering whether the pricing practices of a dominant undertaking are abusive is to assess the matter in the round, taking into account all of the circumstances, and considering whether the conduct went beyond 'normal' competition in the market, was reasonable and proportionate and was intended or likely to affect the structure of the market, by preserving or strengthening its dominant position (*Claymore*, at paragraph 188 of the Tribunal's judgment).

C27 For the purposes of analysis, commentators have attempted to identify, in the case law referred to above, distinct principles and rules relating to predatory pricing, on the one hand, and selective pricing, on the other. However, the case here is that EWS's pricing in respect of the Cottam and West Burton flows is abusive when looked at in the round, and that its predatory and selective features are different aspects of its abusive nature.

---

<sup>298</sup> Document 2 of documents provided by EWS at the site visit, confirmation that rate also applies to Cottam provided in an e-mail from David White to Richard Plumb of LEG on 8 July 2002 (document 5 of documents provided by EWS at the site visit).

## Calculating EWS's costs

C28 In order to assess whether EWS's prices are predatory and abusive, it is necessary to identify EWS's costs over the relevant period, and in particular the relevant average total cost (ATC), defined as total costs divided by the relevant measure of output and average variable cost (AVC), defined as variable costs divided by the relevant measure of output.

### *ORR's approach to cost calculations*

C29 Where one is concerned with only part of an undertaking's business, determining costs may not be a straightforward exercise. For example, issues arise concerning the allocation of common costs (*Claymore*, at paragraph 210 of the Tribunal's judgment). This is the situation in this case, where the concern is how best to estimate the costs of EWS hauling specific volumes of coal on specific flows.

C30 EWS staff did not always record the precise basis on which particular prices were set. In relation to this, EWS stated in its Response (2.44) that its commercial managers:

“had a keen understanding of the appropriate rates to quote having regard to the need to ensure an adequate return on costs and exercised their discretion in setting precise rates depending on various factors [...]. The approach of EWS employees to documenting the reasons for particular pricing decision is understood to have been consistent with general industry practice. That their consideration of, and application, these factors to prices was not fully documented in every instance should not give rise to any inference that rates were set without regard to appropriate factors specific to the contractual arrangement in question”.

C31 EWS provided no explanation or evidence of its assertion that it was general industry practice not always to record the basis on which prices were set. It is not clear to what industry EWS is referring, particularly given the fact that EWS was for a long period a monopolist on its side of the market. EWS provided no evidence of how the generators conducted themselves on pricing matters.

C32 Further, on the basis of a claim of legal privilege EWS declined to provide ORR with the practical guidance drafted by Frontier Economics (Paragraph C169)

C33 Despite the lack of information on exactly how EWS employees calculated rates for specific coal haulage contracts, it is clear that EWS employees had the benefit of a series of cost models which had been in development from at least 1996 and which would allow EWS “to assess the costs involved with hauling particular flows or packages of flows” (Response, 2.45). By June 2002, EWS was using a cost model designed (and further developed) by Frontier Economics (the ‘Frontier model’). EWS reports that the Frontier model was introduced “as one of several internal compliance measures implemented by EWS over the period of ORR’s

investigation”, and that the purpose of the model was “to improve and clarify EWS’s internal procedures for assessing its capital costs in relation to prices quoted”<sup>299</sup>.

C34 Prior to the Frontier model, EWS had used at least two other cost models. The Back Check Model was used until early summer 2000, but has been described by EWS as “rudimentary” (Response, 2.48). The Standard Cost Model had been introduced in July 2000. EWS reported that the Standard model had been developed to enable senior management to gain a better understanding of EWS’s costs (Response, 2.48). The Frontier model was a direct development of the Standard model, and used broadly the same set of calculations to estimate, for a particular route and wagon type, the costs of items such as drivers, ground staff, track access charges, fuel and locomotive and wagon maintenance<sup>300</sup>.

C35 Therefore, although the Frontier model was introduced as part of EWS’s competition law compliance measures, that model also represented the next generation of a series of cost models that EWS had been using and developing since 1996 for internal business purposes. ORR therefore considers the Frontier model the most appropriate starting point for its own cost analysis. In reaching this conclusion, ORR is mindful of the Tribunal’s reasoning in *Claymore*. In particular, at paragraph 211 the Tribunal noted that a reasonably detailed understanding of the nature of the business is generally necessary when determining how particular costs should be allocated, and that how the business itself treats the costs internally will normally be an invaluable source of information.

#### *Fixed and variable costs*

C36 The following paragraphs set out which costs have been classified as fixed and variable and the wagon mix input adopted by ORR for the purpose of calculating EWS’s ATC and AVC. However, further details as to how ORR has calculated ATC and AVC are set out in Annex K, which also elaborates on ORR’s reasoning in respect of some of those costs and inputs and explains the differences between ORR’s approach in the SO and the Decision and that taken in the Notice. ORR was provided with an electronic version of the Frontier model on 28 October 2002<sup>301</sup>. ORR has received no evidence from EWS that this version of the model was different to that used by EWS in July and August 2002, at the time that it was preparing quotes for LEG and UK Coal on the Cottam and West Burton flows. References to the ‘Frontier model’ in the remainder of this part should be taken to refer to this version of the Frontier model unless otherwise stated.

---

299 Paragraph 2.51 of the Response.

300 The main differences between the two models in terms of the way that costs are calculated are that: (a) the Frontier model had a more detailed method to calculate depreciation costs and the return on capital employed; and (b) the Frontier model calculated automatically, for each cost item (e.g. fuel costs), a weighted average cost based on assumptions about the number of HAA wagons and HTA wagons in the EWS fleet.

301 Specifically, ORR was provided with three Microsoft Excel workbooks, described as “*the Frontier model[s] used in arriving at quotes from Maltby, Welbeck and Thoresby*”. Provided by Nicholas Long of Freshfields as three attachments to an e-mail to Cathryn Ross, ORR, on 28 October 2002.

C37 [ ... ]

(a) [ ... ]

(b) [ ... ]

(c) [ ... ]

(d) [ ... ]

(e) [ ... ]

(f) [ ... ]

C38 [ ... ]

C39 [ ... ]

(a) [ ... ]

(b) [ ... ]

(c) [ ... ]

(d) [ ... ]

C40 [ ... ]<sup>302</sup>

C41 [ ... ]

#### *Corrections and adjustments to the Frontier model*

C42 ORR has made several amendments to the Frontier model for the purposes of calculating AVC and ATC. These are explained in Annex K, and summarised very briefly below.

C43 First, ORR has corrected for a modelling error in the Frontier model, which meant that the calculation of corporate overheads mistakenly picked up an empty cell in the Microsoft Excel worksheet.

C44 Second, ORR has adjusted the assumption of the payload of HTA wagons from [ ... ] tonnes per wagon to [ ... ] tonnes. This is in light of some uncertainty and inconsistency as to an appropriate assumption. EWS indicates at paragraph 8.45 of its Response that the HTA payload should be [ ... ] tonnes. No supporting evidence is provided. This payload figure is contrary to both the [ ... ] tonnes assumed in the Frontier model and the [ ... ] tonnes assumed in the Standard model. To resolve this issue, ORR has used an assumption of [ ... ] tonnes. This is the payload for HTA wagons obtained from the ORR model upon which EWS's freight track access

---

<sup>302</sup> [ ... ][28/287].

charges are based. (For HAA wagons, that model provides consistent payload and tare (i.e. unloaded wagon weight) data to the Frontier model.)

C45 Third, ORR has amended the Frontier model to include a more accurate calculation of the track access charges that EWS would have paid in respect of haulage on the LEG and UK Coal flows. [ ... ]

C46 Annex K provides sensitivity analysis of the impact of these amendments on the calculations of AVC and ATC. Both the individual and cumulative impacts of the amendments are reasonably small. For instance, Tables 5 and 6 of Annex K show the cumulative impact of the amendments for the Redcar to Cottam flow (the flow for which the AVC and ATC estimates are highest). The Tables show that, for the input data assumed by ORR, the effect of moving from the original Frontier model to ORR's revised model is to decrease AVC from £[ ... ] to £[ ... ] and to increase ATC from £[ ... ] to £[ ... ]. The impacts on other flows, such as Maltby to Cottam, are smaller than for this flow. The finding set out below, that EWS's prices to LEG and UK Coal were above the calculated level of AVC and significantly below the calculated level of ATC, is not dependent on whether or not the amendments identified above are implemented.

#### *Wagon mix*

C47 For the purpose of calculating ATC and AVC for a flow, one of the necessary inputs into the Frontier model is the wagon mix, namely the proportion of HTA or HAA wagons on the basis of which AVC is to be calculated. This is because “[a]s HTA wagons carry greater tonnage than HAA wagons and fewer are required per train, the variable costs associated with their use are lower” (Response, 8.32). Thus, for the same flow, a cost calculation that assumes 100% use of HTA wagons will be significantly lower than a cost calculation that assumes 100% use of HAA wagons.

C48 [ ... ] For its cost analysis of the LEG quotes, ORR has not changed the input data on the numbers of HTA and HAA wagons from that contained in the electronic version of the Frontier model received by ORR on 28 October 2002. This version gave a mix of [ ... ] HAAs and [ ... ] HTAs. ORR understands (from paragraphs 8.33 to 8.36 of the Response) that this wagon mix represented the mix that would be available to EWS by December 2002. ORR considers this a reasonable approach on the basis that even though the LEG quotes were submitted to EWS in August 2002, the quotes were prepared for coal haulage that would take place in the calendar year 2003.

C49 For its cost analysis of the UK Coal quotes, ORR has used a different wagon mix. This is because the UK Coal haulage was expected to take place in September and October 2002, at which stage EWS had fewer of the low-cost HTA wagons in its fleet. In the absence of month-by-month data on the EWS coal wagon fleet for the period in question, ORR has used EWS's reports on the fleet data for (a) July 2002 and (b) December 2002 to calculate an estimate of the EWS fleet at the start of October 2002<sup>303</sup>. As a result, for its analysis for the UK Coal flows, ORR has used

---

<sup>303</sup> See Annex K for the sources for this wagon fleet data.

the following input data on the EWS wagon fleet: [ ... ] HAAs and [ ... ] HTAs. More information on these calculations is provided in Annex K.

*Flow-specific input data*

C50 [ ... ]

C51 ORR has generally used the input data contained in print outs provided by EWS, which show the input data that EWS had assumed when applying the Frontier model in respect of the LEG and UK Coal flows. However, in several instances there were gaps or inconsistencies, and ORR has used other data obtained from EWS to resolve these. The flow-specific input data assumed by ORR has been set out in full in Annex K.

*Price – cost comparisons*

C52 On the basis of the approach to calculating costs summarised above and set out in more detail in Annex K, it is possible to compare the prices quoted to LEG and UK Coal for the relevant flows with estimates of EWS’s ATC and AVC on those flows. These comparisons are shown in Tables 23 and 24. In addition, the final row in the Tables below shows the estimated return on capital employed (ROCE) that is implied by the price set for each flow<sup>304</sup>.

**Table 23. Comparisons of prices and costs for LEG flows**

	Immingham to Cottam	Immingham to West Burton	Redcar to Cottam	Redcar to West Burton
AVC (£/tonne)	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Price (£/tonne)	[ ... ]	[ ... ]	[ ... ]	[ ... ]
ATC (£/tonne)	[ ... ]	[ ... ]	[ ... ]	[ ... ]
ROCE	[ ... ]	[ ... ]	[ ... ]	[ ... ]

**Table 24. Comparisons of prices and costs for UK Coal flows**

	Maltby to Cottam / West Burton	Thoresby to Cottam / West Burton	Welbeck to Cottam / West Burton
AVC (£/tonne)	[ ... ]	[ ... ]	[ ... ]
Price (£/tonne)	[ ... ]	[ ... ]	[ ... ]
ATC (£/tonne)	[ ... ]	[ ... ]	[ ... ]
ROCE	[ ... ]	[ ... ]	[ ... ]

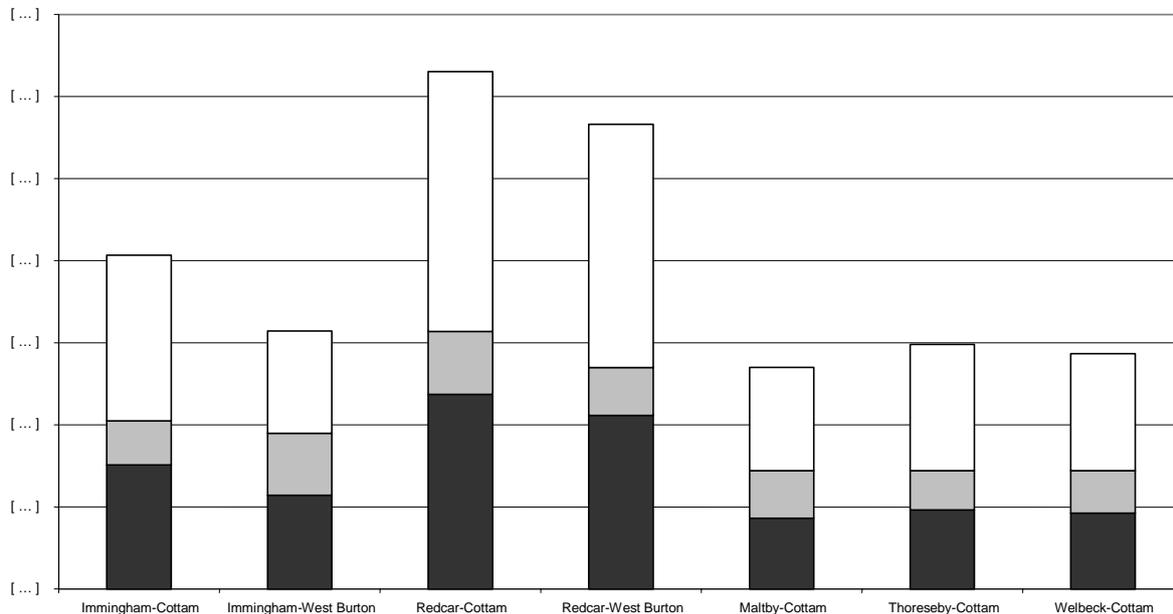
C53 The prices quoted to LEG and UK Coal are all between AVC and ATC<sup>305</sup>.

<sup>304</sup> This is calculated by subtracting all the costs items identified above, except the cost of capital, from the price, and dividing the remainder by the value of capital employed. Since the measure of ATC used above includes an allowance for the cost of capital employed at a [ ... ]% cost of capital, the price would need to equal ATC in order for the ROCE to be [ ... ]%. In this case, a negative ROCE indicates that the price is lower than the sum of AVC, the calculated contribution to operating cost overheads and depreciation.

<sup>305</sup> As is evident from Tables 7 and 8 of Annex K, the prices remain between AVC and ATC even if ATC is calculated on the basis of a [ ... ]% HTA wagon mix.

C54 On the basis of this analysis, EWS's prices were far closer to AVC than to ATC and none achieved a positive return on capital employed. The chart below shows the price–cost position diagrammatically.

**Chart 1. Overview of cost results for flows to Cottam and West Burton**



C55 In the chart above, for each of the seven flows under consideration, the three different column areas represent different measures of price and cost. Black =AVC; Grey=price and White=ATC.

C56 In the chart, the black vertical bars show the calculated AVC for each flow. The top of the grey shaded area indicates the price set by EWS for each flow, and the grey shaded areas therefore show the margins that EWS is calculated to have set above AVC. The top of each vertical bar shows the calculated ATC. The white rectangle at the top of each bar, therefore, shows the shortfall between price and ATC for each flow.

C57 Across each of the flows, there is a large difference between the estimated values of AVC and ATC. ATC is more than double AVC in every case. Since the prices that EWS set would only have allowed EWS relatively small margins above AVC, these prices left EWS with a substantial shortfall between price and the estimated ATC for each of the flows in question.

### **Determining whether prices between ATC and AVC are abusive**

C58 The prices quoted by EWS to LEG and UK Coal for the flows to Cottam and West Burton were between ATC and AVC. In determining whether such prices were abusive, the following principles may be derived from the case law:

- (a) Whilst the fact that an undertaking is in a dominant position cannot deprive it of the entitlement to protect its own commercial interests if they are attacked; and whilst such an undertaking

must also be allowed the right to take such reasonable steps as it deems appropriate to protect those interests, such behaviour cannot be allowed if its real purpose is to strengthen this dominant position, and thereby abuse it: see e.g. Cases T-24-26 and 28/93 *Compagnie Maritime Belge v Commission* [1996] ECR II-1201, para 146.

- (b) Where prices of a dominant undertaking are above average variable costs but below average total costs, an “*intention to eliminate a competitor*” must be shown to be present in order to constitute abuse. This element may be inferred from the circumstances, and it involves conduct on the part of a dominant firm which (i) has the reasonably foreseeable result of driving a rival from the market; (ii) goes beyond a normal competitive response and is disproportionate to the threat; and (iii) has the object or effect of preserving or strengthening a dominant position: see *Claymore Dairies v. Office of Fair Trading* [2005] CAT 30 at paras 270-271.
- (c) Specifically, where prices of a dominant undertaking are above average variable costs but below average total costs, and there is evidence that those prices result from, or originate in, an aggressive response by the dominant firm to competition, such conduct requires close scrutiny from the point of view of the Chapter II prohibition. It is not necessarily a “*safe haven*” as far as the Chapter II prohibition is concerned: see *Aberdeen Journals v. Director General of Fair Trading* [2003] CAT 12, at para 371.
- (d) Pricing between average variable cost and average total cost is, in particular, likely to be abusive when the circumstances are that it is undertaken in anticipation of competitive entry or in order to undercut a new entrant: see *Aberdeen Journals v. Director General of Fair Trading* [2003] CAT 12, at para 352.
- (e) Similarly, an objective justification for pricing below cost will normally be particularly difficult to establish if there is evidence of selective price cutting by a dominant undertaking that is targeted specifically towards the customers or potential customers of a competitor: see *Aberdeen Journals v. Director General of Fair Trading* [2003] CAT 12, at para 358.
- (f) If a dominant firm prices below average total costs, including a proportionate share of general overheads, for a prolonged period, sooner or later an equally efficient competitor will be forced out of the market: see *Aberdeen Journals v. Director General of Fair Trading* [2003] CAT 12, at para 370.
- (g) When a dominant undertaking selling below cost contends that its policy is not motivated by an intention to eliminate competition but is based on some other, legitimate, commercial rationale, the best way for that undertaking to defend itself is by producing contemporary internal documents showing that such a rationale did in fact form the basis of the company’s policy at the material time: see *Napp Pharmaceuticals v. Director General of Fair*

C59 EWS's pricing on these flows is held to have been abusive and contrary to Article 82 and the Chapter II prohibition in the light of that case law and the matters set out below.

### **EWS's abusive intent**

#### *The historical background to EWS's pricing on the Cottam and West Burton flows*

C60 In *Assessment of abuse of dominance - Exclusionary contracts and Discrimination*, parts A and B above, ORR has set out contemporaneous evidence as to how EWS countered the threat of new entry by entering into exclusionary contracts with power stations and setting discriminatory prices to ECSL.

C61 It also appears that, before FHH had started to haul coal, EWS recognised the scope to prevent FHH's entry by setting low prices direct to power stations. It is clear from internal e-mails that EWS fully appreciated that certain business was of strategic importance for FHH, and that if FHH failed to secure a certain level of business it might consider withdrawing from the market. For example, in *Assessment of abuse of dominance - Discrimination* in part B above, ORR refers to an e-mail from David White relating to an Autumn 2000 tender process with BE which stated:

"I believe that Roger [Roger Pettit, FHH] is desperate because he will know that if he doesn't get Eggborough his business case on the basis of 1mnt to Drax and an unknown tonnage to Eggborough on Enron's account is stuffed – especially as Enron have said that EWS will also get some of the Enron tonnage. More pertinently Eddie Fitzsimons [FHH] and their banks will think the same too. John Shedden [BE] strongly implied that of the total tonnage they buy the E2E proportion will fall over time – not to zero, but it will fall. If we have stitched up all of the DIY tonnage – then strategically I don't know where Roger goes next. He will try Cottam – but we are well in there. I believe that we now need to open up contract negotiations very soon with TXU (Mark Walters) too. Roger [FHH] has a hump big enough to do all this just to drive down our margins – but what else are we to do? We can either walk away from what we need to do at Eggborough and run the risk of getting nothing or we can offer low prices to snooker Freightliner".

C62 As set out in the section on *Discrimination* in part B above, EWS was not directly successful in the BE tender for flows to Eggborough. This business was awarded to ECSL who used both EWS and FHH for haulage. Nonetheless, as that part explains, the rates offered by EWS to BE were generally significantly lower than the rates EWS had offered to ECSL in May 2000 for the same flows, and this is consistent with EWS not only considering the strategy proposed in the e-mail above but also implementing it.

C63 EWS's aggressive pricing practices on the Cottam and West Burton flows in the summer of 2002 should therefore be seen against the background of its aggressive response to FHH's prospective entry in 2000.

*The nature of the evidence available from summer 2002*

C64 In assessing whether EWS's pricing was abusive, three main categories of evidence have been considered: (i) contemporary documents; (ii) responses to section 26 notices; and (iii) the surrounding economic and market context. ORR has attempted to assess this evidence consistently with the approach of the Tribunal. In particular, it has looked at the evidence as a whole, and had regard to whether one piece of evidence is corroborated or contradicted by other pieces of evidence<sup>306</sup>. Further, as between the first two types of evidence listed above, it has generally taken the view that a document prepared at the time is likely to be more credible than explanations given later. ORR has therefore given weight to contemporary documents, unless there is a good reason not to do so<sup>307</sup>.

C65 However, as noted above, EWS has stated that its commercial managers did not always fully document their reasons for pricing decisions or the role that different factors, such as the need to ensure an adequate return on costs, affected each decision but it has denied that it failed to record any information with the intent of concealing the basis of any pricing decision<sup>308</sup>.

C66 Further, there is an indication that during the relevant period members of the EWS coal team were developing a more cautious attitude about what was recorded, in respect of that strategy, in e-mail exchanges. In an e-mail exchange between David White and James Wilson (General Manager Coal), dated 9 July 2002<sup>309</sup>, entitled "*Re: New rates; commercial strategy*", David White stated, "*Jim, I suggest that we do the following:*" The remainder of the e-mail is blank with no attachments – so it is not clear what David White is suggesting. Indeed this is confirmed by James Wilson's reply of 15 July 2002: "*and what was that?*"

C67 David White then replied on 29 July 2002: "*I'd better not say!*" That David White expressed a reluctance to reveal his intended strategy may reveal sensitiveness within EWS to record, in documentary form, strategies that might be construed as abusive. In particular, at the time there was much discussion within EWS about its pricing and competitive strategy, as revealed by the documents cited below and the fact that this was a sensitive issue given the involvement of Freshfields and Frontier Economics within these debates.

C68 This sensitivity is revealed by another e-mail from David White also sent on 29 July 2002 (and cited above)<sup>310</sup> in which he replied to Andrew Martin's e-mail of the same date which addressed wagon usage and competitive strategy:

"Andy,

---

<sup>306</sup> Argos [2004] 24, paragraph 311.

<sup>307</sup> JJB Sports [2004] CAT 17, paragraph 287.

<sup>308</sup> EWS Response, paragraph 2.44.

<sup>309</sup> Document 6 of documents provided by EWS in response to a section 26 notice of 27 November 2002.

<sup>310</sup> Document 14 of documents provided at the site visit.

Good questions. I do wish you wouldn't show that much interest!

Our friends advise that [the following text is deleted on the ground of legal privilege]

[...]"

311

C69 Consequently, ORR notes that the situation here appears to be similar to that which existed on the facts in the *Argos* case, and notes the Tribunal's comments:<sup>312</sup>

"[...] There is evidence that Hasbro employees, at least, thought it better not to put anything in writing [...] In those circumstances one would not expect to find comprehensive documentary proof of what is alleged. In cases such as the present the documentary evidence is likely to be sparse, incomplete and perhaps elliptically expressed".

C70 With this consideration in mind, the contemporary documents referred to below provide evidence of abusive intent. This is particularly the case in the light of the evidence that EWS employees were reluctant to commit to paper decisions and reasoning that might be construed as abusive.

*The views and approach of EWS towards pricing in July and August 2002*

C71 The contemporaneous evidence strongly indicates that, following the arrival of the new General Manager – Coal, David Purves, in mid-July 2002, the company decided to adopt a much more aggressive pricing policy for the purpose of a deliberate attempt significantly to reduce FHH's market share.

C72 On 29 July 2002, James Wilson circulated an e-mail within EWS<sup>313</sup> inviting people to a meeting of the coal team on 31 July 2002 to discuss strategy<sup>314</sup>:

"Gents,

---

311 This caution is also reflected in EWS's '*Coal Team, Competition Law Guidelines*', dated August 2004<sup>311</sup>. On page 1 of the guidelines, EWS advises its coal team on '*Emails and use of language*', as follows:

"You should assume that any document you create – whether electronic, hard copy or manuscript – would be disclosed to the competition authorities and/or the courts in the event of a dispute and closely examined. You should take care not to refer to matters in documents in terms that could later be misunderstood by the competition authorities.

"You should also avoid making any derogatory statements about EWS's competitors. Do not make any statement either as to the threats competitors pose to EWS or the impact that actions taken by EWS may have on competitors."

312 *Argos* [2004] CAT 24, paragraph 312.

313 The e-mail was circulated to Tim Bilby, David White, David Israel, David Purves, David Young, David Griffiths, Andrew Martin and Neil Cawood.

314 Document 7 of documents provided at the site visit.

David and I would like to sit down with whoever is available to do so for a preliminary discussion on pricing strategy, it will be in my office in CSDC at 14:00hrs this Wednesday.

[...]"

C73 This meeting of Wednesday 31 July followed the exchange of e-mails relating to commercial strategy from 9 July 2002, between David White and James Wilson (cited above in the section entitled *The nature of the evidence available from summer 2002*).

C74 Neil Cawood of the coal team attended the 31 July meeting (attended also by David Purves, James Wilson, Tim Bilby, David White, David Young and David Israel<sup>315</sup>) and took handwritten notes. Mr Cawood noted that market share was to be recaptured "*through aggressive pricing*" and further recorded that there was a need "*to get Freight liner [sic] down to 10-11% - currently at 17-20%*", and that LEG was identified as being "*50% of FLHH business*"<sup>316</sup>.

C75 In a response to a section 26 notice David Israel has provided his own account of the 31 July meeting and its context<sup>317</sup>:

"Following the appointment of David Purves in July 2002, he had a meeting with Philip Mengel [CEO EWS], and he in turn then convened a meeting with the Coal Market Managers and James Wilson on the 31<sup>st</sup> July 2002 to discuss future strategy. During this meeting, David Purves outlined the discussion by the EWS Board that the Coal Commercial Team (the market Managers) was **not aggressive enough within the market place** and that they were **allowing Freightliner Heavy Haul to increase their market share**. David Purves agreed with Philip Mengel and wanted to show that he could **put in place a strategy that would stop this** [...]"

"David Purves had met with Philip Mengel to discuss the strategy, which ultimately resulted in the decision on the lower rates for London Electric [...] David Purves was remitted to discuss with James Wilson and re-focus the coal team and minimise the Freightliner Heavy Haul market share whilst increasing the EWS share of the market, **at virtually any cost**". (Emphasis added.)

C76 On 1 August 2002, the day after the meeting, David White sent Mr Purves and Mr Wilson an e-mail entitled "*RE: Bullet Points*"<sup>318</sup>. The e-mail discussed strategy in

---

<sup>315</sup> Further handwritten notes (provided at document S3 of documents provided by EWS at the site visit) record that the meeting was attended by "*DP/TB/DW/DI/DY/NC*". EWS confirms in its 19 December 2002 response to the section 26 Notice of 27 November 2002 that the author of this handwritten note was **James Wilson** and that these initials refer to **David Purves, Tim Bilby, David White, David Israel, David Young and Neil Cawood**.

<sup>316</sup> Document 21 of documents provided at the site visit.

<sup>317</sup> David Israel response of 14 October 2003 to a section 26 notice of 22 September 2003. [20/1915a.3]

relation to different generators under headings “*London Power*”, “*AEP*”, and “*Powergen*”.

C77 Mr White analysed the tonnage that EWS and FHH hauled to LEG’s power stations at Cottam and West Burton, and concluded that EWS had a 65% and FHH a 35% share on those flows. He went on to consider the likely revenue consequences of rate cuts. In respect of the Immingham flows, Mr White stated:

“I am not sure we can move much further on the Immingham rate of £[ ... ] without making real faces at the Immingham rates to other places. However, if we cut the rate to the PG level on this flow (£[ ... ] exc discharge incentive of [ ... ]p/tonne) say – then may we [sic] would get another half of FLHH’s business ([ ... ] tonnes); which is worth an additional £[ ... ]”.

C78 The reference to “*get another half of FLHH’s business*” suggests that EWS’s focus was not on making a profit, but rather reducing FHH’s market share. Indeed, nowhere in the e-mail does Mr White analyse the likely profitability of possible rate cuts, since revenues are not set against costs.

C79 Mr White went on to state:

“We have to be very careful offering incremental price reductions for marginal tonnage because of the competition reasons explored elsewhere – as advised by our lawyers – so I think price reductions have to be offered “across the board.”

C80 Mr White was therefore aware, and highlighted to Mr Purves and Mr Wilson, that offering price reductions selectively might place EWS in breach of competition law. Yet this is precisely what EWS did. In its Response (8.116), EWS attempts to justify its low prices to LEG and UK Coal on the basis that these low prices were necessary to “*meet the market*”, i.e. to meet FHH’s prices in order to ensure that EWS won the business on particular flows on which FHH competed with EWS. Nowhere does EWS suggest that the price reductions offered to LEG and UK Coal were part of a general reduction of prices “*across the board*”. Indeed, such a general reduction of prices would have been contrary to EWS’s strategy at the time. EWS has stated that from 2000 to 2004 it was engaged in a drive to increase profitability, and that one of the ways it sought to do this was by “*[a]ttempting to raise prices within the competitive ceiling whenever possible*”<sup>318</sup>.

C81 Mr White’s e-mail also analysed the likely revenue consequences of different price cuts, and noted that ‘*across the board*’ price cuts, even if they resulted in EWS winning some business from FHH, would result in a revenue loss for EWS in respect of EWS’s existing business on the Immingham and Redcar flows. Mr White stated:

---

<sup>318</sup> Document 25, page 1 of documents provided by EWS at the site visit and Document 21, page 1 of the documents provided with EWS’s 19 December 2002 response to ORR’s notice of 27 November 2002 (which EWS has confirmed was part of the documents referred to as ‘Item 2’ within document 70 of documents provided at the site visit). In the first document, EWS redacted the paragraph beginning “*We have to be very careful [...]*”, but this was included in the later document supplied to ORR.

<sup>319</sup> Response, 2.70 to 2.75.

“So to “protect” what we currently have the cost would be a gross revenue loss of £[ ... ]mn. I think this could be a best case scenario – *if* Roger [FHH] responds it could be worse. [Emphasis in text.]

But..... [sic] to recover the loss of income we would have to recover [ ... ] million tonnes – or about [ ... ]% of FLHH’s business.

So we are working harder for the same revenue.

Do we want to compete on price in this way?

Observations of other industries etc..[sic] suggests that all we will end up doing is reducing everybody’s gross revenue for no net gain in market share.”

C82 Mr White’s comment that “*if Roger responds it could be worse*” appears to envisage that if FHH responded by itself offering lower prices, EWS would react with more price reductions, further worsening its revenue position. This is consistent with David Israel’s evidence that EWS’s strategy was to minimise FHH’s market share “*at virtually any cost*”.

C83 EWS offered low quotes to LEG for coal haulage on flows to Cottam and West Burton initially on 8 August and formally on 13 August 2002. This was followed on 22 August 2002 by EWS offering low quotes to UK Coal on flows to Cottam and West Burton on 22 August 2002.

C84 On 27 August David White sent an e-mail to David Purves and James Wilson attaching a document entitled “*Coal Pricing*”<sup>320</sup>. In its Response<sup>321</sup>, EWS explained that this was the first draft of a document prepared by David White for review and consideration by David Purves who intended ultimately to provide it to Allen Johnson, EWS’s Chief Operating Officer.

C85 EWS has further explained (at Paragraph 8.46 of its Supplementary Response) that it was not a first hand account of the meeting with Mr Mengel as Mr White had not been present at that meeting. The document was not subsequently provided to or endorsed by any member of the EWS senior executive team or its Board.

C86 As stated above, ORR considers that the document is evidence of a strategy on EWS’s part to target FHH by pricing aggressively although ORR does not have any persuasive evidence to suggest that such a strategy emanated from EWS senior management or any evidence that the EWS Board had any knowledge of it.

C87 After noting that, “*EWS’s Coal Business is mindful of its responsibilities under the Competition Act*”, the ‘*Coal Pricing*’ paper discusses the relative position of EWS and FHH, noting that at present EWS had a market share of 80-85%. FHH’s business was identified at around [ ... ] trains per week, as compared to EWS’s [ ... ]. The paper then stated:

---

<sup>320</sup> Document 70 of documents provided by EWS at the site visit.

<sup>321</sup> Paragraphs 7.102 and 7.103.

“FLHH’s coal market is crudely comprised of:

London Electricity [ ... ] trains per week

AEP [ ... ]

AES Drax [ ... ]

TXU [ ... ]

UK Coal [ ... ]

**So the key market is London Electricity**”. (Emphasis added.)

C88 It is noteworthy that London Electricity is identified as being “*the key market*” primarily because of the fact that it accounted for a large proportion of FHH’s coal market business. In particular, London Electricity was not identified because securing its business would necessarily be profitable. The paper did go on to refer to the attractiveness of London Electricity as a customer, but this appeared to be a secondary consideration.

C89 The paper went on to state:

“[...] We made a move on 5<sup>th</sup> July to secure business from FLHH to London’s station at Cottam. After legal advice was sought from Michelle Davies [EWS legal] and Freshfields we reduced our price from Oxcroft to Cottam and West Burton from £[ ... ]/tonne (quoted in August 2001 and which was consistent with our quotes to Enron on 24<sup>th</sup>/27<sup>th</sup> April 2001) to £[ ... ]/tonne. £[ ... ] yielded an EBITDAL on the Frontier model of [ ... ]% [...]. **We offered to quote similar prices to London from other local supply points but London declined.**

When I [i.e. David Purves] joined EWS in week commencing 15 July it was said to me that the Chief Executive believed that FLHH’s overall coal market share was about 10%. It was also made clear to me that the Executive believes that the Coal Business is too conservative, too cautious, too concerned with protecting (higher) legacy price margins and contract positions and **is not aggressive enough in capturing business and limiting FLHH**. Your views [i.e. the views of Allen Johnson] were reiterated when we spoke on Wednesday 7<sup>th</sup> August.

Whilst pursuing London Power [LEG] we have also been discussing prices with UK Coal for supplies to Drax [...]

Initially we quoted prices to UK Coal exactly the same as our current prices with AES Drax. On 12<sup>th</sup> August UK Coal, reputable people, said that we were a long way above FLHH. We suggested that the rate from Kellingley could be [ ... ] (an exact [ ... ]% Ebitdal) as opposed to the AES price of £[ ... ]. The reaction was to suggest that we had matched FLHHs price.

With all these factors in mind the Coal Business has pursued a much more aggressive stance in the last few weeks and has captured business that would

otherwise been moved by FLHH. On 13<sup>th</sup> August 2002 we formally quoted London Power:

	Immingham		Redcar	
	Current prices	Revised price	Current prices	Revised prices
Cottam	£[ ... ]	£[ ... ]	£[ ... ]	£[ ... ]
West Burton	£[ ... ]	£[ ... ]	£[ ... ]	£[ ... ]

[...]

However, as a result of quoting these prices we have secured a cape size ship's worth of coal (about [ ... ] tonnes from Redcar to West Burton in late September 2002 and an additional parcel of coal from Immingham to Cottam, [ ... ] tonnes just after.

We have also secured an additional [ ... ] tonnes of coal from UK Coal supply points in Nottinghamshire to Cottam and West Burton to London's stations in September and October.

	Enron price	5 <sup>th</sup> July 2002 price	Revised price
Cottam	[ ... ]	[ ... ]	[ ... ]
West Burton	[ ... ]	[ ... ]	[ ... ]

[...]"

C90 In its Response, EWS pointed out that the paragraph "*When I joined EWS in week commencing 15 July...*" was removed from a subsequent version of the paper. This is discussed further below. Even so, these contemporary documents, supported by David Israel's account in response to a section 26 notice, evidence the following developments in EWS during July and August 2002:

- (a) David Purves outlined a strategy to the coal team at a meeting on 31 July 2002. At that meeting, it was agreed that there was a need to bring about a significant reduction in FHH's market share. That would be achieved by "*aggressive pricing*", as reducing FHH's market share rather than profitability was the primary consideration in the short-term. Price reductions were to be introduced selectively in order to target FHH and LEG was identified as "*the key market*" because it was FHH's largest customer.
- (b) During August, the coal team evaluated some of the likely consequences of adopting this strategy, and identified some revenue risks.
- (c) Despite this, EWS quoted greatly reduced low prices to LEG and UK Coal for the Cottam and West Burton flows identified above. Those quotes were accepted by LEG and UK Coal. The coal team offered to quote similarly low prices to LEG from additional local supply points, but LEG declined.

(d) On 27 August David White sent David Purves a document<sup>322</sup>, which he had drafted on his behalf, which was intended to be sent to EWS's Chief Operating Officer. The document explained how, in large part through the quotes to LEG and UK Coal for the Cottam and West Burton flows, the coal team had achieved its aim of being more aggressive on price in order to limit FHH during August.

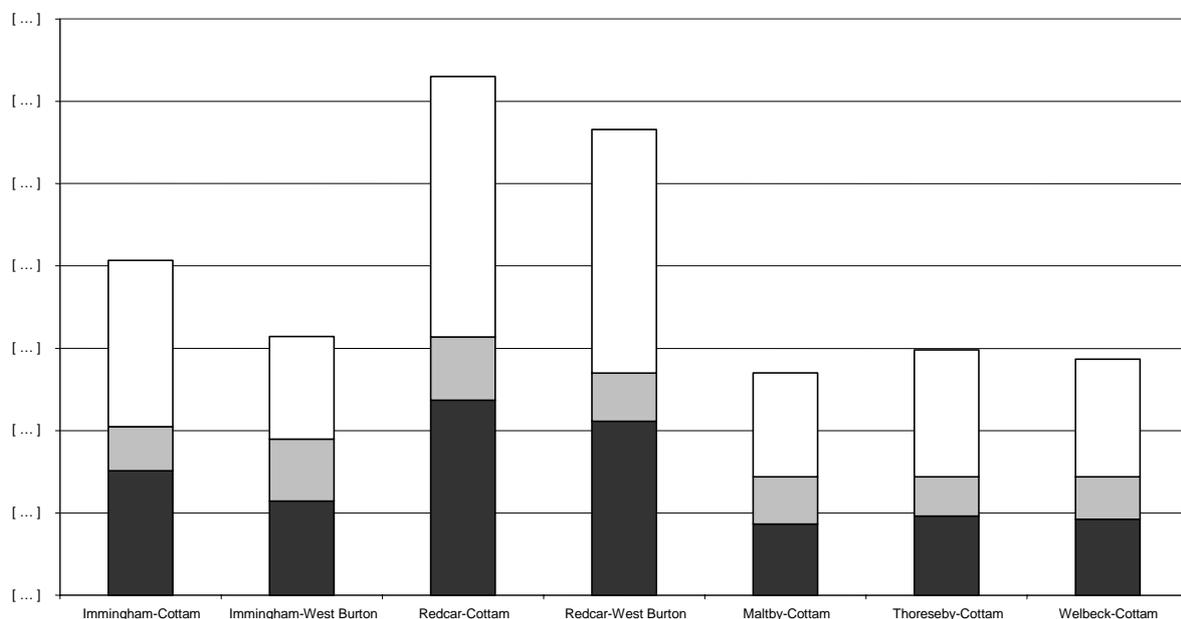
C91 This evidence shows that EWS's rationale for pricing below ATC on these flows was specifically in order to strike strategically at FHH in order significantly to reduce its market share, and that this supports a conclusion that EWS's pricing was abusive (cf, in particular, *Aberdeen Journals* at paragraphs 352 and 358).

*The extent to which EWS's prices were below ATC*

C92 In addition to evidence of subjective intent, a conclusion of an abusive intent may be inferred from all the circumstances. In particular, the further below ATC the prices under scrutiny, and the longer the period for which they are adopted, the easier it is to infer an abusive intent (see, for example, *Aberdeen Journals*, paragraph 356).

C93 In this instance, the relevant prices of EWS were far closer to AVC than to ATC. For ease of reference, Chart 1 above, showing that EWS's prices left it with a substantial shortfall between price and the estimated ATC for each of the flows in question, is again presented.

**Chart 1. Overview of cost results for flows to Cottam and West Burton**



<sup>322</sup> EWS has explained that the document was not subsequently provided to or endorsed by any member of the EWS Senior Executive team or its Board.

C94 The large shortfall between calculated ATC and EWS’s prices is predominantly due to capital costs. This is illustrated in the Table below, which sets out the different categories of costs for the LEG flows (Annex K contains this Table and a corresponding Table for the UK Coal flows).

**Table 25. Decomposition of ATC in ORR cost analysis LEG flows**

Cost item (£ per tonne)	Immingham to Cottam	Immingham to West Burton	Redcar to Cottam	Redcar to West Burton
Average variable cost	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Contribution to operating cost overheads	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Depreciation	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Cost of capital employed (at 10% WACC)	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Average total cost	[ ... ]	[ ... ]	[ ... ]	[ ... ]

C95 For instance, for the Immingham to Cottam flow, most of the difference between AVC (£[ ... ]) and ATC (£[ ... ]) is due to the depreciation charge and the costs of capital employed (which are predominantly accounted for by the locomotives and wagons needed for that flow). Furthermore, the £[ ... ] figure for the contribution to operating cost overheads includes not simply corporate overheads, but also includes “engineering” and “operations” overheads. This pattern is repeated for the other flows in the LEG contract as well as for the quotes to UK Coal.

C96 As a commercial enterprise, EWS would generally be expected to be keen to recover capital costs, and not to tie up capital assets for lengthy periods of time for only a small margin above AVC<sup>323</sup>.

C97 The haulage carried out by EWS for LEG and UK Coal on the Cottam and West Burton flows was therefore carried out at prices which were significantly below ATC and which made little, if any, contribution to EWS’s significant capital costs. It is unlikely that EWS could have been motivated by legitimate commercial reasons to quote prices at this level, and these factors, therefore, support a finding of abusive intent.

C98 Furthermore, the prices quoted by EWS were for a significant volume of haulage, and were to be applicable over several months. This is true of the haulage for both LEG and UK Coal, but is particularly true of the LEG volume.

C99 For example, the LEG haulage was expected to be hauled in the latter half of 2002 and the calendar year 2003. EWS therefore committed to prices for LEG that provided little, if any, contribution to capital costs and were much closer to AVC than ATC (as shown in the chart above) for a period covering both the 12 months of 2003 as well as for some coal haulage during 2002.

C100 In addition to recognition of the period of time over which the prices applied, these prices can be put into further perspective by looking at the volumes of coal haulage foreseen at the time of contracting.

<sup>323</sup> [ ... ] in Annex K explains [ ... ].

C101 The volume of coal from Immingham and Redcar to Cottam and West Burton to which the prices were to apply were expected to be approximately [ ... ] tonnes<sup>324</sup>. ORR calculates that each HAA train set had a payload of 1,044 tonnes and each HTA train set of 1,296 tonnes<sup>325</sup>. Assuming that the coal was to be carried proportionately across a fleet of [ ... ] HAA wagons and [ ... ] HTA wagons (ORR understands that EWS expected such a fleet to apply from December 2002), this volume translates into a requirement for [ ... ] train movements for HAA train sets and [ ... ] train movements for HTA train sets<sup>326</sup>. On this basis, the contract for LEG would therefore have required around 1,600 train movements over the autumn of 2002 and the calendar year 2003.

C102 Each train movement would tie up EWS assets for a number of hours. For instance, based on input data used by EWS in preparing cost estimates for these flows, ORR has calculated that a train movement from Immingham to Cottam would take (including ground-staff time) around 11 hours; that Immingham to West Burton would take around 8.5 hours; that Redcar to Cottam would take around 16.5 hours; and that Redcar to West Burton would take around 15 hours<sup>327</sup>.

C103 With an expected requirement of around 1,600 train movements, each with a journey time of 8.5 to 16.5 hours, it seems clear that when EWS agreed terms for the LEG haulage from Immingham and Redcar, it was making a commitment to tie up substantial numbers of locomotives and wagons in return for prices that yielded no return on capital employed and were far below ATC. This supports a finding of abusive intent.

C104 EWS argued strongly in its Supplementary Response that its ATC on the relevant routes was in fact substantially lower than that found by ORR. However, in light of EWS's admission that it has priced below ATC with the requisite intent on either basis, it was not necessary for ORR fully to evaluate those representations and for the purposes of this Decision, therefore, a final finding as to the level of ATC can be left open.

---

<sup>324</sup> See EWS Response at paragraphs 8.123 and 8.140 and Document 70 of documents provided by EWS at the site visit.

<sup>325</sup> The payload figure for HTAs is based on an assumption of 68.2 tonnes per wagon. This differs from the number assumed in the Frontier model ([ ... ] tonnes), and ORR explains in Annex K why it has used this figure. This difference in the payload figure also affects the implied wagon mix assumption (i.e. the proportion of tonnes expected to be carried on HTA versus HAA trains) used in the estimation of required train movements under the LEG contract. This does not have a significant impact on the results of that estimation.

<sup>326</sup> The calculation of train movements required for each wagon type includes the assumption that each HTA train set comprises 19 HTA wagons and each HAA train set comprises HAA 36 wagons.

<sup>327</sup> These calculations are based on an assumed average speed of 20 miles per hour, idling/groundstaff times of 3 hours for the Immingham flows and 4 hours for the Redcar flows, and the following distances: Immingham to Cottam: 78 miles; Immingham to West Burton: 55 miles; Redcar to Cottam: 126 miles; Redcar to West Burton: 110 miles. Annex K set outs the sources relied on by ORR for this input data.

*EWS's prices failed to meet its own competition law compliance profitability targets*

C105 A detailed discussion of the steps taken by EWS's employees before quoting prices to LEG and UK Coal in August 2002 is set out in the section below *The analysis undertaken by EWS in respect of quotes to LEG and UK Coal*. Although that section responds to arguments raised by EWS, the matters discussed support a finding of abusive intent. In particular, they show that the prices quoted to LEG and UK Coal failed to meet EWS's internal compliance requirements for all but one of the flows, and that the EWS employees responsible for quoting the prices either knew or ought to have known that. In summary, the main points emerging from those paragraphs are as follows:

- First, the EWS coal team was aware that, for the purpose of the compliance programme, average costs should not be calculated on the basis of a [ ... ]% HTA wagon mix, as that would be objectionable for the purpose of competition law. Rather, the correct approach was to base calculations on the basis of a mix of HTA and HAA wagons. As stated by David White in an e-mail to the coal team on 29 July 2002<sup>328</sup>: “[...][ ... ]
- Second, EWS's competition law compliance programme set a profitability target for prices of [ ... ]% EBIT (earnings before interest and tax) and [ ... ]% EBITDAL (earnings before interest, tax, depreciation, amortisation and leasing)<sup>329</sup>. However, for all but one of the flows the prices quoted by EWS to LEG and UK Coal failed to achieve its own internal compliance targets of [ ... ]% EBIT or [ ... ]% EBITDAL when the calculations were based on a mixture of HTA and HAA wagons.

C106 In respect of the quotes to LEG, Mr Cawood produced the calculations shown in Table 26 below, which demonstrate that the prices quoted by EWS failed to achieve EWS's own compliance target of [ ... ]% EBIT in respect of three of the four routes<sup>330</sup>.

**Table 26. LEG prices compared to price targets presented for different wagon mix assumptions in Item 2 attached to the Coal Pricing paper**

Flow	Price agreed (£)	Price (£) required to achieve 15% EBIT Wagon mix assumes 52% HTA / 48 % HAA	Price (£) required to achieve 15% EBIT Wagon mix assumes 36% HTA / 64% HAA
Immingham – Cottam	[ ... ]	[ ... ]	[ ... ]
Imingham – West Burton	[ ... ]	[ ... ]	[ ... ]
Redcar – Cottam	[ ... ]	[ ... ]	[ ... ]
Redcar – West Burton	[ ... ]	[ ... ]	[ ... ]

<sup>328</sup> Document 14 of documents provided by EWS at the site visit.

<sup>329</sup> EBIT and EBITDAL are conventionally measured in monetary terms, the % figures quoted by EWS refer to EBIT and EBITDAL are margins measured as a percentage of turnover.

<sup>330</sup> Document 29 of the documents attached to a response by EWS dated 19 December 2002 to an ORR notice of 27 November 2002 is hand-dated “27/8/02” and is confirmed as being the document referred to as ‘item 2’ in document 70 provided at the site visit.

C107 In respect of the quotes to UK Coal, and as shown in Table 27 below, ORR's calculations<sup>331</sup> show that EWS's price would have failed to achieve its (alternative) compliance target of [ ... ]% EBITDAL on all three Cottam flows. (EWS did not undertake separate cost analysis for the flows to West Burton "as the distances from UK Coal's collieries to West Burton were essentially the same as to Cottam"<sup>332</sup>.)

**Table 27. Comparison of UK Coal prices against [ ... ]% EBITDAL compliance target generated by original Frontier model**

Flow	Price (£)	Price (£) required for 25% EBITDAL
Maltby – Cottam	[ ... ]	[ ... ]
Thoresby – Cottam	[ ... ]	[ ... ]
Welbeck - Cottam	[ ... ]	[ ... ]

C108 Fourth, Mr Purves, who was responsible for providing the quotes to LEG, knew or ought to have known that he quoted prices which failed to comply with EWS's internal compliance system. In particular, in respect of the Immingham – Cottam and Redcar – Cottam flows, Mr Purves had received costings on 8 August 2002 showing that the prices necessary to achieve an EBIT of [ ... ]% on the basis of a [ ... ]% HTA / [ ... ]% HAA wagon mix were £[ ... ] and £[ ... ] respectively. Despite that, on 13 August Mr Purves formally quoted to LEG prices for those two routes of £[ ... ] and £[ ... ]. Mr Purves either did know or ought to have known that the [ ... ]% EBIT assessment should not be made on the basis of a [ ... ]% HTA wagon assumption, but on the basis of a mix of HTA and HAA wagons: Mr Purves received Mr White's e-mail of 29 July 2002 to that effect, and he was supplied by the coal team with calculations based on a number of different wagon mixes.

C109 Fifth, Mr White either knew or ought to have known that the prices he quoted to UK Coal also failed to comply with EWS's internal compliance system. Mr White was familiar with the Frontier model and EWS's compliance guidelines, and the Frontier model calculations generated by Mr White on 22 August 2002 would or should have made it obvious to him that the prices that he quoted to UK Coal failed to achieve an EBITDAL of [ ... ]%. EWS's suggestion that Mr White considered the appropriate level of return to be [ ... ]% EBITDAL is not credible, in particular in the light of the following e-mail exchange on 1 March 2002 between Tim Bilby, Mr White and others in the coal team. In relation to costings generated in response to a quote request from AEP, Tim Bilby wrote:<sup>333</sup>

"Self-explanatory. Note until further notice/guidance (from above) to the contrary, our target is now EBITDAL of [ ... ]%".

<sup>331</sup> ORR's calculations are based on the Frontier model spreadsheets for these flows, received by ORR on 28 October 2002. For the purposes of these calculations, the only change that ORR has made to the spreadsheets received from EWS has been to set the target EBITDAL margin to [ ... ]% rather than [ ... ]% (note that the Frontier model does not directly allow the calculation of an EBIT target).

<sup>332</sup> EWS Response at paragraph 1.148.

<sup>333</sup> E-mail from Tim Bilby to David White, David Israel and James Wilson dated 1 March 2002 entitled "RE: Daw Mill – AES Prices". Document R8/194 of Volume 2 of documents provided in response to a section 26 Notice of 17 June 2005.

C110 David White responded as follows:

“!!!

Jim – Tim and I have had a chat. Apparently the move from [ ... ]% to [ ... ]% comes from comments made by Chris Tingle that EBIT should be [ ... ]% and that EBITDAL should be [ ... ]%.

I think that in the context of you know what that, although changing our profit target might well be right, the fact that we have been quoting in the ESI market at [ ... ]% looks at best difficult and at worst ...

Would it be worthwhile arranging to brief the Authorities on the potential consequences of decisions taken in a vacuum? Do we need legal advice?”

### **Appreciable effect on competition**

C111 The various types of conduct by EWS considered in part II of this Decision, namely relating to exclusionary contracts (part A), discrimination (part B) and predatory pricing (this part, part C), form part of an overall strategy intended to impede competition that satisfies the requirements of Article 82 and the Chapter II prohibition that the conduct may affect trade between Member States and within the United Kingdom. The specific contribution to that analysis made by EWS's predatory pricing on the Cottam and West Burton flows is now considered in more detail.

C112 In particular, there now follows a discussion on the actual and/or potential effect of EWS's abusive and predatory pricing on the competitive process and structure of the market, a consideration relevant to the analysis under both Article 82 and the Chapter II prohibition, the latter of which which requires that the abuse be capable of having an appreciable effect on trade within the United Kingdom.

C113 The actual or potential effect of EWS's abusive and predatory pricing strategy falls to be assessed in the light of the fact that competition in the market for the haulage of coal by rail in Great Britain is already weakened as a result of the presence of EWS, which operates across the whole of Great Britain and has a strongly dominant position. The consequence of this is not only that competition with existing competitors is weakened, but also that market penetration by any new entrant is likely to be more difficult<sup>334</sup>. ORR has borne in mind that the predation on the Cottam and West Burton flows only directly affected approximately 6% of the relevant market.<sup>335</sup> However FHH has been the only other company in direct competition with EWS in the relevant market since privatisation and the EWS Coal Team considered that these flows represented a key market to FHH.

C114 The evidence suggests that EWS adopted a strategy of attempting to bring about a significant reduction in the market share of FHH through aggressive pricing targeted, in particular, at FHH's major customer. Specifically, the evidence indicates

---

<sup>334</sup> Commission's Guidelines on effect on trade, paragraph 95.

that EWS's strategy in July and August 2002 was to 'limit' FHH and to reduce its market share to 10-11% (from an estimated 17-20%).

C115 There were various potential effects of EWS's aggressive strategy. First, it may have sent a message to FHH that EWS would not tolerate the erosion of its monopoly in the market for coal haulage by rail and was willing to incur losses in order to prevent FHH from winning key contracts. FHH could have interpreted this either as an attempt by EWS to aggressively limit FHH's presence in the market or to drive it from the market altogether. In addition, it may have sent a message to potential new entrants that EWS was prepared through such conduct aggressively to defend its dominant position and market share, thereby tending to dissuade them from entry.

C116 A total of around [ ... ]m tonnes of coal was expected to be hauled to LEG's power stations at Cottam and West Burton under the predatory discounts. In 2002 the total volume of coal hauled to Cottam by rail was just over [ ... ]m tonnes and the total volume hauled to West Burton by rail was just over [ ... ]m tonnes, making a total of over [ ... ]m tonnes. Thus, assuming roughly stable total volumes to these power stations over the relevant time period, the coal expected to be hauled under these prices represented around [ ... ]% of all rail haulage to these power stations. Given that the total market for coal haulage by rail in 2002 was around 36m tonnes<sup>336</sup> and in 2002/03 was around 40.7m tonnes<sup>337</sup> the proportion of the total market directly affected amounted to [ ... ]%.

C117 However, an assessment of the proportion of the total market affected fails to capture the extent of the significance of this business to FHH for the following reasons.

- (a) As explained in part II A above – *Exclusionary contracts*, EWS had agreed a series of exclusionary contracts with customers on the market for coal haulage by rail, significantly reducing the amount of coal haulage for which FHH could compete. Moreover, and in consequence, FHH has reported that as a result of EWS's legacy contracts, E.ON and RWE, the two largest customers in the market for coal haulage by rail in 2002 "*made it clear that they cannot consider [FHH] for any parts of their business*"<sup>338</sup>. In light of this, the importance of the LEG and UK

---

<sup>336</sup> Based on ESI tonnage in 2002 (including some projections for Drakelow, Ironbridge, High Marnham and Rugeley) scaled up to reflect the ESI share of the market for coal haulage by rail, i.e. 89%.

<sup>337</sup> See National Rail Trends:  
[http://www.sra.gov.uk/pubs2/performance\\_statistics/Nat\\_trends\\_yearbook/Nat\\_Year.pdf](http://www.sra.gov.uk/pubs2/performance_statistics/Nat_trends_yearbook/Nat_Year.pdf)

<sup>338</sup> "*Freightliner was met with some reluctance to discuss terms from other potential coal customers, particularly those which were long established within the privatised market such as Innogy [RWE] and Powergen [E.ON]. Such reluctance continues to this day where each has made it clear that they cannot consider Freightliner for any parts of their business whilst they can achieve such advantageous rates from EWS. Indeed it has not been uncommon for Freightliner to lose business to Powergen [E.ON] who have offered rail rates to generators such as AEP (SSE) using their advantageous contracts with EWS. Freightliner simply cannot compete in such a scenario.*" FHH response dated 16 May 2005 to an ORR information request of 15 April 2005, paragraph 7. [27/228a.6]

Coal contracts to FHH was much greater than that reflected by a calculation of the volumes under the LEG and UK Coal contracts as a percentage of total coal haulage by rail.

- (b) The e-mail from David White cited above (in the section entitled *The historical background to EWS's pricing on the Cottam and West Burton flows*) indicates that EWS was aware of the importance of marginal tonnage to FHH and was also aware that, if EWS could successfully 'shut out' FHH from certain business, FHH might be forced to reconsider its continued presence in the market.
- (c) As identified in EWS's contemporary documents (such as the Coal Pricing paper of 27 August 2002 which, having identified the composition of FHH's weekly coal market, concluded "[s]o the key market is London Electricity"), the haulage of coal for LEG constituted more than half of FHH's business.
- (d) Further, EWS's strategy was not limited to the Cottam and West Burton business secured in August 2002. The strategy towards FHH agreed within EWS in late July and early August 2002 was a general strategy to limit FHH by almost halving its market share, and the low quotes to LEG and UK Coal represented only the first implementation of that general strategy. That is the clear impression given by the contemporary documents and in particular the Coal Pricing paper of 27 August, which states that, in addition to the low quotes to LEG for flows from Immingham and Redcar, "[w]e offered to quote similar prices to London from other local supply points but London declined".

C118 However, on 19 August 2002, FHH made a complaint to the ORR that EWS had engaged in predatory pricing on these flows, and, at the very latest, EWS became aware of the ORR's investigation into predatory pricing when it received Notice of entry of premises (pursuant to section 27 of the Act) on 17 October 2002. EWS's knowledge of the investigation is almost certain to have affected its conduct, and may well have caused it to check its aggressive pricing strategy.

C119 The CFI in *CMB* notes that the fact that an eliminatory strategy by a dominant undertaking "*is not achieved is not enough to avoid the practice being characterised as an abuse of a dominant position*"<sup>339</sup>. It is relevant to take into account the potential as well as the actual consequences of EWS's general strategy to reduce FHH's market share to 10-11%. For example, the potential consequences of EWS offering LEG prices for other local supply points to Cottam and West Burton similar to those offered in August 2002 remain relevant, despite the fact that LEG declined EWS's offer.

C120 The evidence indicates that EWS deliberately targeted the Cottam and West Burton business because it fully appreciated that the loss of that business to EWS would be keenly felt by FHH. The assessment of the potential impact of such a

---

<sup>339</sup> Cases T-24-26 and 28/93 *Compagnie Maritime Belge v Commission* [1996] ECR II-1201, paragraph 149.

strategy on FHH should take into account the fact that EWS had demonstrated over a number of years that it was prepared to act in an abusive manner in an attempt to limit entry. In these circumstances, there is a very real possibility that FHH would have concluded that, in order to preserve and strengthen its dominant position, EWS was prepared to act in a way that was aggressive, abusive and went beyond normal competition. This would almost certainly have affected FHH's conduct on the market, and (had ORR not started an investigation into whether EWS had behaved illegally in this aggressive pricing) might have led FHH to consider withdrawing from the market, on the basis that it could not continue profitably to compete if EWS continued to conduct itself in this way. The EWS Coal Team has acknowledged that the flows represented a key market to FHH<sup>340</sup> but ORR has no evidence which quantifies the degree to which FHH was affected. ORR considers that the predation was of limited duration over a limited number of flows and FHH did not in fact exit the market.

C121 EWS's conduct may also have further reduced the likelihood of other new entrants entering the market. As noted in part I – *Market definition and Assessment of dominance* - considerable barriers to entry exist in this market. The knowledge that the incumbent dominant firm was prepared to engage in aggressive below cost pricing and to strike strategically at new entrants would almost certainly have acted as a further deterrent to entry.

## Conclusion

C122 In particular for the reasons set out above, but also those set out below in response to EWS's arguments, the prices quoted by EWS to LEG and UK Coal in August 2002 for the Cottam and West Burton flows are found to have been abusive and contrary to Article 82 EC and the Chapter II prohibition.

## Response to EWS's arguments

C123 EWS's Response contains several submissions which are relevant to the analysis set out above. ORR's response to those is set out below.

- (a) EWS's arguments relating to the calculation of EWS's costs, including:
  - (i) Arguments that the Frontier model overstates variable costs;
  - (ii) Arguments relating to the wagon mix assumption; and
  - (iii) Arguments relating to the revised Frontier model.
- (b) EWS's criticisms of some of the evidence relied on by ORR.
- (c) EWS's argument as to why, even on the basis of ORR's case, EWS's pricing cannot be considered abusive, including:

---

<sup>340</sup> Cf The draft document prepared by David White and described as the "Coal Pricing" paper referred to in Part IIC in the section headed "The views and approach of EWS towards pricing in July and August 2002" above

- (i) Pricing between ATC and AVC cannot be considered predatory on this range of routes;
  - (ii) EWS was merely engaging in competition to ‘meet the market’;
  - (iii) No ‘eliminator intent’ or possibility of elimination;
  - (iv) Feasibility of recouping of losses;
  - (v) No appreciable effect on competition; and
  - (vi) EWS’s criticisms of the evidence of intent relating to UK coal.
- (d) EWS’s arguments based on its compliance measures.
- (e) EWS’s arguments that, in fact, its prices on the relevant flows were motivated and dictated by legitimate considerations, including:
- (i) The attractiveness of LEG as a customer and securing short term revenue; and
  - (ii) The analysis undertaken by EWS in respect of quotes to LEG and UK Coal.

#### **(a) EWS’s arguments relating to the calculation of EWS’s costs**

##### *Overview of arguments on the calculation of EWS’s costs*

C124 EWS argued that various “assumptions in the Frontier model have been conservative and tended to overstate variable costs. Examples are maintenance costs, track access charges and groundstaff costs” (Response, 8.24). The points made by EWS in respect of maintenance and groundstaff costs are considered, in turn, below<sup>341</sup>. ORR also presents its views on the appropriate wagon mix to apply. The conclusion is that EWS’s arguments do not justify a view that the Frontier model overstates variable costs.

C125 Furthermore, whilst ORR made amendments to the Frontier model in order to estimate EWS’s costs, the revised cost estimated produced in the Response cannot be relied on as part of the analysis required in this part (see section below entitled *The revised cost estimates produced by EWS*).

#### **(a) (i) Arguments that the Frontier model overstates variable costs**

[ ... ]

C126 [ ... ]

---

<sup>341</sup> The arguments on track access charges were relevant to our consideration of flows which are no longer relevant to our decision.

C127 [ ... ]

C128 [ ... ]

C129 [ ... ]

C130 [ ... ]

C131 [ ... ]

[ ... ]

C132 [ ... ]

[ ... ]

C133 [ ... ]

C134 Furthermore, a significant competition concern would arise if EWS, given its dominant position, persistently priced at a level corresponding to a very short-run concept of marginal cost<sup>342</sup> wherever it faced competition for 'spot' or short-term business and financed other costs through rates on those flows or contracts not subject to such competition. Competition during the investigatory period in coal haulage by rail has been for relatively marginal business and a new or prospective entrant would not be able to profitably replicate a pricing structure where prices were driven down to short-run marginal/variable costs on a consistent basis. This point was made by the CAT in *Aberdeen Journals* (paragraph 370):

“[...] in order to survive in the market, a competitor to a dominant firm must normally cover its total costs (including overheads) and earn a return on its investment. Moreover, in our view, in normal commercial business, each product line is expected not merely to cover its variable costs, but to make an appropriate contribution to general overheads. If a dominant firm prices below average total costs, including a proportionate share of general overheads, for a prolonged period, sooner or later an equally efficient competitor will be forced out of the market.”

C135 In any case, given the very small proportion of both AVC and ATC accounted for by groundstaff costs, ORR's treatment of groundstaff costs does not materially affect its analysis. For instance, for the Immingham to Cottam flow, ORR has estimated AVC to be £[ ... ] per tonne, of which £[ ... ] per tonne, or [ ... ]%, is accounted for by groundstaff costs.

---

<sup>342</sup>

Marginal costs are the costs of producing an additional unit of output over a specified period of time. If marginal revenues, which are the same as price when demand is perfectly elastic or if perfect price discrimination is possible, exceed marginal costs then it is profitable to expand output. Marginal costs are often difficult to measure and variable costs are used as a proxy, moreover, with a linear cost function the two will coincide. In the very short-run, it is possible that few inputs (and hence costs) will vary with output, although exceptions would be fuel and variable track access charges.

**(a) (ii) Arguments relating to the wagon mix assumption**

C136 As noted above, ORR has calculated ATC and AVC on the basis of a mix of both HAA and HTA wagons in the EWS fleet. In particular, for the LEG contract, ORR has used the assumption of [ ... ] HTA wagons and [ ... ] HAA wagons, recorded in the Frontier model, which ORR understands to be EWS's forward-looking expectation of its whole fleet by December 2002.

C137 EWS has argued that such an approach to the wagon mix assumption is inappropriate.

C138 In its Response (8.32 to 8.35 and 8.39), EWS stated that in most cases that assumption will not be used and that in most cases "*the Frontier model is simply amended to use an assumption of [ ... ]% HTA wagons or [ ... ]% HAA wagons as appropriate*". EWS further stated that the cost calculations, which it performed for the purpose of providing the quotes under consideration, were all done on the basis that only HTA wagons would be used. EWS concluded that the "*use of [ ... ] the default [ ... ]%/ [ ... ]% [sic] Frontier model wagon mix [ ... ] results in an overstatement of EWS's costs on those flows*". Although not expressly stated, the implication appears to be that, for the purpose of its competition assessment, ORR should calculate EWS's ATC and AVC for these flows on the basis of [ ... ]% HTA wagon use.

C139 ORR does not accept that for the purpose of its competition assessment it should calculate AVC or ATC on the basis of a [ ... ]% HTA wagon mix. First, evidence is presented that shows that EWS's understanding of how it should approach the issue of wagon mix was different during the period under investigation than is reflected in its Response. There follows a detailed explanation as to why it would be wrong to accept that the prices set for the flows in question should be examined by assuming [ ... ]% HTA wagons in the cost analysis.

*EWS's contemporaneous position on wagon mix*

C140 It appears that EWS's contemporaneous position was that average costs should be assessed on the basis of its overall wagon mix, and that it was aware that generating quotes based on [ ... ]% HTA use would be objectionable from a competition law perspective.

C141 For example, on 29 July 2002 an e-mail exchange took place between David White, Andrew Martin, James Wilson and David Purves (who all received the three e-mails detailed below).

C142 David White sent an e-mail in which, in the version seen by the ORR, a substantial amount of text has been redacted (apparently on the basis of legal privilege)<sup>343</sup>. The unredacted text does not refer to the selective use of HTAs.

C143 In response, Andrew Martin (Business Manager – Scotland) sent the following e-mail:<sup>344</sup>

---

<sup>343</sup> Page 2 of document 14 of documents provided by EWS at the site visit.

“David

With regard to selective use of HTA’s:

Until we reach a point where the HTA’s have the capacity to serve ALL sites capable of loading them, then surely, by implication, decision about where they are utilised will have to be made (by EWS) i.e. selective use! It’s unavoidable. And, in my naivety, since we invested in the wagons do we not have the divine right to use them in a way that will make the best return on that investment, the same as any company investing in it’s business, whether it’s wagons or widgets?

Furthermore, does using HTA’s on certain flows not free up resources (due to less resource used/tonne) for use on other non-HTA flows, thus creating indirect benefit to those non-HTA flows, countering any discrimination that could be levelled?

Just showing an interest .....

Andy”

C144 Mr White stated in his reply dated 29 July:<sup>345</sup>

“Andy,

Good questions. I do wish you wouldn’t show that much of an interest!

Our friends advise that [text redacted]

We have to be careful if we seek to translate a potential physical advantage in one flow over another to financial gain through rate management. Or especially if between the same two points we are quoting different prices on the basis of the more favourable deployment of some resources to different people. We could be open to various accusations. **Our new model [the Frontier model] (endorsed by Michelle) et al at a durbah in mid-June with Jim, Allen etc does use an amalgam of costs for HAAs and HTAs. I think Michelle thinks that this is the model we are using.** As an aside – perhaps Jim could confirm [text redacted] which Freshfields [text redacted].

Your second question drives at the heart of what we are dealing with. Because we have an 80% market share and because we are Regulated [sic] we are not like any other company. So far as coal is concerned, specifically, our concern is that we may be found to be Dominant or Super-Dominant (both in a legal sense). [...] So we are not necessarily our own masters when it comes to the way we earn a commercial return from our several different assets. We can’t favour one client over another – **the decision to devote a set of assets to one client and then reduce prices to below average costs (I think that’s right Jim?) may well be discriminatory because somebody else must be paying more to offset their above average costs.**

---

344 Page 2 of document 14 of documents provided by EWS at the site visit.

345 Page 1 of document 14 of documents provided by EWS at the site visit.

If we were to quote a reduced price to party A and then quote a higher price to the next party B that comes along we are likely to be in difficulty.

***We may also be predatory pricing too.***

***You are right to say that we can deploy the HTAs how we wish – but what we can't do is go then go [sic] the next stage and reduce prices to below average costs on that flow accordingly simply because we have introduced the HTAs on that flow to that one client.***

***The key factor influencing our decision making is our market share – 80%".*** (Emphasis added.)

C145 These e-mails indicate that, at the time, the understanding of David White which he conveyed to others in the coal team was that average costs should be calculated on the basis of EWS's overall wagon mix, and that quotes should not be prepared by assuming that a low-cost wagon type would be dedicated to the customer that the quote was being prepared for.

C146 That understanding is consistent with the way in which the Frontier model had been designed.

#### *Design of the Frontier model*

C147 [ ... ]<sup>346</sup>. [ ... ]

C148 [ ... ]

C149 [ ... ]

C150 EWS has advised that the Frontier model was implemented as part of EWS's compliance strategy. It would seem to be against the very purpose of EWS's compliance procedures if EWS employees took such an approach when using the Frontier model. EWS has produced no evidence to suggest that EWS employees were told that such an approach was legitimate. EWS has also declined to provide ORR with the Frontier model guidance supplied to its employees (see Paragraph C169)

#### Uncertainty as to the wagon mix that would be used

C151 A wagon mix of [ ... ]% HTA wagons is not appropriate because it would not generally be possible, at the time that a quote was prepared, for EWS to know with certainty the wagon mix that would actually be used on the flow in question.

C152 Contemporaneous evidence from EWS indicates that in general there was a risk that "[...] any wagon from the fleet would be used[...]"<sup>347</sup>. This statement is

---

<sup>346</sup> EWS Response, at paragraph 8.33.

<sup>347</sup> Page 34 of EWS response of 19 December 2002 which responds to paragraph 9(w)(i) of ORR's section 26 Notice of 27 November 2002.

consistent with the general business model operated at the time by EWS, under which wagons and locomotives were not dedicated exclusively to particular customers.

C153 Further, David Israel at a meeting with ORR on 2 September 2005<sup>348</sup> stated that, following the introduction of the Frontier model, Market Managers would specify the numbers and types of wagons to be used in modelling a particular flow, fully in the knowledge that this might not be the mix of wagons ultimately used in practice. He explained that deployment of wagons depended upon availability and the capability of the network at the time the service is run.

C154 For the purpose of understanding expected costs at the time a quote was prepared, it therefore does not seem appropriate to accept assumptions based on an actual wagon mix of [ ... ]% HTA. A wagon mix of [ ... ]% HTA does not seem a plausible best estimate of the wagon mix that would be used in practice.

#### *The actual wagon mix*

C155 Even leaving aside the uncertainty as to what wagon mix would eventually be used, there is a more fundamental reason why an assumption of [ ... ]% HTA wagons is inappropriate for the cost analysis.

C156 Unless EWS expected to have significant excess capacity of HTA wagons, the effect on EWS of “dedicating” HTA wagons to one particular flow would be to reduce the availability of HTA wagons on other flows. Since the variable cost (per tonne) of using HTA wagons is less than that of HAA wagons, this creates serious risks of analytical error in the cost analysis.

C157 A superficial analysis of the costs of assigning HTA wagons to a particular flow might be based on the (lower) variable costs of using the HTA wagon type. However, this would tend to under-estimate the variable costs of choosing to operate the flow in question on a [ ... ]% HTA basis. Specifically, it would also be necessary to make an allowance in the analysis of variable costs to account for the likelihood that EWS would incur increased variable costs on other flows, as a result of greater need to use (high-cost) HAA wagons on these flows. Without information to calculate the magnitude of this allowance, an actual wagon mix assumption cannot be used to calculate AVC reliably.

C158 The rejection of a simple actual wagon mix approach also has intuitive appeal for the purposes of understanding the constraints imposed on EWS by competition law. Clearly it would be inconsistent with the special responsibility of a dominant firm not to impair genuine undistorted competition, if EWS were to avoid suspicion of charging predatory prices to a particular customer simply by diverting all its low-cost assets to serve that customer, at the expense of incurring higher costs when serving other customers.

---

<sup>348</sup>

[29/360]

*Implications for the wagon mix assumption in the calculation of ATC*

C159 [ ... ]

C160 [ ... ]

**(a) (iii) Arguments relating to the revised Frontier model**

C161 At paragraphs 8.45-8.47 of its Response, EWS reported that in Autumn 2002, revisions were made to the Frontier model.

C162 Although ORR received electronic versions of the Frontier model on 28 October 2002 and 6 December 2002, these related to versions of the model that had been used by EWS in July and August 2002. In its Supplementary Response EWS did not provide the revised version of the model<sup>349</sup>. A consideration of the issues raised by EWS in respect of its revised model is therefore confined to the issues raised in the Response.

*The revised cost estimates produced by EWS*

C163 In its Response, EWS mentioned several changes that it has implemented in its revised cost model (paragraph 8.45). The net effect of EWS's revisions is to *reduce* EWS's costs, in some cases dramatically.

C164 For example, in respect of the Thoresby to Cottam flow, EWS reports that AVC is calculated at £[ ... ] per tonne, and ATC (assuming [ ... ]% return on capital) at £[ ... ] per tonne. This can be compared against the calculations provided in the electronic version of the Frontier model received by ORR on 28 October 2002, which calculates AVC for that flow of £[ ... ] per tonne and ATC (assuming [ ... ]% return on capital) of £[ ... ] per tonne. This represents a [ ... ]% change in AVC between the two calculations.

C165 EWS's purported application of its revised Frontier model at paragraphs 8.76 to 8.80 of its Response shows the prices quoted on the Cottam and West Burton flows to be at or close to ATC (using a [ ... ]% ROCE measure), leading EWS to conclude that there can therefore "*be no question of predatory pricing having occurred on these routes*".

C166 For the reasons set out below, this approach by EWS is not accepted.

C167 In order to assess whether the figures generated by a revised model were appropriate figures on which to base its analysis, ORR would have to be in a position to understand the precise nature of the revisions. This would have required, at the very least, EWS to provide ORR with the revised version of the model and a full

---

<sup>349</sup>

In its Supplementary Response (para 8.9), EWS offered to provide the revised version of the model if required by ORR. The SO had made it clear that this was one aspect of evidence EWS would need to produce to persuade the ORR of its arguments. At the stage at which EWS accepted ORR's findings, therefore, it had not yet provided the requisite evidence in this regard.

explanation of the changes made. EWS did neither of these things. Such information would have been necessary to allow ORR to assess the merits of the individual changes made. ORR would also need to be satisfied that the identified revisions were comprehensive, consistent and balanced. To that end, ORR would need to have received an explanation of what aspects of the model have been scrutinised by EWS (whether in collaboration with its advisers or not) and in particular, why some parts of the model were adjusted and, where relevant, why others were left unchanged. This might have required EWS to provide ORR with documents showing what aspects of the model have been scrutinised by EWS and its advisors, and explaining not only why some parts of the model were adjusted but also why others were left unchanged.

C168 Information of this nature is particularly important in the case of revisions to a cost model that EWS had developed and used for its own compliance purposes, which was itself based on another cost model that EWS had been using for two years as part of its commercial decision-making.

C169 To the date of the SO, EWS declined to provide ORR with correspondence between Freshfields and Frontier Economics and between EWS and Frontier Economics relating to the introduction and development of the Frontier model on the basis that it was protected by litigation privilege.

C170 Close scrutiny of the alterations to the model would have been particularly necessary for two reasons:

- (a) First, the alterations constitute *ex post* revisions by a company after it became aware that it was being investigated by a regulator for predatory pricing.
- (b) Second, Mr Israel has given evidence suggesting that it was widely known within EWS, Freshfields and Frontier Economics that the Frontier model was flawed, and that he believes that the flaw “*concerned the cost of the resource base, loco’s [sic], wagons and traincrew costs being **too low***”. (Emphasis added.)<sup>350</sup> If it was felt at the time that the Frontier model *underestimated* costs, one would expect any subsequent revisions to have the effect of identifying higher costs, not lower costs, as suggested by EWS’s revisions.

---

<sup>350</sup>

At paragraph 8.43 of its Response, EWS states that it does not accept that “*Mr Israel was in a position to make an informed statement in relation to the accuracy or otherwise of the Frontier model*” because “*he had very limited opportunity to apply the Frontier model and was not in any way involved in its development or refinement*”. However, as a Coal Market Manager who had used the Frontier model, Mr Israel was in a position to make an informed judgment about the costs of EWS’s coal haulage business and attempts to model those costs. Further, in response to a section 26 notice (of 22 July 2005 [28/307] Mr Israel has responded to non-confidential extracts of EWS’s Response as follows: “*My comments regarding the Frontier model being flawed were as a result of various discussion had been myself, members of the coal team, and in particular a long conversation in Doncaster with Neil Cawood and a member of the Frontier Economics & business team who were on the premises advising us on the usage of the cost model at the time. From memory, the conversation centred around the allocation of variable costs, and it was mentioned to me that this is where the flaw was, but that Frontier were working on putting it right*”. [29/352]

C171 Additionally, ORR understands that the estimates in EWS's revised model are based on certain assumptions that ORR considers to be inappropriate, notably in the area of wagon mix, being based on a [ ... ]% HTA assumption (see paragraphs [C136-160] above).

C172 In the light of the above factors it follows that the revised figures proposed by EWS provide an unreliable measure of costs for the purposes of examining the prices set by EWS for the LEG and UK Coal contracts.

#### *The specific revisions identified by EWS*

C173 It is set out above why it is not appropriate for ORR to base its own cost analysis on the revised cost figures that EWS presents in Tables 11 and 12 of the Response. Nonetheless, in so far as it has been in a position to do so, ORR has considered the various points made at paragraph 8.45 of the Response, in assessing how best to apply the Frontier cost model for its own analysis, the results of which were set out in the section above entitled *Price – cost comparisons*.

C174 ORR has made several amendments to the Frontier model which are consistent with the issues identified by EWS: ORR has corrected the formula error in respect of corporate overheads; it has corrected the way that the Frontier model calculates track access charges, in light of the final charges published by ORR in October 2002; and it has further investigated the payload of HTA wagons and made a change to the assumption in the Frontier model. In each case, notwithstanding EWS's failure to provide a detailed explanation of the nature and rationale for the changes to its cost model, ORR has been able to use its own information or analysis to test the validity of the issue raised by EWS, and to implement an amendment to the Frontier model that could be clearly justified.

C175 More detail on how ORR has used the Frontier model in its calculations of AVC and ATC is provided in Annex K.

### **(b) EWS's criticisms of the evidence relied on by ORR**

#### *The evidence of Mr David Israel*

C176 The ORR relies on the evidence of Mr David Israel, in particular within the section above entitled *The revised cost estimates produced by EWS*. In its Response, EWS made various criticisms of Mr David Israel's evidence. In addition, Mr Israel is now employed by FHH, and ORR is conscious that Mr Israel's evidence could be coloured by the interests of his new employer. ORR has therefore given careful consideration to the evidence and the weight which should be placed on it.

C177 Importantly, the case is not dependent on the evidence of Mr Israel. Mr Israel's statements in response to section 26 notices are merely one piece of evidence amongst many. In particular, Mr Israel's recollections of the thinking and approach of EWS in July and August 2002 are in addition to contemporary documents.

C178 EWS submitted in its Response (paragraph 8.105) that Mr Israel's account of the meeting of the coal team on 31 July 2002 is inaccurate and does not accord with the recollections of the other attendees. Indeed at paragraph 8.99 of the Response, EWS advised that David Israel attended the meeting only by telephone.

C179 However, Mr Israel has refuted the suggestion that he did not attend the meeting in person and has verified this by providing copies of his diary entry for that date along with a copy of his car mileage sheet for the period 30 July to 1 August 2002<sup>351</sup>. ORR has sympathy with his view "*[i]n demonstrating above that EWS have been incorrect with their information in my attending the meeting, must [sic] also question the other coal team member's recollection of the events of that day*".

C180 Moreover the Response is inconsistent with EWS's earlier advice of 19 December 2002 (in response to a section 26 notice of 27 November 2002) that the initials recording attendees "*DP/TB/DW/DI/DY/NC*" which appear on a handwritten note of the meeting<sup>352</sup> refer to **David Purves, Tim Bilby, David White, David Israel, David Young and Neil Cawood**.

C181 Mr Israel's statements are also consistent with the other contemporary documentary evidence relied on by ORR. In particular Mr Israel's statement that Mr Purves indicated at the meeting of 31 July 2002 a re-focus of the coal team on minimising FHH's market share while increasing EWS's share, is consistent with the contemporaneous notes made by Mr Cawood at the 31 July 2002 meeting, called by Mr Purves and Mr Wilson, that EWS's market share was to be recaptured "*through aggressive pricing*" and that there was a need "*to get Freight liner down to 10-11% - currently at 17-20%*", and with the comment in Mr White's e-mail of 1 August 2002 to Mr Purves and Mr Wilson (cited in the section headed *The nature of the evidence available from summer 2002, above*) suggesting that EWS had resolved to meet or beat FHH's prices even if FHH itself introduced price cuts.

C182 Consequently, there is no good reason to disregard the evidence of Mr Israel in relation to the 31 July meeting and it weighs in support of the contemporary documents cited.

C183 Mr Israel's evidence also suggested that instruction as to the strategy to price aggressively came from Mr Mengel (Chief Executive Officer at the time). EWS has denied that any such view was ever held or imparted by its Board and has submitted an account of the meeting between Mr Mengel and Mr Purves (paragraph 8.92-8.94 of its Response) which, it asserts, shows such instruction was not given to Mr Purves. That account acknowledges that there was discussion of the need for EWS to be competitive and that there may have been mention of FHH's market share, but stresses that there was no discussion of any action EWS should take in respect of FHH. As Mr Israel's account of discussions between the EWS Board and Mr Purves are second hand, it is accepted by ORR that it would be inappropriate for ORR to rely solely on this to refute the submissions made by EWS on this point. In the absence of any further evidence, it is acknowledged that the existence of a precise

---

<sup>351</sup> David Israel response dated 18 August 2005 to a section 26 notice of 22 July 2005. [29/352]

<sup>352</sup> Provided at document S3 of documents provided by EWS at the site visit.

direction from Mr Mengel to Mr Purves, as to any strategy to target FHH discussed at the latter meeting, is not established to the requisite legal standard.

### *The evidence of Neil Cawood*

C184 In the section entitled *The views and approach of EWS towards pricing in July and August 2000* above, ORR relies upon a handwritten note of the 31 July 2002 meeting by Neil Cawood. EWS stated in its Response (paragraph 8.105) that Neil Cawood took this note at a time when he had been employed with EWS for just over a week. EWS went on to explain that prior to joining EWS, Mr. Cawood was a trainee accountant at a construction company. EWS maintained that at the time of taking the note, he was therefore unfamiliar with the rail haulage industry, with EWS's business and the majority of the matters that were discussed at the meeting. EWS submitted that the notes reflect his understanding of the discussion at the time and include notes to himself about ideas of his own and things he wanted to ask people about after the meeting had finished.

C185 This explanation is unconvincing and Mr Cawood's notes cannot be rejected for the following reasons.

C186 First, it is highly unlikely that a member of staff recruited at Finance Manager level would inaccurately record the discussion of strategy in respect of basic issues such as customers and competitors, even if he had not previously worked in the relevant market.

C187 Second, in respect of key statistics and policy, Mr Cawood's notes are consistent with the views of senior members of the coal team at the time. This is demonstrated by the later Coal Pricing document<sup>353</sup> drafted by David White for David Purves, attached to an e-mail dated 27 August 2002, in which it is stated that:(i) "[...] *the Executive believes that the Coal Business is too conservative, too cautious, too concerned with protecting (higher) legacy price margins and contract positions and is not aggressive enough in capturing business and limiting FLHH [...]*"; (ii) "[s]o far in 2002 EWS's market share ranges between 80% and 85%..." (this accords with Mr Cawood's note recording FHH's market share as 17-20%); and (ii) that crudely FHH ran "70 trains per week" to LEG out of a total of 130 trains per week (this accords with Mr Cawood's note that LEG accounted for 50% of FHH's business)<sup>354</sup>.

### *The evidence of Mr White*

C188 In the section entitled *The views and approach of EWS towards pricing in July and August 2000* above, ORR relies on two pieces of evidence drafted by Mr White. The first is Mr White's e-mail dated 1 August 2002, following the meeting of the coal

---

<sup>353</sup> Document 70 of documents provided at the site visit.

<sup>354</sup> EWS's estimate that FHH's haulage to LEG accounted for 50% of FHH's business is broadly consistent with ORR's own data which indicates that for the period January-July 2002, Cottam and West Burton accounted for around 43% of FHH's share of ESI tonnages and around 42% of the total market.

team on 31 July. The second is the Coal Pricing paper attached to Mr White's e-mail to Mr Purves of 27 August 2002.

C189 In relation to the 1 August 2002 e-mail, EWS submitted in its Response (paragraph 8.109) that it reflected David White's personal views about possible options that EWS could consider in terms of increasing its revenues and further submitted that the e-mail:

"[...] was put forward for discussion purposes only in response to the request made at the meeting on 31 July 2002 for ideas and suggestions about ways to increase EWS's revenue. It sets out Mr White's view that there were limited opportunities to obtain further business from Powergen, AES Drax and TXU and that LEG represented the best opportunity to obtain new business."

C190 ORR considers, however, that the purpose of Mr White's e-mail of 1 August 2002 was not to set out the detailed final position of EWS, but to explore precisely how to implement the strategy of targeting FHH, and in particular its key customer, through aggressive pricing, and the possible consequences of such implementation. It is, therefore, consistent with the evidence of Mr Cawood and Mr Israel that such a strategy was communicated to the coal team at the 31 July 2002 meeting. It also demonstrates that Mr White was aware at the time that such a strategy carried with it competition law risks and that he communicated his view of those risks to Mr Purves and Mr Wilson.

C191 In relation to the Coal Pricing paper, EWS, at paragraph 8.97 of its Response, submitted that the paper was later redrafted by Mr Purves<sup>355</sup> and the paragraph commencing: "*When I joined EWS in week commencing 15 July [...] limiting FLHH*" was removed because:

"Mr Purves did not consider that the paragraph was necessary in the context of the document, the purpose of which was to discuss the current state of EWS's coal business [...]. He also considered that the paragraph reflected David White's second-hand interpretation of his (Mr Purves') account of his meeting with Mr Mengel and Mr Johnson and his subsequent discussion with Mr Johnson on 7 August 2002 [...] and that it was inaccurate as the words "*limiting FHH*" were never used during the course of any of those discussions".

C192 EWS further argues in its Supplementary Response (at paragraph 8.46) that the first draft of the paper was never subsequently provided to or endorsed by any member of senior management or any member of the EWS Board.

C193 It is noted by ORR that it has seen no contemporaneous record of the discussions at the meetings between Mr Purves and Messers Mengel and Johnson.

---

<sup>355</sup> EWS provided with its Response a copy of document 70, which omits this paragraph. It stated in the covering letter to the Response that this new document constitutes the "final draft" of the Coal Pricing document produced by EWS as Document 70 of the documents provided at the site visit. It further submitted that "[i]t became apparent in the course of preparing EWS's Response that, due to an oversight, this document may not have previously been produced to the ORR".

It is also accepted that there is no evidence that the earlier draft of the Coal Pricing paper was ever seen or approved by EWS' Board or the senior executive team. These matters do not, however, take away from the fact that ORR has inferred from the evidence an intent on the part of certain members of the Coal Team to target FHH in relation to quotes to LEG and UK Coal on flows from Cottam and West Burton developed following the meeting of 31 July.

C194 ORR considers that the Coal Pricing document attached to Mr White's 27 August e-mail is a contemporary document created by a member of the coal team (Mr White was EWS Marketing Manager – Electricity and Coal) and is consistent with the evidence of Mr Cawood and Mr Israel of the 31 July meeting as to the strategy that was to be adopted in respect of FHH.

### **(c) EWS's arguments as to why its pricing cannot be considered abusive**

#### **(c) (i) Pricing between ATC and AVC cannot be considered predatory on this range of routes**

C195 EWS has argued that prices above AVC but below ATC cannot be considered evidence of predatory behaviour because a freight operator typically operates on a range of routes covering different points of origin to the same destination and will “*seek to recover its overheads and capital costs across these routes as a whole but not necessarily equally across each route*” (Response, 8.73(a)). EWS's argument continued that the manner in which overheads and capital costs are “*recovered*” will depend upon the preferences of customers. EWS argued that customers prefer that overheads and capital costs are “*principally recovered on shorter routes*”. EWS concluded that, in a competitive market, some routes would be priced between AVC and ATC.

C196 This argument does not appear to be relevant to the pricing behaviour of EWS that has been analysed above.

C197 For the prices to LEG and UK Coal for coal haulage to Cottam and West Burton, the haulage services to which these prices applied were not individual routes that were part of a wider contract that specified prices across a large number of different routes. EWS offered terms to LEG and UK Coal in August 2002 for coal haulage that did not extend to haulage to any routes other than those considered in the cost analysis above. As far as ORR understands, EWS did not make the transactions for haulage to Cottam and West Burton conditional on the customers' acceptance of any other business. The quotes for the flows in question can be treated as self-standing sales by EWS to LEG and UK Coal. This means that there is no reason to believe that the relevant cost analysis should be undertaken at the level of a wider package of business to LEG or UK Coal rather than the individual flows that ORR has considered.

C198 ORR's cost estimates of AVC, which are grounded on the Frontier model, employ rather a short-term concept of variable costs. This is explained in the sub-section entitled *Treatment of depreciation and consideration of capital costs* in Annex K. In particular, whilst ORR's estimation of AVC includes costs such as fuel, driver wages and rolling stock maintenance expenditure, it does not include any allowance for depreciation or the capital costs of EWS tying up locomotives and wagons

in serving a particular flow. The section above headed *The extent to which EWS's prices were below ATC* explains why, particularly for the LEG contract, the prices set by EWS are in themselves evidence of abuse.

**(c) (ii) EWS was merely engaging in competition to 'meet the market'**

C199 In its Response, EWS argued that the evidence shows only that EWS was engaging in strong but legitimate price competition to meet the market, and that the inevitable consequence of EWS winning business on the basis of such competition, namely that FFH would lose the business, is not evidence of anti-competitive intent.

C200 Specifically, EWS argued that:

- (a) ORR has misconstrued documents showing a desire to engage in strong but legitimate price competition as evidencing exclusionary or predatory intent. (8.56)
- (b) Low prices were quoted "*on the basis of a legitimate belief that they were pricing competitively in order to meet the market*". (8.116)
- (c) Due to the limited number of competing rail hauliers and the absence of competition from road and canal on those particular flows, the almost inevitable consequence of EWS winning business for coal haulage to Cottam and West Burton would be that Freightliner would not haul that particular business. This likely *factual* consequence of EWS legitimately competing for and winning business on those flows does not, however, equate *legally* to evidence of anti-competitive intent where EWS had objective commercial motivations for wanting to compete for and win the business concerned. (8.83)

C201 The mere fact that FHH lost business to EWS is not sufficient evidence that EWS has acted abusively. Dominant undertakings are regularly successful in winning business from their competitors in legitimate circumstances. What matters is not the mere fact that a dominant undertaking has won business, but *how* it won the business. The conduct of a dominant undertaking falls to be assessed in the light of the fact that it bears a special responsibility not to hinder competition that is not incumbent on non-dominant undertakings.

C202 As to EWS's argument that its price cuts were introduced merely to '*meet the market*', the introduction by a dominant undertaking of price cuts to meet competition will in some circumstances be compatible with the competition rules. This may be the case, for example, where a dominant undertaking has previously been pricing significantly above ATC, or where its price reductions follow the introduction of efficiency savings significantly reducing its costs. Meeting the market may also, in some circumstances, provide a good justification for a dominant firming adopting prices between ATC and AVC, particularly where price cuts are introduced "*across the board*".

C203 On the other hand, a desire by a dominant undertaking to win business by matching or beating the price of a competitor cannot in itself negate a finding of abusive intent. Indeed, meeting or beating the market will often be the object of

unlawful predatory prices.

C204 Whether the adoption by a dominant undertaking of prices which meet or beat the market are abusive should be determined in the light of all the circumstances, taking into account, among other things, the market position of the dominant undertaking and its competitors, the likely consequences of the prices for the competitive process, the duration of the prices and the extent to which they are below ATC, whether the price reductions are selective, evidence of the subjective intention of the dominant undertaking, and other evidence as to whether or not the price reductions are consistent with normal competition.

C205 It is explained above why, in the light of all the circumstances, the prices quoted by EWS on the Cottam and West Burton flows were abusive. It is not sufficient for EWS to argue that the prices were necessary in order for it to meet or beat FHH's prices. Indeed, on the circumstances of this case, meeting or beating FHH's prices to LEG through aggressive pricing was a key part of EWS' abusive strategy to limit FHH by selectively targeting its largest customer.

### **(c) (iii) No 'eliminary intent' or possibility of elimination**

C206 EWS argued that "[t]he most that is expressed [in the contemporary documents relied on by the ORR] is a desire to **"recapture lost market share through aggressive pricing"** in order to **"limit"** the extent of business lost to Freightliner. That statement does not suffice to justify an inference of eliminatory intent" (8.59). The implication appears to be that in order for a dominant undertaking to have an abusive intention, it must intend to entirely eliminate an undertaking from a market, and that any lesser intention, such as an intention to bring about a significant reduction in its market share, cannot suffice.

C207 This is not the position under Article 82 and the Chapter II prohibition.

C208 While the case law relating to abusive prices does contain reference to the 'elimination' of a competitor, the courts do not thereby intend to limit the scope and application of competition law in the way suggested by EWS. Precisely what conduct is and is not abusive depends on all the circumstances, including market conditions and the degree of dominance enjoyed by the undertaking under scrutiny. It is not, therefore, possible to specify in the abstract the requirements of Article 82 and/or the Chapter II prohibition in this respect.

C209 At least in some circumstances, it may be abusive for a dominant undertaking deliberately to seek to bring about, through aggressive pricing below ATC, a significant reduction in the market share of a particular competitor, or even to prevent the growth of a competitor by such means. For example, it would be absurd if it were abusive for a dominant undertaking to seek entirely to eliminate a competitor through such means, but was not abusive if the dominant undertaking intended only to reduce the competitor's market share to, say, 1%.

C210 In the circumstances, including the market conditions and the strong position of EWS within it, and for the reasons set out above in the section headed *EWS's abusive intent* it is found that EWS's conduct has been abusive as it was motivated by an intention significantly to reduce FHH's market share and thereby "limit" it

through the selective targeting of aggressive pricing to its key customer, LEG.

C211 Further, the following comments of the Tribunal in *Claymore* are noted:<sup>356</sup>

“The phrase “intention to eliminate a competitor” is not entirely straightforward to interpret, since in one sense any competitor, competing in the market, is striving to eliminate – i.e. to drive out – a less efficient rival competitor. What is meant in our view is conduct on the part of the dominant firm which (i) has the reasonably foreseeable result of driving a rival from the market; (ii) goes beyond a normal competitive response and is disproportionate to the threat; and (iii) has the object or effect of preserving or strengthening a dominant position.”

C212 The Tribunal’s comments indicate that, at least in some circumstances, conduct of a dominant undertaking may be abusive even without a subjective intention to eliminate a competitor, and specifically where the conduct has the reasonably foreseeable risk of driving a rival from the market.

C213 EWS also argues that in “*a market that [...] extends to the whole of Great Britain, it is economically impossible for rates on a relatively small number of routes such as those relied on by the ORR to eliminate Freightliner from the market*” (8.73(b)). This argument is not accepted.

C214 For the reasons set out in the section headed *Appreciable effect on competition* in this part above, it is possible that EWS’s strategy to bring about a significant reduction in FHH’s market share through below cost selective price reductions targeting, in particular, FHH’s main customer, might have caused FHH to consider withdrawing from the market.

### **(c) (iv) Feasibility of recouping of losses**

C215 In its Response EWS argued that its conduct is not abusive because it had no prospect of recoupment, in particular because recoupment would not be possible if FHH remained in the market (8.50).

C216 This argument is not accepted for the following reasons:

- (a) First, in the section headed *Appreciable effect on competition* in this part above it is explained how EWS’s conduct could have affected FHH and the competitive structure of the market.
- (b) Second, the case law clearly indicates that it is not necessary, in order to show an abuse, to prove that the dominant undertaking would or might have been able to recoup its losses.

C217 In particular, in *Tetra Pak II*, the ECJ stated<sup>357</sup>:

---

<sup>356</sup> Case 1008/2/1/02 *Claymore Dairies Limited and Arla Foods UK PLC v Office of Fair Trading* [2005] CAT 30.

“[...] it would not be appropriate, in the circumstances of the present case, to require in addition proof that Tetra Pak had a realistic chance of recouping its losses. It must be possible to penalise predatory pricing whenever there is a risk that competitors will be eliminated. The Court of First Instance found [...] that there was such a risk in this case. The aim pursued, which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors.”

C218 The facts of this case are similar in several respects to those in *Tetra Pak II*. In particular, EWS: (i) was dominant for the period in question with a very high market share; (ii) adopted an abusive strategy targeted against its only existing competitor; and (iii) was responsible for a number of other abuses in the relevant market. In these circumstances, it is not necessary to demonstrate a possibility or likelihood of recoupment in order to prove an abuse.

### **(c) (v) No appreciable effect on competition**

C219 In its Response, EWS advanced various arguments as to why its pricing practices could not have had an appreciable effect on competition.

C220 The specific points raised by EWS are addressed below. More generally, however, EWS's arguments focus on the extent to which the particular arrangements agreed between EWS, LEG and UK Coal in August 2002 had an *actual* effect on the market.

C221 Although relevant to an assessment of whether the conduct had an appreciable effect on competition, this approach is unduly narrow in at least three ways.

- (a) First, it fails to consider *potential* effects.
- (b) Second, it fails to consider the more general pricing strategy agreed on by EWS in late July and early August 2002, described in the section above headed *The views and approach of EWS towards pricing in July and August 2002*.
- (c) Third, it fails to take into account the fact that EWS's pricing practices in August 2002 were part of a consistently abusive course of conduct adopted by EWS over several years, intended to limit and exclude new entry to the market for coal haulage by rail through a variety of means, which also included entering into and extending exclusionary contracts and discriminatory pricing against ECSL.

C222 For the reasons set out in the section headed *Appreciable effect on competition* above, it is clear that EWS's conduct more than satisfies the requirements of Article 82 and the Chapter II prohibition.

---

<sup>357</sup> Case C-333/94 P *Tetra Pak International SA v Commission* [1996] ECR I5951, [1997] 4 CMLR 662, paragraph 44.

*The actual volume of coal hauled under the August 2002 arrangements*

C223 At paragraph 8.161 of its Response, EWS argued that:

“EWS records indicate that total volumes hauled for LEG and UK Coal at the relevant rates in fact totalled only [ ... ] tonnes ([ ... ] tonnes for LEG and [ ... ] tonnes for UK Coal). This represents approximately 26% of the total coal the ORR alleges at paragraph 723 of the Notice [i.e. total tonnage in 2002 to Cottam and West Burton][...]”.

C224 While it may have been the case that ex-post, EWS hauled less for LEG than expected and quoted for ex-ante, this does not undermine a conclusion that EWS’s pricing to LEG and UK contributed to a strategy which had an appreciable effect on competition for the following reasons:

- (a) First, it remains the case that EWS quoted the low rates at the time when its understanding was that volumes would be of the order of [ ... ] million tonnes.
- (b) Second, as recognised by EWS, UK Coal decided to transfer 70,000 tonnes to FHH<sup>358</sup>. As the e-mail from UK Coal makes clear<sup>359</sup> this was as a result of poor performance by EWS. In the absence of such poor performance, there is no reason to believe that the volumes would not have remained with EWS.
- (c) Third, data ORR has used as part of its market share calculations in part I – *Assessment of Dominance*, compiled from submissions from the generating companies, indicates that, in 2002, FHH hauled around [confidential] million tonnes in total. This means that even using the actual volume that EWS reported that it moved under these contracts, it seems that FHH would have lost around a quarter of its annual haulage (at the time of the quotes) due to the below-cost rates offered by EWS to LEG and UK Coal. This reflects a potentially significant impact on FHH. Moreover, and as discussed previously, the importance of the LEG and UK Coal to FHH contracts should be seen in light of the limitations FHH already faced in competing effectively on the market for coal haulage by rail as a result of the long-term contracts EWS held with power generators.

*The alleged limited nature of the arrangements*

C225 At paragraph 8.162 of its Response EWS argued that the rates could not and did not have any anti-competitive effect because the arrangements with LEG and UK

---

<sup>358</sup> See e-mail exchanges of 8 October 2002 at document 120 of documents provided by EWS at the site visit. The revenue implication is stated to be about £[ ... ], which at a rate of £[ ... ] per tonne, implies [ ... ] tonnes.

<sup>359</sup> E-mail from Martin Higgins of UK Coal dated 7 October 2002 (document 120 of documents provided by EWS at the site visit).

Coal to which the rates applied were 'short-term' and over 70% of the business to Cottam and West Burton was contestable.

C226 ORR has not been provided with information to establish that 70% is an appropriate figure. ORR's understanding is that EWS obtains this figure by comparing how much coal EWS carried to Cottam and West Burton at "*the relevant rates*" ([ ... ] tonnes, the Response at paragraph 8.161) against evidence ORR provided at paragraph 723 of the Notice on the total haulage to Cottam and West Burton in the calendar year 2002 ([ ... ] tonnes). However, the LEG contract was for the calendar year 2003, and therefore such a comparison does not show that 70% of haulage to Cottam and West Burton remained contestable once EWS had secured the LEG and UK coal contracts considered in this section.

C227 Moreover, as discussed above, even on the basis of EWS's data for its volume hauled under these contracts, the haulage that FHH lost to EWS represents around a quarter of FHH's total annual haulage at the time of the quotes.

C228 In relation to the short-term nature of the rates it is noted that the arrangements with:

- (a) UK Coal was for a period covering up to four months; and
- (b) LEG was applicable both to coal haulage throughout the calendar year 2003 and also to haulage of specific coal shipments during the latter half of 2002, this business, in particular, cannot be described as "short-term".

C229 With regard to the importance to FHH of the relevant business, even if other business of LEG was also contestable, the amount that it was anticipated would be hauled under the agreement made in August 2002 was considerable, and the loss of this business would have been significant for FHH.

C230 More fundamentally, however, the prices provided to LEG for the Immingham and Redcar flows were only part of EWS's general strategy significantly to reduce FHH's market share through selective aggressive pricing. For example, the 'Coal Pricing' paper, discussed above, stated that EWS "*offered to quote similar prices to London from other local supply points but London declined*". Had EWS's general strategy been successful, including its approach to LEG in respect of other flows, it would plainly have had a very significant impact on FHH. (See also the discussion in the section above headed "*Appreciable effect on competition*").

#### *Reputational effects*

C231 EWS argued that there is no possibility of reputational effects being generated in circumstances such as these (Response, 8.163 and 8.164). This argument is based in part on EWS's assertion that it was merely engaged in "*legitimate price competition*", an assertion addressed and rejected in the sub-section (e) below. EWS's arguments that its prices to LEG and UK Coal were motivated and driven by legitimate considerations. EWS also argued that "*[t]o create anything like the reputational effects alleged by the ORR, EWS would have had to engage in predatory pricing for an extensive period over a series of flows*".

C232 Reputational effects may be established, in particular, where a dominant undertaking is able to introduce discounts that are selective (and therefore more likely to be sustainable) and strike strategically at a competitor, for example by targeting its most important customer. The likelihood of EWS's abusive strategy generating reputational effects is greater still because it forms part of a course of abusive anti-competitive conduct stretching over several years. The argument put forward by EWS is, therefore, not persuasive.

#### *An increase in FHH's market share*

C233 Finally, EWS attempted to argue that because FHH's market share increased over the period in question (i.e. between quarters 3 and 4 of 2002), this further supports its argument of lack of anti-competitive effect. However, the CFI has stated that the pricing practices of a dominant undertaking may be abusive even if the market share of the targeted competitor increases over the period in question, at paragraph 149 of the CFI's judgment in *CMB*), it states:

“[...] the fact that [the competitor's] market share increased does not mean that the practice was without effect, given that, if the practice had not been implemented, [its] market share might have increased more significantly”.

C234 Therefore, the fact that FHH grew between the third and fourth quarters of 2002 (when the exclusionary conduct identified above occurred) is not inconsistent with a finding of abuse. In the absence of the abusive conduct, FHH could have grown by more than it did<sup>360</sup>, not least by being awarded (some or all of) the business which was awarded to EWS as a result of the predatory discounts.

C235 Furthermore, it is important to recognise that only a very short period of time elapsed between EWS's decision to quote very low prices to LEG and the expansion of the scope of ORR's investigation to include consideration of those prices. The LEG prices were offered by EWS on 8 August 2002, and ORR had been investigating EWS under the Competition Act since February 2001 (see *Annex A for a chronology of the case*). ORR received a letter of complaint from FHH dated 19 August 2002, which set out FHH's concerns about below-cost pricing by EWS. EWS was made aware of these concerns before the site visit to EWS's Doncaster premises, which took place on 22 October 2002 and at which ORR obtained various items relating to EWS's pricing in respect of the rates to LEG and UK Coal. It is

---

<sup>360</sup> See the Judgment of the Court of First Instance (First Chamber) of 17 December 2003, in the case of *British Airways plc v Commission*, where the Court states, “[...] *the growth in the market shares of some of BA's airline competitors, which was modest in absolute value having regard to the small size of their original market shares, does not mean that BA's practices had no effect. In the absence of those practices, it may legitimately be considered that the market shares of those competitors would have been able to grow more significantly.*”

Similarly in *JJ Burgess & Sons v OFT*, Case No: 1044/2/1/04 dated 6 July 2005, the Tribunal states, when commenting adversely on a finding by the OFT that the number of cremations able to be carried out by the complainant actually rose during the investigatory period, the Tribunal states “*On the other hand, those figures do not necessarily show what business [the complainant] would have achieved in normal circumstances in the period.[...]*” (paragraph 356).

therefore not possible to see what the full effect of EWS's predatory pricing on FHH would have been had ORR not sought to investigate that pricing.

C236 An analysis of the market shares that evolve following an abuse can provide a misleading picture of whether that conduct risked the elimination of a competitor or had otherwise abusive effects, in circumstances where a competition law investigation is likely, or is in progress. A victim of anti-competitive conduct might continue to operate in a market in the short-term, under an assumption that the enforcement of competition law will, in due course, bring the abusive conduct to an end (e.g. this was clearly the case in *Genzyme*<sup>361</sup>). For this reason, evidence of exactly what happened in the coal haulage by rail market subsequent to August 2002 is insufficient to inform on the risks that EWS's conduct presented to effective competition in that market.

**(c) (vi) EWS's criticisms of the evidence of intent relating to UK Coal**

C237 At paragraph 8.153 of its Response, EWS argued that:

“With the exception of a brief reference to the fact that EWS had won the UK Coal business from the North Nottinghamshire pits at the end of the paper attached to the e-mail from David White to David Purves dated 27 August 2002, none of the documents relied upon by the ORR as evidence of EWS's alleged intent to target and/or eliminate Freightliner in respect of flows to Cottam and West Burton makes any reference to EWS's dealings with UK Coal. EWS denies that any such evidence does exist, or could exist as EWS has never at any stage held such an intention whether in respect of its dealings with UK Coal, LEG or otherwise.”

C238 There is, nonetheless, strong evidence on the basis of which an abusive intent can be inferred in respect of the UK Coal business, summarised as follows:

- (a) The abusive strategy adopted by EWS in late July and August 2002, evidenced by contemporary documents and discussed in the section above headed *The views and approach of EWS towards pricing in July and August 2002*, sought to limit FHH and significantly to reduce its market share. The strategy demanded that EWS target FHH's business generally, and was not limited to targeting LEG.
- (b) The Coal Pricing paper, cited above, confirms that EWS's low quotes to UK Coal were part of this overall abusive strategy. The first page of the paper summarises market conditions, including the breakdown of FHH's business, and notes the Executive's view that the Coal Business is not aggressive enough in capturing business and limiting FHH. It states “*With all these factors in mind the Coal Business has pursued a much more aggressive stance in the last few weeks and has captured business that would otherwise been moved by FLHH*”, and then goes on to refer to both the LEG business and the UK Coal business.

---

<sup>361</sup> Case No:1016/1/1/03, 11 March 2004, Genzyme Limited and The Office of Fair Trading.

- (c) The UK Coal discounts were introduced selectively by EWS and resulted in prices that were well below ATC and provided little, if any, contribution to EWS's significant capital costs. These circumstances also support an inference of abusive intent.

#### **(d) The compliance measures taken by EWS**

C239 At paragraphs 8.117 to 8.119 of its Response, EWS argued that it has “*taken all appropriate steps to ensure it complies with its competition law obligations*” and that “*ORR appears to have overlooked the existence of EWS's competition compliance policies and procedures when concluding that EWS was motivated by widespread anti-competitive intent throughout the relevant period*”. EWS describes its monitoring procedures, including the introduction of the Frontier model, the refinement of a ‘Competition Law Compliance Code’ and ‘Competition Law Guidelines’, competition compliance training of all relevant employees, and the receipt of legal advice in respect of the quoting of haulage rates.

C240 The introduction of a competition law compliance programme cannot, in itself, preclude a finding of abusive conduct. Whether a dominant undertaking has committed an abuse falls to be assessed in all the circumstances. Further, when considering what significance, if any, should be attributed to the fact that an undertaking has introduced a compliance programme, it is necessary to take into account whether the undertaking has taken the necessary steps to ensure its full and effective implementation, at all levels.

C241 A very important consideration here is how EWS's competition law compliance programme operated in July and August 2002, immediately prior to the relevant quotes being provided to LEG and UK Coal for the Cottam and West Burton flows. This is considered in more detail in the section *The analysis undertaken by EWS in respect of quotes to LEG and UK Coal*.

C242 The evidence demonstrates that, at best, the coal team's application of the compliance programme was inadequate and, at worst, that it was deliberately misapplied by members of the coal team in an attempt to justify significant price reductions. In particular:

- (a) The coal team implemented an aggressive pricing strategy designed to strike strategically at EWS's only competitor.
- (b) In several instances the Standard Cost Model was applied by Mr Cawood rather than the Frontier model.
- (c) Mr Purves and Mr White relied on costings that they knew or ought to have known were prepared on a basis that was inconsistent with the terms of EWS's compliance programme and inappropriate for the purpose of a competition law assessment.

C243 In addition, there is evidence that EWS's implementation of its competition law compliance programme was more generally unsatisfactory around this period. In contrast to EWS's claim at paragraph 8.117 of its response that it took “*all appropriate*” compliance measures, including compliance training of all relevant

employees, EWS admits at paragraphs 8.127 and 8.128:

“The Frontier Model had been introduced to the Coal Team in June 2002. However, by July 2002, not everyone in the Coal Team had experience in using it [...]” (8.127)

C244 In July 2002, there was therefore some confusion within the coal team about whether the Frontier Model or the EWS Standard Cost Model should be used when considering particular rates. The Frontier Model was still being phased in and some staff were not fully familiar with how it worked. By July 2002, therefore, not all members of the coal team used that Model.

C245 Other evidence suggests that, at least on occasions, the coal team used the Frontier model for the purpose of creating an historical account of compliance rather than as an operational tool systematically applied to ensure that costs were covered at the time of giving a quote. For example:

- (a) In an e-mail dated 16 September 2002 discussing prices to RWE, David White stated<sup>362</sup>: “*Have you the cost [sic] appropriate cost modelling pls (for the file)?*”; and
- (b) In an internal e-mail of 3 September 2002<sup>363</sup>, when discussing prices to be quoted to Innogy for Killoch-Didcot, James Wilson (General Manager – Coal) stated: “[...] *would prefer to keep Didcot above £[ ... ] after we factor correct costs etc, I am **sure** it will be circa £[ ... ]!!!*” (Emphasis in original.)

C246 In these circumstances, the existence of EWS’s compliance programme is incapable of precluding a finding of abuse, in particular in the light of the positive evidence of abusive intent set out above in the section headed *EWS’s abusive intent*.

#### **(e) EWS’s arguments that its prices to LEG and UK Coal were motivated and driven by legitimate considerations**

C247 The following subsections consider specific arguments by EWS that its prices on the Cottam and West Burton flows were motivated and driven by legitimate commercial considerations other than those identified by ORR. At the outset these arguments of EWS are fatally undermined by its failure to provide supporting evidence.

C248 The best way for EWS to make out such a case would be for it to produce contemporary internal documents showing that its conduct was in fact driven by such a legitimate rationale (*Napp*, paragraph 251). EWS did not do so. Instead, it suggested rationales that are either unsupported by any contemporary documents or attempted to find support for them in the documents relied on by the ORR, which on any plain reading in fact provide strong evidence of an abusive intent.

---

<sup>362</sup> Document 103 of documents obtained at the site visit.

<sup>363</sup> Document 98 of documents obtained at the site visit.

C249 Further, although EWS did, at points in its Response, explicitly or implicitly refer to the views or recollections of members of the EWS coal team and the senior executive, it did not produce witness statements from any such person supported by detailed reference to the contemporary documents.

**(e) (i) The attractiveness of LEG as a customer and securing short term revenue**

C250 EWS argued that its intent behind quoting low prices on the Cottam and West Burton routes was not unlawfully to seek to limit or target Freightliner. Rather, EWS suggests that securing LEG's business was attractive because it would allow EWS "to obtain marginal or short-term revenue" and because LEG "was considered a good credit risk and was one of the few vertically integrated electricity generators that owned its own retail business. As such, it was hedged against movements in electricity prices". (8.106).

C251 These arguments are not accepted.

C252 As noted above, EWS's prices were well below ATC and it has not provided ORR with any contemporary documents that support a conclusion that its quotes were driven by legitimate commercial considerations. The contemporary documents that have been supplied to ORR, considered in the section headed *EWS's abusive intent*, in fact indicate that the real reasons behind EWS's decision to quote low prices on the Cottam and West Burton routes support a finding of abuse.

C253 In respect of the alleged objective of securing additional "revenue" for EWS, ORR notes generally that firms secure additional revenue by securing additional business, at the expense of their rivals, thereby increasing their market share. The fact that a dominant undertaking wishes to secure additional revenue in this way, regardless of whether or not the additional business is profitable, cannot generally act as a justification for adopting methods that depart from normal competitive practices and have the effect of strengthening its dominant position. Were it otherwise, Article 82 and the Chapter II prohibition would be deprived of almost all effect.

C254 The possibility that short-term revenue difficulties might in some circumstances be capable of justifying a dominant undertaking adapting its conduct on the market, cannot be ruled out. However, any such behaviour by a dominant undertaking would also have to be consistent with and proportionate to its special responsibility to avoid hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.

C255 In its Response EWS stated in very general terms that its revenue was falling in 2002 as a result of market conditions and the fact that it had failed to win some business. However, EWS did not provide any detailed explanation of its revenue position in mid-2002, for example, by reference to internal accounting documents indicating a short-term revenue crisis. Nor did EWS attempt to justify how its decision to provide LEG with quotes for greatly reduced prices on the relevant flows and to offer to provide it with similar prices from other local supply points was a proportionate response to any revenue difficulties in the light of its special responsibility as a dominant undertaking.

C256 In respect of the alleged attractiveness of LEG in the light of its vertically integrated nature and the absence of credit issues, these characteristics of LEG were referred to in the Coal Pricing document attached to the e-mail of David White of 27 August 2002. However, as noted above, these characteristics appear from that paper to have been secondary considerations for EWS, as they are referred to only after LEG has been identified as “*the key market*” because it accounted for a large proportion of FHH’s business.

C257 Further, while such characteristics of a potential client might well be relevant to the attractiveness of contracting with it, another very important consideration is the terms, and particularly the price, of the contract. Here, EWS agreed prices with LEG that were significantly below ATC, with the consequence that its haulage for LEG allowed it to make little if any contribution towards its significant capital costs. EWS has not explained why the characteristics of LEG referred to in the Coal Pricing paper were so significant for EWS, or why they justified it entering into an agreement with LEG at such low prices.

**(e) (ii) The analysis undertaken by EWS in respect of quotes to LEG and UK Coal**

C258 In paragraphs 8.120 to 8.152 of its Response EWS summarised the background to its quotation of rates to both LEG and UK Coal and argued that they indicate that EWS had no anti-competitive intent in respect of the prices quoted. Below these arguments are considered in respect of both the LEG and UK Coal quotes.

*EBIT and EBITDAL*

C259 The Response refers to EBIT and EBITDAL. A brief explanation of the relevance of these concepts is required, and is provided below. A fuller explanation of these concepts and their role within EWS’s different cost models is set out in Annex K.

C260 EBIT (earnings before interest and tax) and EBITDAL (earnings before interest, tax, depreciation, amortisation and leasing) are earnings/profitability concepts. For a given set of costs, it is possible to calculate the EBIT and EBITDAL margins (e.g. as a percentage) that a particular price would achieve.

C261 [ ... ]

C262 [ ... ]

C263 [ ... ]<sup>364</sup>.

---

<sup>364</sup> The Standard model also allows the use of the results on EBIT and EBITDAL margins to enable calculation of the prices that would be required in order to achieve a particular percentage margin on EBIT and EBITDAL *for a given mix of different wagon types*. For instance, this can be achieved by using trial and error applications of the model to identify the price that provides a [ ... ]% EBIT margin for HAA wagons and the price that provides a [ ...

C264 In these models the key difference between EBIT and EBITDAL is that depreciation charges (capital consumption) are included in the costs under EBIT but not EBITDAL. Therefore, the same price will always achieve a larger EBITDAL margin than EBIT margin. Put differently, a lower price is required to achieve an EBITDAL margin of  $x\%$  than to achieve an EBIT margin of  $x\%$ .

#### *Prices to LEG*

C265 EWS argued that the background to its quotation of rates to LEG shows that the rates were “*offered in the absence of any anti-competitive intent toward Freightliner*”. (Response, 8.143.)

C266 EWS stated that it had been in discussions with LEG since August 2001 for a [ ... ] month contract to haul coal to its power stations at Cottam and West Burton. Draft contracts had been exchanged containing the “initial prices” set out in Table 20 above. EWS stated that on 19 July 2002 LEG informed it that, in order to win its business, EWS would have to reduce those rates, and that a meeting was arranged for 25 July. EWS stated that it considered that, depending on the volumes involved, the initial rates could be improved upon because “*the contract rates were consistent with rates previously quoted when EWS had very few HTA wagons and paid higher track access charges*”. (Response, 8.125.)

C267 However, EWS stated that, at the 25 July meeting, it offered LEG reduced prices some of which reflected the “*reductions that LEG had indicated would be necessary in order for EWS’s rates to be competitive*”. (Response, 8.126.) EWS further stated that, at that 25 July meeting, LEG indicated that further reductions would be required if EWS were to win the business. (Response, 8.132.) Further reductions were subsequently offered by EWS when it provided its quotes to LEG, initially on 9 August, and formally on 13 August 2002.

C268 It therefore appears that, on EWS’s own case, the main reason for EWS greatly reducing its prices to LEG was in order to win LEG’s business (and not because of cost reductions brought about by its purchase of HTA wagons or changes to track access charges)<sup>365</sup>. It is set out above in the section entitled *EWS’s abusive intent why*, in the circumstances of this case, a desire on the part of EWS to meet or beat FHH’s prices is consistent with a finding of abuse.

C269 The other component of EWS’s argument was that “*the rates to LEG were offered by Mr Purves on the basis of his understanding that a minimum return to EWS of [ ... ]% EBIT was acceptable (which each rate achieved)*” (Response, 8.143.) EWS stated that Mr Purves relied on costings that “*were prepared using the EWS Standard Cost Model and assumed that the contract would be serviced using only HTA wagons*”. (Response, 8.133.)

---

] % EBIT margin on HTA wagons, from which the model can calculate the weighted average price that would bring a [ ... ] % EBIT margin for a mix of HAA and HTA wagons.

365

ORR made its final announcements in respect of the changes to track access charges in October 2001, so by August 2002 EWS had known of the new position for 9 months. EWS does not consider that the significant price reductions to LEG and UK Coal were driven or justified by the changes to track access charges.

C270 EWS seemed to imply in this that Mr Purves had good grounds for considering the prices that he quoted to be ‘acceptable’ from a competition law perspective, and that this indicated that EWS lacked an abusive intent, notwithstanding the evidence of abusive intent discussed in the section headed *EWS’s abusive intent* above.

C271 This argument is not accepted.

C272 Mr Purves relied on Standard Cost Model costings, rather than Frontier model costings, despite the fact that EWS stated in paragraph 8.92(d) of its Response that, in their meeting on 18 July 2002, Mr Mengel (Chief Executive, EWS) had “*stressed [to Mr Purves] that the Coal Team needed to ensure that all rates quoted on spot business were checked against the **Frontier model***” (emphasis added).

C273 The Response referred to and set out (Tables at paragraphs 8.135 and 8.136) only costings based on a wagon mix of [ ... ]% HTA. However, it is not the case that Mr Purves was supplied only with costings based on a [ ... ]% HTA wagon mix.

C274 [ ... ]. One example not relating to the LEG quotes is in the e-mail sent by Neil Cawood to Andrew Martin on 15 August 2002<sup>366</sup>, relating to the Knockshinnoch – Hope Works flow. In it, Neil Cawood uses the Standard Cost Model to generate EBIT and EBITDAL percentages on the basis of the following wagon mix assumptions: (i) [ ... ]% HTA; (ii) [ ... ]% HAA (referred to as MGR Fleet); and (iii) [ ... ]% HTA / [ ... ]% HAA.

C275 Figures calculated on different wagon mix assumptions were also generated by Neil Cawood for Mr Purves, for the purpose of the LEG quotes.

C276 On 7 August at 4.04pm, Neil Cawood sent an e-mail to David Wilson, David White and David Purves containing costings for the Immingham – West Burton flow<sup>367</sup>. EWS stated (Response, 8.133) that these costings were produced using an incorrect mileage, which was the reason that further costings were requested and produced the following day (see below). Nonetheless, Neil Cawood’s 7 August e-mail contained costings based on the following wagon mix assumptions: (i) [ ... ]% HTA; (ii) [ ... ]% HAA; and (iii) [ ... ]% HTA / [ ... ]% HAA.

C277 The Response stated that Mr Purves relied on Neil Cawood’s costings of 8 August and that these assumed that the contract would be serviced using only HTA wagons (8.133). This is not correct. Although the summary tables produced by Neil Cawood provide results only on the basis of a [ ... ]% HTA assumption, he produced some costings also for wagon mix assumptions of [ ... ]% HAA and [ ... ]% HTA / [ ... ]% HAA.

---

<sup>366</sup> Document 7/1214 of Volume 1 of documents provided in October 2005 by EWS in response to the a section 26 Notice dated 17 June 2005.

<sup>367</sup> Documents 40 and 43 of documents provided by EWS at the site visit.

C278 On 8 August Neil Cawood sent two e-mails containing costings, from the Standard Cost Model, for the LEG flows. The first was timed at 9.45am and related to the two Immingham flows<sup>368</sup> and is summarised as follows:

- (a) In respect of the Immingham – Cottam flow, costings were generated on the basis of wagon mix assumptions of: (i) [ ... ]% HTA; (ii) [ ... ]% HAA; and (iii) [ ... ]% HTA / [ ... ]% HAA. The price ultimately quoted by EWS for this flow was £[ ... ]. The costings showed that, on a [ ... ]% HTA assumption, £[ ... ] generated an EBIT margin of [ ... ]%. However, on a [ ... ]% HAA assumption, £[ ... ] generated a negative EBIT of -[ ... ]%. The costings showed that on the basis of a [ ... ]% HTA / [ ... ]% HAA wagon mix assumption the price necessary to achieve an EBIT margin of [ ... ]% was £[ ... ].
- (b) In respect of the Immingham – West Burton flow, costings were generated on the basis of wagon mix assumptions of: (i) [ ... ]% HTA; and (ii) [ ... ]% HAA. The price ultimately quoted by EWS for this flow was £[ ... ]. The costings showed that £[ ... ] failed to achieve an EBIT of [ ... ]% on the basis of a [ ... ]% HAA wagon mix assumption.

C279 The second e-mail was timed at 9.48 am and related to the two Redcar flows<sup>369</sup> and is summarised as follows:

- (a) In respect of the Redcar – Cottam flow, costings were generated on the basis of wagon mix assumptions of: (i) [ ... ]% HTA; (ii) [ ... ]% HAA; and (iii) [ ... ]% HTA / [ ... ]% HAA. The price ultimately quoted by EWS for this flow was £[ ... ]. The costings showed that, on a [ ... ]% HTA assumption, £[ ... ] generated an EBIT margin of [ ... ]%. However, on a [ ... ]% HAA assumption, £[ ... ] generated a negative EBIT of [ ... ]%. The costings showed that on the basis of a [ ... ]% HTA / [ ... ]% HAA wagon mix assumption the price necessary to achieve an EBIT margin of [ ... ]% was £[ ... ].
- (b) In respect of the Redcar – West Burton flow, only [ ... ]% HTA costings appear to have been generated.

C280 At the time of providing LEG with quotes, Mr Purves had therefore been supplied with costings based on various different wagon mix assumptions. In particular, he had been provided with costings (using the correct mileage information) showing that, assuming a wagon mix of [ ... ]% HTA / [ ... ]% HAA, the prices quoted for two of the four flows were significantly below what was required in order to achieve an EBIT of [ ... ]%. He had also been supplied with costings showing that the price quoted for a third flow failed to achieve an EBIT of [ ... ]% on the basis of a [ ... ]% HAA wagon mix.

C281 Further, at this time Mr Purves also knew or ought to have known that he and the rest of the coal team ought not to provide quotes based on a [ ... ]% HTA wagon

---

<sup>368</sup> Document 44 of documents provided by EWS at the site visit.

<sup>369</sup> Document 45 of documents provided by EWS at the site visit.

mix in the light of competition law requirements. Mr White had circulated an e-mail to that effect to the coal team, including Mr Purves, on 29 July 2002. The text of the e-mail is set out above. Mr Purves, therefore, knew or ought to have known that he was providing quotes on a basis that was inconsistent with EWS's compliance program and inappropriate from the perspective of competition law. The suggestion that Mr Purves' reliance on costings for the purpose of providing quotes to LEG in any way supports a conclusion that he or EWS as a company lacked abusive intent is, therefore, rejected.

C282 Moreover, there are other documents dating from after Mr Purves formally quoted the rates to LEG on 13 August suggesting that Mr Purves and members of the coal team were aware that quotes should be prepared by reference to costings based on a mix of HTA and HAA wagons.

C283 EWS provided ORR with what appears to be David Purves' own printout of an e-mail he sent to Richard Plumb of LEG dated 20 August 2002, and which he CCed to James Wilson and David White. The bottom of the e-mail incorporates an earlier e-mail sent by David Purves to Richard Plumb on 13 August 2002<sup>370</sup>, setting out the Cottam and West Burton rates. Alongside the rates quoted to and agreed by LEG, Neil Cawood has hand-written<sup>371</sup> beside each of the rates EBIT and EBITDAL margins on the basis of different wagon mixes. One set of figures is stated to be calculated on a "Pro Rata" basis<sup>372</sup>. The prices stated to be required to achieve an EBIT of [ ... ]% are set out in the table below. For three out of the four flows, the required prices are greater than the price actually quoted and agreed with LEG.

**Table 28. LEG prices compared to Neil Cawood's handwritten "pro rata" targets for LEG flows**

Flow	Price agreed (£)	Price required to secure [ ... ]% EBIT on the basis of Neil Cawood's "Pro Rata" wagon mix (£)
Immingham – Cottam	[ ... ]	[ ... ]
Immingham – West Burton	[ ... ]	[ ... ]
Redcar – Cottam	[ ... ]	[ ... ]
Redcar – West Burton	[ ... ]	[ ... ]

C284 Subsequently, it appears that further costings were prepared by Neil Cawood for the purpose of Mr White's Coal Pricing Paper of 27 August 2002, and were attached to that paper as 'Item 2'.

<sup>370</sup> As is evident from the David White's printout of the 13 August e-mail at document 50 of documents provided by EWS at the site visit.

<sup>371</sup> Originator of manuscript notes confirmed by EWS in its 19 December 2002 response to a section 26 Notice of 27 November 2002.

<sup>372</sup> The bottom of the e-mail contains an annotation as follows: "HTA [ ... ] HAA [ ... ]". However, this is not the wagon mix assumption that has been used to generate the hand-written figures denoted as pro rata. Those figures are calculated on the basis of a [ ... ]% HTA / [ ... ]% HAA wagon mix. This is clearly established by comparison with pages 1 to 4 of document 29 of the EWS Response to a section 26 Notice of 27 November.

C285 Neil Cawood's costings<sup>373</sup> were prepared with the following explanations: "[...] in order to create a record of the final assumptions used and results reached for the flow from Redcar to West Burton" and (more generally in respect of all four flows in question) "[...] in order to create a record for his own purposes of the returns and rates on the assumption that any wagon from the fleet would be used, i.e. taking a weighted average of the fleet."<sup>374</sup> The costings for four different wagon mix assumptions, namely: (i) [...] % HTA; (ii) [...] % HAA; (iii) [...] % HTA / [...] % HAA; and (iv) [...] % HTA / [...] % HAA.

C286 Of particular note is the fact that the costings indicated the prices required on the different flows to achieve an EBIT of [...] % on the basis of wagon mix assumptions of: (i) [...] % HTA / [...] % HAA; and (ii) [...] % HTA / [...] % HAA. The results are set out below, and again indicate that the prices for three of the four flows failed to achieve [...] % EBIT on the basis of either of these two wagon mix assumptions.

**Table 29. LEG prices compared to price targets presented for different wagon mix assumptions in Item 2 attached to the Coal Pricing paper**

Flow	Price agreed (£)	Price required to achieve [...] % EBIT (£) Wagon mix assumes [...] % HTA / [...] % HAA	Price required to achieve [...] % EBIT (£) Wagon mix assumes [...] % HTA / [...] % HAA
Immingham – Cottam	[...]	[...]	[...]
Immingham – West Burton	[...]	[...]	[...]
Redcar – Cottam	[...]	[...]	[...]
Redcar – West Burton	[...]	[...]	[...]

C287 Thus the analysis undertaken by EWS shows that the prices set for the LEG flows were insufficient to achieve the returns required by EWS's own compliance programme.

### *Prices to UK Coal*

C288 In respect of the quotes to UK Coal, EWS argued that in providing the quotes Mr White had regard to a number of factors and that it was these rather than an intent to target FHH which influenced the rates quoted (Response, 8.152). The factors listed by EWS are: (i) the fact that the rate achieved a return of at least [...] % EBITDAL; (ii) the need to price competitively to what it believed to be the prevailing market level at the time; (iii) the need to avoid complaints from UK Coal that EWS was discriminating between imported and indigenous coal in pricing and haulage; (iv) the fact that HTAs could be used on the relevant flows; (v) the

<sup>373</sup> Document 29 of the documents attached to a response by EWS dated 19 December 2002 to an ORR notice of 27 November 2002 is hand-dated "27/8/02" and is confirmed as being the document referred to as 'item 2' in document 70 provided at the site visit.

<sup>374</sup> See Document 72 and 71 of documents provided by EWS at the site visit from the cost data and the explanation of those documents at page 34 of the EWS response dated 19 December 2002 which responds to 9(v) and (w) of a section 26 Notice dated 27 November 2002.

considerable spare capacity available at the time; and (vi) EWS's falling revenues and budgetary pressures.

C289 EWS did not provide any contemporary documents evidencing that these were the considerations taken into account by Mr White, or a statement from Mr White explaining his thinking.

C290 As to each of the factors listed by Mr White, ORR's views in relation to factors (ii) and (vi) are set out in the sections above headed *EWS was merely engaging in competition to meet the market* and *The attractiveness of LEG as a customer and securing short term revenue*.

C291 In relation to factor (v), EWS provided no evidence or detailed explanation of the "*considerable spare capacity*" alleged to exist at the time. Nor did it provide any explanation as to why any such spare capacity justified the prices quoted to UK Coal.

C292 Similarly, in relation to factor (iii), EWS provided no explanation as to why UK Coal would have had good grounds for a discrimination complaint if it had quoted prices to UK Coal higher than those actually quoted (£[ ... ]).

C293 In relation to (iv), it is unclear what point EWS sought to make by stating that Mr White had regard to the fact that "*HTA's could be used on the relevant flows*". The finding that the prices that EWS set to UK Coal were considerably below ATC is not based on an assumption that no HTA wagons could be used on the UK Coal flows, and therefore account has already been taken of the possibility that EWS might have been able to use HTA wagons on these flows. To the extent that EWS's statement reflects a view that the relevant costs for the UK Coal should be calculated on an assumption of [ ... ]% HTA wagons, this point has already been discussed and dismissed in the section above entitled *Arguments relating to the wagon mix assumption*.

C294 In relation to (i), and the fact that Mr White is stated to have had regard to the fact that the rate achieved a return of at least [ ... ]% EBITDAL, evidence cited above indicates that Mr White knew (or at the very least ought to have known) that 15% EBITDAL was not the correct threshold for the purpose of EWS's compliance programme.

C295 On 1 March 2002, an e-mail exchange took place to which the following EWS employees were party: Tim Bilby, David White, David Israel and James Wilson. In relation to costings generated in response to a quote request from AEP, Tim Bilby wrote.<sup>375</sup>

"Self-explanatory. Note until further notice/guidance (from above) to the contrary, our target is now EBITDAL of [ ... ]%".

C296 David White responded as follows:

---

<sup>375</sup> Document R8/194 of Volume 2 of documents provided by EWS in October 2005 in response to a section 26 Notice dated 17 June 2005.

“!!!

Jim – Tim and I have had a chat. Apparently the move from [ ... ]% to [ ... ]% comes from comments made by Chris Tingle that EBIT should be [ ... ]% and that EBITDAL should be [ ... ]%.

I think that in the context of you know what that, although changing our profit target might well be right, the fact that we have been quoting in the ESI market at [ ... ]% looks at best difficult and at worst ...

Would it be worthwhile arranging to brief the Authorities on the potential consequences of decisions taken in a vacuum? Do we need legal advice?”

C297 Consequently, since March 2002 Mr White had been aware that the appropriate targets were [ ... ]% EBIT and [ ... ]% EBITDAL (not [ ... ]% EBITDAL), and was aware that providing quotes satisfying only the (lower) requirement of [ ... ]% EBITDAL might place EWS in legal difficulties.

C298 Subsequently, on 8 August 2002, Neil Cawood circulated an e-mail to the coal team, including Mr White, stating: “*in order to avoid future confusion, we should be using the EBIT percentage when looking at costings*”.<sup>376</sup>

C299 EWS’s claim that when Mr White quoted prices to UK Coal on 22 August 2002 he considered the appropriate target to be [ ... ]% EBITDAL, is, therefore, not credible. The required EBITDAL margin in the Frontier model was a manual input, and it would have been very easy for David White to have ensured that the model calculated a price for an EBITDAL margin of [ ... ]% rather than an EBITDAL margin of [ ... ]%<sup>377</sup>.

C300 EWS states (Response, 8.148):

“Upon receipt of UK Coal’s request, Mr White inserted the variables for each of the three origin points specified by UK Coal to Cottam into the version of the Frontier Model in use at the time. No corresponding exercise was undertaken for West Burton as the distances from UK Coal’s collieries to West Burton were essentially the same as to Cottam”.

C301 For the three Cottam flows Mr White’s costings indicated the price needed to cover AVC, a return on assets of [ ... ]% and the incorrect target of [ ... ]% EBITDAL. These price indications are set out in Table 30 below. Using the version of the Frontier model used by EWS at the time<sup>378</sup>, ORR has also calculated what prices would have been required to achieve the EBITDAL target specified by EWS’s compliance programme, namely [ ... ]% EBITDAL, and those prices are also listed.

---

<sup>376</sup> Document 47 of documents provided by EWS at the site visit.

<sup>377</sup> Note that the Frontier Model is not designed to allow the calculations of EBIT margins.

<sup>378</sup> ORR’s calculations are based on the Frontier model spreadsheets for these flows, received by ORR on 28 October 2002 (electronic versions of document 62 of the site visit). The only change that ORR has made to the spreadsheets received from EWS has been to set the target EBITDAL margin to [ ... ]% rather than [ ... ]%.

The calculations show that the prices for all three Cottam flows failed to achieve [ ... ]% EBITDAL.

**Table 30. UK Coal prices compared against various price targets based on information from EWS and application of the original Frontier model**

Flow	Price	Average variable cost	Price (£) required for [ ... ]% EBITDAL	Price (£) required for [ ... ]% EBITDAL	Price (£) required for [ ... ]% return on assets
Maltby – Cottam	[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Thoresby – Cottam	[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]
Welbeck - Cottam	[ ... ]	[ ... ]	[ ... ]	[ ... ]	[ ... ]

C302 Thus, the prices set by EWS for the UK coal flows were insufficient to achieve the returns required by EWS’s own compliance programme.

#### *Conclusion on legitimate pricing arguments*

C303 EWS has advanced no reliable evidence that the intention behind its low quotes to LEG and UK Coal was anything other than significantly to reduce FHH’s market share through selective aggressive price cuts, in accordance with the strategy, evidenced by contemporaneous documents, agreed within EWS in late July and early August 2002.

C304 EWS’s arguments that the individual employees responsible for providing quotes to LEG had regard to its compliance programme also has to be seen in the light of that agreed strategy, and the other evidence supporting a finding of abusive intent such as the extent to which the prices quoted were below ATC.

C305 The appropriateness of the EBIT and EBITDAL thresholds adopted by EWS’s compliance programme, as the proper and effective application of a compliance programme would not necessarily preclude a finding of abusive intention, in particular if the thresholds adopted in it were inappropriate. The case law has generally analysed allegedly abusive prices in terms of ATC and AVC, and not in terms of concepts such as EBIT and EBITDAL.

C306 However, EWS has not made out such a case. To the contrary, it is plain from the evidence that Mr Purves and Mr White relied on costings that they knew or ought to have known were prepared on a basis that was inconsistent with the terms of EWS’s compliance programme and inappropriate for the purpose of a competition law assessment. In the light of all the evidence, EWS’s suggestion that the steps taken by Mr Purves and Mr White indicate that EWS’s conduct was driven by legitimate considerations is rejected.

#### **Conclusion in relation to the arguments raised in EWS’s response**

C307 For all the reasons set out above the arguments advanced by EWS in its Response do not undermine the conclusion that the prices quoted by EWS to LEG and UK Coal in August 2002 for the Cottam and West Burton flows were

abusive and contrary to Article 82 and the Chapter II prohibition.

## Part D: ORR's proposed action.

---

D1 ORR finds that the conduct of EWS identified above in relation to:

- (a) exclusionary contracts with industrial users of coal;
- (b) discrimination against ECSL; and
- (c) predatory behaviour directed towards FHH

constitute abuses of a dominant position within the meaning of the Chapter II prohibition and Article 82 EC.

### Directions

D2 As provided for under section 33(1) of the Act, ORR may give to EWS, and such other persons as it considers appropriate, such directions as it considers appropriate to bring the infringements to an end.

D3 ORR has found that the agreement, application, maintenance and extension of certain contractual terms are an abuse of EWS's dominant position as set out in part II A, *Exclusionary contracts*.

D4 ORR therefore directs that, within 30 days, EWS and, as appropriate, the other parties to each of the contracts in question, remove or modify the terms identified below from the contracts currently in existence so as to remove their exclusionary effect and/or in the event that any new contracts are concluded to exclude from those contracts any terms capable of achieving the same or similar exclusionary effect to those identified as abusive.

D5 The terms in question are as follows:

- (a) E.ON – Clauses 4.2, 4.3, 5,4 and 6.1 of the contract originally made between Powergen plc (now E.ON) and EWS dated 14 March 1997
- (b) RWE – the elective discount structure set out in Schedule 1(iii) and the accompanying flow tables to the contract originally made between National Power plc (later Innogy and now RWE) and EWS dated 31 March 1998
- (c) AES Drax – Clause 7.3.2 of the contract made between AES Drax Power Limited and EWS dated 12 July 2001
- (c) Corus – Clauses 4.4.1, 4.4.3 and 14.1 of the contract originally concluded between Loadhaul Limited (purchased by EWS) and British Steel plc (later to become Corus) dated 20 September 1995

### Penalties

D6 Section 36(2) of the Act provides that on making a decision that conduct has infringed Article 82 EC or the Chapter II prohibition, ORR may require the

undertaking concerned to pay a penalty in respect of the infringement. The 'undertaking concerned' comprises those legal bodies forming a single economic entity with EWS, namely that entity falling under the ultimate control of English Welsh and Scottish Railway Holding Limited (EW&SRH). No penalty which has been fixed by ORR may exceed 10% of the worldwide turnover of the undertaking calculated in accordance with the provisions of the Competition Act 1998 (Determination of Turnover for Penalties Order) 2000 (as amended by the Competition Act 1998 (Determination of Turnover for Penalties) (Amendment) Order 2004)<sup>379</sup>.

D7 ORR is satisfied that EWS cannot benefit from the provisions of section 40(3) of the Act relating to immunity from penalty where conduct is of minor significance.

### *Intent/Negligence*

D8 ORR may impose a penalty on an undertaking which has infringed Article 82 EC or the Chapter II prohibition only if it is satisfied that the infringement has been committed intentionally or negligently. ORR is not under any obligation to determine specifically whether the conduct was intentional or negligent<sup>380</sup>.

D9 EWS knew or should have known that it held a dominant position in the relevant market. This is reflected in its own assessment of its market power during the relevant period<sup>381</sup>.

D10 With regard to the infringing conduct relating to contracts, EWS had identified a lack of on rail competition as at June/July 2000 and that this absence diminished its customers' negotiating position<sup>382</sup>.

D11 With regard to the infringing conduct relating to discrimination in prices offered to ECSL, an email dated 4 February 2000 from Nigel Jones to Philip Mengel and Allen Johnson in relation to an earlier Joint Venture proposal made by ECSL, Mr Jones refers to EWS's knowledge at the time that it: "[...] [*had*] 100% of the rail market share and 90%+ of the inland coal ESI market"<sup>383</sup>. This indicates that EWS knew that ECSL had no other realistic choice but to contract with EWS for rail haulage services at that time.

---

379 Section 36(8) of the Act and SI 2000/309.

380 Section 36(3) of the Act. Case 1001/1/01 Napp Pharmaceutical Holdings Ltd and Subsidiaries and Director General of Fair Trading [2002] CAT 1.

381 See, for example, the email from William Sunnucks to Nigel Jones of 18 January 2000 cited in the section entitled "(d) *Countervailing buyer power/vertical integration*" in Part I Assessment of Dominance, above.

382 Ibid and the EWS Minerals Business Plan 2000 (cited in the section entitled "(c)(i) *Barriers to entry, Sunk costs – coal wagons*" also in Part I Assessment of Dominance, above), in which EWS records, "[t]here is currently no on-rail competition in this sector".

383 See section entitled "(a) *Market Shares*" in Part I Assessment of Dominance, above.

D12 With regard to the infringing conduct related to predatory pricing, EWS employees were aware of EWS's status as the dominant player in the market and the constraints that this placed upon their employer<sup>384</sup>.

D13 EWS therefore was or should have been aware that it had a dominant position in the market and that the actions it took, as the dominant undertaking, could restrict competition because they involved tying up a significant part of the market for coal haulage by way of contract with exclusionary terms and pricing with a view to making the position of new entrants to its market, namely ECSL and FHH, more difficult. ORR considers that EWS was aware of its special responsibility<sup>385</sup> not to abuse its dominant position. EWS was or should have been aware that the scope of that special responsibility must be assessed by reference to the circumstances of the individual case<sup>386</sup>. The circumstances in EWS's case were that it had, over the relevant period, moved from the position of being the only supplier in the market to occupying a position in which it, whilst falling short of being an outright monopolist, retained a very high market share. The competitive structure of the market was therefore already weak. As such, the applicable case law indicates that particular care had to be exercised by EWS, as the dominant incumbent, not to reduce further the degree of possible competition. ORR considers that EWS either knew or should have known that pursuing exclusionary contracts to tie up a significant proportion of the market and then engaging in targeted exclusionary conduct against ECSL and FHH went beyond an acceptable range of actions for a firm in its position.

D14 ORR considers that, for the purposes of section 36, EWS has, at the very least, negligently engaged in conduct which has been found to infringe the Chapter II prohibition and Article 82.

#### *Calculation of Penalty*

D15 ORR is imposing a penalty on EWS. In accordance with section 38(8) of the Act, ORR must have regard to the guidance on penalties issued under section 38(1) of the Act when setting the amount of the penalty ('the Guidance')<sup>387</sup>. The policy objectives for OFT and concurrent regulators such as ORR in fining are stated in the Guidance to be as follows:

- "To impose penalties on infringing undertakings which reflect the seriousness of the infringement, and

---

<sup>384</sup> See the exchange between Andrew Martin and David White cited in Part IIC in the section headed "*EWS's contemporaneous position on wagon mix*" above and the email from David White to David Purves and James Wilson cited in Part IIC in the section headed "*The views and approach of EWS towards pricing in July and August 2002*" above.

<sup>385</sup> As set out in *Michelin v Commission*, Case 322/81 [1983] ECR 3461, [1985] 1 CMLR 282, paragraph 57.

<sup>386</sup> *C-333/94P Tetra Pak II* [1996] I 5951, paragraph 24; *C-395P CMB* [2000] I 1365, paragraph 114.

<sup>387</sup> OFT 423 OFT's Guidance as to the Appropriate Amount of Penalty, December 2004.

- To ensure that the threat of penalties will deter undertakings from engaging in anti-competitive practices.”

D16 Having regard to the policy objectives set out in the Guidance and having considered the other matters set out below, ORR proposes to fine EWS the sum of £4.1 million. This represents approximately 4% of EWS’s turnover in the relevant market for the financial year to the end of December 2005, which amounted to £97 million. ORR considers that this represents an appropriate figure taking into account the various factors identified as potentially relevant by the framework of the Guidance and its underlying principles.

D17 Following issue of the SO in March 2006 and subsequent to the Supplementary Response, ORR entered into discussions with EWS aimed at expediting the conclusion of ORR’s investigation. EWS agreed that as a result of the significant reduction in the fine that it would otherwise have received (prompted by its co-operation in accepting that it had infringed the Act) and given that ORR did not, having considered EWS’s representations<sup>388</sup>, reach any finding in relation to an EWS Board strategy to exclude any third party from the market or as to the amount of damage that may have been suffered by ECSL or FHH, EWS would accept the three findings of infringement now set out in this Decision.

D18 Had EWS not accepted ORR’s findings shortly after submitting its Supplementary Response, both sides would have been obliged to commit considerable resources to reaching a conclusion in addition to the significant levels that have already been expended. ORR considers it appropriate that the fine should reflect the fact that EWS’s conduct at this stage has allowed for an efficient resolution of the Case. This enables ORR to provide guidance to the industry it regulates as to the kind of behaviour that it is likely to find unacceptable at an earlier stage than would otherwise have been possible.

## Relevant Factors

### *Seriousness of the conduct*

D19 ORR has given consideration to the following factors in assessing the seriousness of EWS’s conduct:

- the type of conduct in question;
- market structure and EWS’s position within that structure; and
- the effect of EWS’s conduct on competitors and consumers.

D20 EWS has sought to argue that the infringing conduct set out above should not be treated as having a particularly serious effect on competition. In particular, it contended that discriminatory pricing and contracts with exclusionary effect have not

---

<sup>388</sup> EWS strongly disputed on the facts that there had been any strategy emanating from the EWS Board and also that there was any evidence that quantified the degree to which FHH or ECSL had been affected by EWS’s conduct.

been found by the OFT or the CAT to be the type of infringements that should be treated as serious for the purposes of assessing an appropriate penalty.

D21 ORR holds, however, that it is appropriate to take account of the fact that, as described within this Decision, there has been a continuum of infringing conduct which amounts to a serious breach of competition law. The case law of the European Court<sup>389</sup> shows that practices involving discrimination and exclusivity agreements can properly be treated as serious along with predation.

D22 The structure of the market for coal haulage by rail is a relevant factor in assessing EWS's conduct. EWS's share of coal haulage by rail between March 2000 and January 2001 was 100% and remained above 90% until November 2001. It remained above 80% from that point until the end of 2002. EWS has argued that the fact that it was not a monopoly supplier during the period of investigation mitigates the seriousness of its conduct, but ORR does not accept that the conduct of a firm in as strong a position as EWS within the relevant market should be viewed with leniency because its position fell short of outright monopoly, given that its position remained very strong, as evidenced by its high market share.

D23 ORR has taken note of the proportion of the market affected directly by the three types of conduct set out above. The contracts together directly affected business that represented around 30% of the market. The discriminatory conduct directly affected to approximately 6% of the market and the proportion was roughly the same for the predation<sup>390</sup>. While ORR can accept that the proportion of the market directly affected by the conduct in question was limited in percentage terms, in all three cases the conduct was aimed at areas of the market that were of strategic importance in terms of maintaining EWS's position of dominance, as set out in Part II A-C, above.

D24 On this issue of materiality, EWS says the predation itself was not significant in that it affected a small percentage of the overall coal haulage for the relevant period and it has not impeded FHH's ability to compete and build market share. The EWS Coal Team has acknowledged that the flows represented a key market for FHH<sup>391</sup> but ORR has no evidence which quantifies the degree to which FHH was affected. ORR considers that the predation was of limited duration over a limited number of flows and FHH did not in fact exit the market.

---

<sup>389</sup> CF Case C-333/94 P Tetra Pak International SA v Commission [1996] ECR I-5951 and Case T-228/97 Irish Sugar v Commission [1999] ECR II-2969.

<sup>390</sup> Market share data for coal haulage by rail was aggregated on a flow-by-flow basis i.e. the annual amount of contracted coal carried between each coal source point and power station in question. The proportion of the total rail coal haulage market covered by each abuse was then calculated by using the annual amount of coal carried on each individual flow within a contract on which each category of abuse took place and *not* the entire amount of coal hauled under each contract.

<sup>391</sup> Cf The draft document prepared by David White and described as the 'Coal Pricing' paper referred to in Part IIC in the section headed 'The views and approach of EWS towards pricing in July and August 2002' above.

D25 Similarly, in relation to the contracts, ORR's view as set out in Part IIA above is that the contemporaneous documents show that EWS considered that the restrictions in the contracts represented an important element of its strategy to retain control over the coal haulage market<sup>392</sup>.

D26 The proportion of the market tied up by pre-existing coal carriage agreements in turn made EWS's conduct in relation to a relatively small section of the market where it faced competitive entry from ECSL and FHH of more significance than would be apparent if only the proportion of the market directly affected by the conduct were considered.

D27 As regards the discriminatory conduct, ORR considers, on the basis of the available evidence, that the contracts to which they related were of importance to ECSL, because they offered to ECSL an opportunity to establish a relationship with the generating companies that might in turn facilitate further entry of competitors for EWS in the coal haulage market<sup>393</sup>. ORR accepts that the proportion of the market directly affected by EWS's actions in offering discriminatory prices to ECSL was small. ORR notes, also, that ECSL's exit from the market cannot be attributed to EWS's conduct and that it has no evidence that quantifies the degree to which ECSL or FHH was affected by EWS's conduct.

D28 ORR is concerned at the reputational<sup>394</sup> effects that can result from a pattern of behaviour such as the one described within this Decision, and how such a pattern of behaviour could impact on competitive entry in the future. It cites in this regard the concerns expressed within contemporaneous documents, of MRL and DRS<sup>395</sup>.

D29 ORR considers it is also appropriate to take into account that while the price of haulage can reasonably be assumed to have some significance for end users<sup>396</sup>, it is not the major component of the end price of delivered coal.

### *Calculation of Penalty*

D30 The OFT Guidance sets out a five-stage approach for assessing the level of the fine to be imposed:

- i. Calculation of the starting point having regard to the seriousness of the infringement and the relevant turnover of the undertaking;
- ii. Adjustment for duration;

---

<sup>392</sup> Cf Part IIA, 'Contemporaneous evidence of EWS's exclusionary strategy' above.

<sup>393</sup> Cf Part IIB, section headed "*Relevant market context*" and "*Evidence of exclusionary intent*", above.

<sup>394</sup> See the section headed '*Reputational Effects*' in Part IIC above.

<sup>395</sup> Cited in the section entitled "*Exclusionary behaviour*" under "(i) *Barriers to entry*" Part I Assessment of Dominance, above.

<sup>396</sup> This is borne out by the rail haulage tenders which did take place over the period and where negotiations clearly took place on the cost of the haul on individual routes.

- iii. Adjustment for other factors;
- iv. Adjustment for further aggravating or mitigating factors; and
- v. Adjustment if the maximum penalty of 10% of the worldwide turnover of the undertaking is exceeded and to avoid double jeopardy.

### *Starting point*

D31 ORR considers that the appropriate starting point for the fine, based on its view at the point at which EWS indicated it would accept ORR's findings, would be in the range of £5.8 - £6.8 million. This is based on ORR's assessment that the appropriate percentage of turnover under Stage 1 of the Guidance, taking into account relevant case law<sup>397</sup> and the facts of the case, should be between 6% and 7%.

### *Duration*

D32 With regard to the duration of the discrimination and the predation, the conduct in question took place over a limited period of time<sup>398</sup>. However, with regard to exclusivity, the contracts were of varying duration with commencement dates between 1995 and 2001. The Corus contract came to an end in September 2003 and the discount scheme in the RWE contract has not been triggered since 2003.

D33 Given the wide variation in duration of the various infringements ORR is satisfied that overall it is not appropriate to adjust the penalty upwards or downwards for duration. The potential effect of a short period of predation has, it should be noted, been considered in relation to an assessment of the seriousness of the infringing conduct as set out above.

### *Other factors*

D34 ORR has considered the following factors were potentially relevant to assessing the appropriate level of fine:

- possible gain by EWS; and
- EWS's profitability.

D35 Consideration can be given to the economic or financial benefit made or likely to be made by the infringing undertaking from the infringement, although the Tribunal in Napp<sup>399</sup> did not take the view that a calculation of the 'gain' should necessarily form the principal means of reaching a deterrent fine in the context of Step 3 of the Guidance.

---

<sup>397</sup> ORR considered in particular the ranges of starting points under Stage 1 of the Guidance applied in Aberdeen Journals, Napp Pharmaceuticals and Genzyme.

<sup>398</sup> See Figure 5 at the end of Part I above.

<sup>399</sup> Op Cit.

D36 The pattern of exclusionary conduct was, in ORR's view, aimed at preserving EWS's position of dominance and it seems likely that some economic or financial benefit could have accrued to it. However, ORR does not consider that any gain EWS might have made from its conduct is sufficiently clear and quantifiable, particularly given the varying nature of the conduct over the relevant period and has not attempted to calculate it.

D37 ORR has also taken into account that the proposed penalty would, even after the discount discussed below, represent around 20% of EWS's profit for the *whole* of its business activities for the financial year ending 2005. ORR therefore considers that no further uplift is necessary to the figure reached under the previous stages, as it reflects sufficiently the seriousness of the infringements and the need to deter.

#### *Aggravating and mitigating factors*

D38 The penalty may also take account of specific aggravating or mitigating circumstances.

D39 A number of possible aggravating factors are set out in the Guidance<sup>400</sup>. One of these is the involvement of senior staff. ORR has considered EWS's representations<sup>401</sup> on this issue carefully. As set out above<sup>402</sup>, ORR has no persuasive evidence that the strategy involving predation emanated from the Senior Executive Team nor has ORR found evidence of endorsement at Board level in relation to any of the infringements. ORR does not consider that there are aggravating factors of this type that would justify an uplift for senior level involvement, given that the figure reached under the previous stages of the assessment of penalty is one which ORR considers both punitive and deterrent.

D40 Also of relevance is evidence that infringements have been committed intentionally rather than negligently. As stated above, ORR considers that EWS must have been negligent at the very least but is not obliged to make a finding as to whether its conduct was intentional or negligent.

D41 As regards co-operation, EWS has rigorously defended its position but has ultimately been prepared to offer a significant act of co-operation in agreeing to accept ORR's findings of infringement in respect of its conduct. ORR considers that a reduction to take account of that step is appropriate as it allows the enforcement process to be concluded more efficiently than would otherwise have been the case. In reaching that conclusion, ORR has taken account of the fact that when admissions of participation in infringements were made by Umbro in the Replica Football Kit case<sup>403</sup>, these were treated by the OFT as a mitigating factor, without criticism or comment when the case went before the Tribunal on appeal.

---

<sup>400</sup> Cf Paragraph 2.15 of the Guidance.

<sup>401</sup> In particular, Paragraphs 3.1-3.12 of EWS's Response.

<sup>402</sup> See, for example, Paragraphs A39, B148, B151, B155, C183 and C193 above.

<sup>403</sup> [Case Ref to OFT decision] and <http://www.catribunal.org.uk/documents/Jdg1021Football190505.pdf>, at Paragraphs 281-333.

D42 ORR's view is that the appropriate degree of reduction should be established by reference to relevant available precedents.

D43 In the aforementioned Replica Kit case, a discount of 40% was given to Umbro for co-operation by way of admissions. In this case, Umbro had not co-operated throughout the investigation but did make admission after the investigation was underway although its application for leniency was not successful. Moreover, Sports Soccer was refused leniency but did receive a 50% discount in recognition of its co-operation throughout and its pro-active stance as a whistleblower.

D44 ORR considers the discounts applied to successful leniency applicants are also instructive. It has therefore had regard to the range of reductions applied in the OFT's Decision on roofing contractors and car park surfacing contracts in England and Scotland<sup>404</sup>. Parties received discounts under the leniency scheme of between 25% and 55% depending on the nature and extent of the co-operation offered.

D45 ORR's view is that, having considered the nature of the co-operation offered by EWS and the relevant precedents referred to above, the appropriate reduction should be in the order of 35% of the penalty. ORR considers that level of discount to be appropriate as EWS's co-operation went beyond the relatively limited assistance that would justify a reduction at the bottom end of the scale but did not amount to the kind of comprehensive admission of liability from the outset of the investigation represented by the upper level of the appropriate discount scale.

D46 As set out above at Paragraph D31, ORR's view at the time EWS opted to accept its findings was that a fine between £5.8 and £6.8 million would be justified by the facts of the case<sup>405</sup>. ORR considers that it would be appropriate to take the midpoint of this range as the figure to which the reduction in respect of EWS's co-operation, should be applied. The midpoint of this range is £6.3 million. Applying a reduction of 35% to £6.3 million produces a figure of £4.1 million.

D47 ORR acknowledges that EWS has presented evidence of compliance measures to avoid breaches of the Act in future. However, ORR does not propose to make a further reduction in respect of such measures as it is not in a position, at this stage, to judge whether these will be effective.

D48 EWS has set out further matters to ORR as relevant to mitigation of the penalty. It has, in particular, referred to the costs incurred and the disruption to its business. ORR does not contest that these have occurred. Such matters are not specifically highlighted as relevant in the Guidance and it is unavoidable that investigations under the Act and Article 82 will cause disruption and expense to the undertaking under investigation. ORR does not consider it appropriate, as a general matter, to make any reduction in respect of such factors. ORR does not, in any event, consider that EWS has been put to unwarranted expense by reason of the nature or scope of the investigation. As such, no reduction in penalty has been given in respect of these factors.

---

404 OFT decision of 23 February 2006.

405 No further adjustment up to this point has been deemed necessary having had regard to the Guidance.

D49 ORR does not accept EWS's contention that the infringements were isolated incidents but rather, as stated above, formed part of a continuum of exclusionary conduct directed at maintaining EWS's high degree of market power.

D50 Further, contrary to arguments made by EWS, ORR does not consider that there could have been any genuine uncertainty on EWS's part as to whether its conduct constituted an infringement of the Act.

D51 EWS has further argued that the fact that it has not previously infringed the Act should be treated as a mitigating factor. ORR does not agree that this should be relevant but rather that the structure of the Guidance envisages this being taken into account, if necessary, when considering aggravating factors. In other words, it can be an aggravating factor for an undertaking to have already breached the Act but undertakings cannot expect to gain credit for having complied with the law in the past. Compliance with the law is expected of all businesses and no special merit for such historic compliance should be accorded for the purposes of calculating the penalty.

*Adjustment to prevent maximum penalty being exceeded and to avoid double jeopardy*

D52 The final amount of any penalty imposed under section 36 of the Act may not exceed ten per cent of the turnover the undertaking calculated in accordance with Competition Act (Determination of Turnover of Penalties) Order<sup>406</sup>. The section 36(8) turnover is not restricted to the turnover in the relevant product market and relevant geographic market.

D53 The amount of the penalty calculated by reference to the factors set out above does not exceed the section 36(8) turnover of EWS and no further adjustments are necessary.

### **Level of Penalty**

D54 ORR requires EWS to pay it a penalty of £4.1 million in respect of the infringements set out in Part II above. The penalty is required to be paid into the Consolidated Fund within 3 months of the issuing this decision.

D55 If EWS fails to pay the penalty within the deadline specified above, and has not brought an appeal against the imposition or amount of the penalty within the time allowed or such an appeal has been made and determined, ORR can commence proceedings to recover the required outstanding amount as a civil debt.

---

<sup>406</sup> Section 36(8) of the Act and SI 2000/309.

# Annex A: Chronology of the Case

Date	
1 February 2001	Complaint made to the OFT by ECSL
20 February 2001	Jurisdiction for investigation of the case transferred to the Office of the Rail Regulator
11 May 2001	1 <sup>st</sup> section 26 notice sent to EWS
24 May 2001	Meeting with EWS
24 May 2001	2 <sup>nd</sup> section 26 notice in respect of GM Parts Credit sent to EWS
20 June 2001	EWS partial response to 1 <sup>st</sup> section 26 notice
12 July 2001	EWS response to 2 <sup>nd</sup> section 26 notice
12 July 2001	Meeting with EWS
10 August 2001	3 <sup>rd</sup> section 26 notice to EWS
10 August 2001	1 <sup>st</sup> (complainant) section 26 notice to FHH and ECSL
7 September 2001	Partial response by EWS to 3 <sup>rd</sup> section 26 notice
11 October 2001	ORR letter to EWS requesting further information and clarification of previous responses
19 October 2001	Response by EWS to 11 October 2001 letter
21 November 2001	ORR letter to EWS further to EWS's response of 19 October 2001
20 December 2001	Response by EWS to ORR letter of 21 November 2001
19 March 2002	4 <sup>th</sup> section 26 notice to EWS
20 March 2002	2 <sup>nd</sup> 26 notice to FHH
20 March 2002	1 <sup>st</sup> section 26 (third party) notices to third parties including UK generators
26 March 2002	Meeting with EWS
12 April 2002	Letter from EWS in respect of 4 <sup>th</sup> section 26 notice
23 April 2002	Further letter from EWS in respect of 4 <sup>th</sup> section 26 notice
26 April 2002	ORR response to EWS letters of 12 and 23 April 2002
10 May 2002	EWS partial response to 4 <sup>th</sup> section 26 notice
24 May 2002	EWS further response to 4 <sup>th</sup> section 26 notice
19 August 2002	FHH make a further complaint
20 September 2002	ORR letter to third parties including UK generators further to 1 <sup>st</sup> (third party) section 26 notice
25 September 2002	ORR letter to EWS pursuant to EWS responses to 4 <sup>th</sup> section 26 notice
4 October 2002	EWS partial response to ORR letter of 25 September 2002
16 October 2002	Meeting with EWS
16 October 2002	ORR letter to EWS in response to EWS letter of 4 October 2002, in which ORR request further searches of archived e-mails
17 October 2002	Notices of entry of premises (at Doncaster and London) without a warrant under section 27 of the Competition Act 1998 issued to EWS in respect of the FHH complaint of 19 August 2002 (Notice of entry of London premises later withdrawn)
18 October 2002	EWS letter in response to section 27 notices
18 October 2002	ORR letter requiring documents to be available at the site visit
21 October 2002	ORR letter to EWS in response to its letter of 18 October 2002

21 October 2002	EWS letter of 21 October 2002 requesting clarification of documents required in ORR letter of 18 October 2002
22 October 2002	Visit to EWS premises at Doncaster
25 October 2002	Letter from EWS pursuant to site visit
25 October 2002	Holding response from ORR in response to EWS letter of 25 October 2002
25 October 2002	EWS response to ORR letter of 16 October 2002 proposing options for searching archived e-mails
1 November 2002	EWS further response to ORR letter of 25 September 2002
5 November 2002	ORR response to EWS letter of 25 October 2002 providing key words for archived e-mail search
27 November 2002	ORR letter to FHH asking for further information and clarification
27 November 2002	5 <sup>th</sup> section 26 notice to EWS pursuant to site visit
4 December 2002	EWS further response to ORR letter of 25 September 2002
6 December 2002	EWS partial response to 5 <sup>th</sup> section 26 notice
19 December 2002	EWS further response to 5 <sup>th</sup> section 26 notice
19 December 2002	ORR further letter to FHH seeking further information and clarification
20 December 2002	ORR 2 <sup>nd</sup> letter to third parties including UK generators further to 1 <sup>st</sup> (third party) section 26 notice
20 December 2002	ORR response to EWS letter of 1 November 2002 also requesting further information
5 February 2003	EWS letter in response to ORR letter of 20 December 2002
18 March 2003	1 <sup>st</sup> section 26 notice to International Power
30 April 2003	Section 26 notices to SCCL
8 May 2003	Section 26 notice to Fastline
5 August 2003	Section 26 notice to Max Crosland (ex-employee of EME)
22 September 2003	Section 26 notice to David Israel (ex-employee of EWS)
6 May 2004	Issue of rule 14 Notice (Response required by 7 September 2004, extended by EWS request until 2 November 2004)
28 May 2004	Provision of non-confidential copy of Notice to FHH
5 August 2004	Provision of non-confidential copy of Notice to E.ON and RWE
17 August 2004	Provision of non-confidential copy of Notice to AES Drax and Corus
5 October 2004	Meeting with RWE
2 November 2004	Response by EWS Representations by E.ON and RWE
28 February 2005	Letter to EWS regarding application of Articles 81 and 82 of the EC Treaty
4 March 2005	EWS response to 28 February letter
18 March 2005	ORR letter to EWS requesting confirmation on whether or not EWS wished to exercise its right to an oral hearing and further clarification requested regarding the application of Articles 81/82
28 March 2005	ORR information request to Network Rail
1 April 2005	EWS response to ORR letter of 18 March 2005 withdrawing from right to oral hearing
7 April 2005	Response by Network Rail to e-mail request of 28 March 2005
14 April 2005	ORR letter to EWS asking that it reconsider its position regarding an oral hearing and pursuing clarity on EWS's view on the application of Articles 81/82
15 April 2005	ORR information request to FHH

20 April 2005	EWS response to ORR letter of 14 April 2005 confirming that no requirement for an oral hearing
24 April 2005	Response by EWS to ORR letter of 14 April 2005
29 April 2005	FHH provided with a non-confidential version of the EWS Response
3 May 2005	ORR letter to EWS requesting clarification of certain matters within EWS Response (in lieu of an oral hearing) including a request for the production of documents by way of the Frontier Model
11 May 2005	EWS response to ORR information request of 3 May 2005, requesting that the letter be framed by way of a section 26 notice and indicating that it considered documents (namely communications between Freshfields and Frontier Economics, and between EWS and Frontier Economics) to be protected by litigation privilege (this claim made without prejudice to any claim for legal advice privilege that may also exist)
16 May 2005	ORR letter informing EWS of intention to issue section 26 notice with revised deadline of 3 June 2005
17 May 2005	FHH representations regarding the ORR notice and the EWS response; and FHH response to ORR information request of 15 April 2005
17 May 2005	6 <sup>th</sup> section 26 notice. With covering letter providing the basis for this information requirement and challenging the claim to litigation privilege. An extension granted for provision of Frontier documents until 10 June 2005 – extended until 7 days after the resolution of the matter, by recourse to the court if necessary
27 May 2005	Section 26 notices to FHH and RWE
27 May 2005	Fastline invited to comment on non-confidential parts of the EWS Response
25 May 2005	EWS response regarding the 6 <sup>th</sup> notice with particular regard to documents relating to the Frontier Model.
27 May 2005	ORR response to EWS letter of 25 May regarding the provision of documents relating to the Frontier Model
31 May 2005	EWS response to ORR letter of 25 May regarding the provision of documents relating to the Frontier Model
2 June 2005	ORR response to EWS letter of 31 May regarding the provision of documents relating to the Frontier Model
3 and 8 June 2005	EWS response to ORR letter of 2 June regarding the provision of documents relating to the Frontier Model
8 June 2005	ORR response to EWS letter of 3 June regarding the provision of documents relating to the Frontier Model
8 June 2005	ORR e-mail information request to FHH
9 June 2005	Response by FHH to e-mail information request of 8 June 2005
10 June 2005	FHH response to section 26 notice of 27 May 2005
13 June 2005	RWE e-mail response to ORR section 26 notice of 27 May 2005
13 June 2005	EWS response to ORR letter of 10 June regarding the provision of documents relating to the Frontier Model
17 June 2005	7 <sup>th</sup> section 26 notice, providing reformulated request relating to documents regarding the Frontier Model. Extension requested and granted until 5 September 2005
17 June 2005	ORR information request to RWE requesting clarification of response of 13 June 2005
23 June 2005	EWS response to ORR notice of 17 June regarding the provision of documents relating to the Frontier Model
23 June 2005	Fastline representations regarding non-confidential extracts of the EWS Response provided on 27 May 2005

29 June 2005	ORR response to EWS letter of 23 June regarding the provision of documents relating to the Frontier Model
1 July 2005	RWE response to 17 June request for clarification
4 July 2005	EWS response to ORR letter of 29 June 2005 regarding the provision of documents relating to the Frontier Model
5 July 2005	ORR response to EWS letter of 4 July 2005 regarding the provision of documents relating to the Frontier Model
6 July 2005	EWS response to ORR letter of 5 July 2005 regarding the provision of documents relating to the Frontier Model; and letter from EWS asking views on search tools to be used in relation to documents required in the 7 <sup>th</sup> notice
8 July 2005	EWS response to ORR letters of 29 June and 5 July 2005 regarding the disclosure of certain documents falling within request 7(i) of the 7 <sup>th</sup> notice
12 July 2005	E-mail from ORR (referring to EWS letter of 4 July 2005) asking whether general guidance, instructions or information regarding pricing was given to the coal team by Frontier Economics or Freshfields
13 July 2005	EWS response to ORR e-mail of 12 July 2005 and request for confirmation of search terms proposed in 6 July 2005 letter to ORR
13 July 2005	ORR resend letter dated 7 July 2005 (previous letter lost in transit) which responds to 6 July 2005 letter on search terms and individuals
15 July 2005	ORR letter adding further search terms to its response of 13 July 2005. Extension for response requested and given until 12 September 2005
15 July 2005	EWS response to 13 July 2005 letter on search terms
18 July 2005	ORR information request of RWE asking for clarity on data previously provided
19 July 2005	ORR response to EWS letter of 15 July 2005 – time for responding to the 7 <sup>th</sup> notice now extended until 20 September 2005
21 July 2005	EWS response to ORR letter of 19 July 2005 and ORR's further letter of 15 July 2005
22 July 2005	Section 26 notice to David Israel (ex-employee of EWS)
26 July 2005	ORR response to EWS's letters of 15 and 21 July 2005
27 July 2005	EWS response to 26 July 2005 letter
29 July 2005	RWE response to the ORR information request of 18 July 2005
1 August 2005	EWS draft JR pleadings on privilege matters
2 August 2005	ORR comments and response to 27 July and 1 August 2005 letters confirming that ORR will not require documents over which EWS claims privilege by 20 September 2005
4 August 2005	EWS response to ORR letter of 2 August 2005, providing further submissions on the requirement for an extension to the 20 September 2005 deadline
5 August 2005	ORR response to 4 August 2005 suggesting that further discussion regarding an extension take place early in September
9 August 2005	EWS response to letter of 5 August 2005 agreeing to pend further discussion until September
15 August 2005	ORR acknowledgement of 9 August 2005 letter
18 August 2005	Response by David Israel to section 26 notice of 22 July 2005
26 August 2005	ORR letter to David Israel advising him of general agenda for the forthcoming meeting
1 September 2005	EWS request for extension to 20 September 2005 deadline for response to 7 <sup>th</sup> Notice
2 September 2005	Meeting with David Israel

6 September 2005	ORR response to 1 September 2005 asking for further details about the process of the document search
7 September 2005	Freshfields respond on behalf of EWS asking for an interim extension while they respond to 6 September letter
7 September 2005	ORR responds confirming interim extension of one week
7 September 2005	ORR e-mail request to RWE for clarity on data provided previously and further to RWE response of 29 July 2005
8 September 2005	RWE e-mail response to ORR information request of 7 September 2005
9 September 2005	EWS provides details of steps taken in securing compliance with the 7 <sup>th</sup> Notice in support of a request for an extension
14 September 2005	ORR grants extension until 18 October 2005
16 September 2005	EWS provides hard copy and locally saved documents in response to 7 <sup>th</sup> Notice
20 September 2005	EWS letter regarding Freshfields review of e-mails and attachments
26 September 2005	ORR confirms receipt of documents
10 October 2005	EWS provides a batch of e-mails and documents in completion of its response to the 7 <sup>th</sup> Notice
30 January 2006	ORR information requests to FHH, Corus, E.ON, Drax and RWE by e-mail relating to effect on trade for the purposes of the application of Article 82
31 January 2006	ORR information requests to SSE by e-mail relating to effect on trade for the purposes of the application of Article 82
31 January 2006	Response from FHH to 31 January 2006 information request
1 February 2006	Response from RWE to 31 January 2006 information request
7 February 2006	Response from Corus to 31 January 2006 information request
15 February 2006	Response from E.ON to 31 January 2006 information request
14 March 2006	Supplementary Statement of Objections (SO) issued to EWS
	Non-confidential versions of the SO provided to FHH, E.ON, RWE, Corus, BE and Drax
22 May 2006	RWE response to non-confidential version of the SO
24 May 2006	BE response to non-confidential version of the SO
31 May 2006	Corus and Drax response to non-confidential version of the SO
5 June 2006	FHH, E.ON response to non-confidential version of the SO
20 June 2006	EWS response to the SO (the Supplementary Response)

# Annex B: Becoming a Rail Freight Operator within Great Britain

---

## Obtaining a licence and safety case to operate trains

1. Section 6 of the Railways Act makes it an offence to be the [operator](#) of a [railway asset](#) without a licence or a [licence exemption](#)<sup>1</sup>. A licence granted under the Railways Act is, therefore, an authorisation to operate railway assets. It sets out the conditions with which an operator must comply to obtain and retain its authorisation and also sets out the circumstances which might lead to revocation. The conditions of a licence will vary depending upon the activity for which application for a licence has been made, but in each licence there is an obligation to obtain and to maintain an appropriate level of insurance and to enter into an industry agreement for the allocation and handling of claims (“CAHA”). In the network licence and the licence issued to applicants who wish to operate trains there is an obligation to comply with Railway Group Standards<sup>23</sup>. Each licence holder must also pay an annual fee to ORR which is based on turnover arising from the licensed activities.

2. The time taken to receive a licence from ORR varies<sup>4</sup> and very much depends upon the quality of the original application. The applicant will also have to have appropriate insurance cover, and have that cover approved. The consideration of a licence application by ORR also includes a statutory 28 day consultation period, whereby ORR posts a notice on the ORR website that it is minded to grant a licence to the applicant. The process of issue may be delayed, therefore, by representations made to that consultation. A licence is not granted until the applicant has achieved the appropriate level of insurance and that cover has been approved and he has entered into industry arrangements such as CAHA. ORR also requires notification from the HSE that the safety case has been approved<sup>5</sup>.

---

<sup>1</sup> A licence exemption has not to date been considered appropriate for the operation of a train on the Network Rail network

<sup>2</sup> Railway Group Standards means technical standards with which railway assets or equipment used on or as part of railway assets must conform; and operating procedures with which the operators of railway assets must comply

<sup>3</sup> With effect from 1 April 1993 the Railway Group Standards condition has been replaced in train operator licences with a condition which obliges the license holder to be a member of the Railway Safety and Standards Body

<sup>4</sup> Merlin Rail applied for railway safety case in May 2001, certificate of acceptance issued in May 2002. Application for operating licence made in January 2002, passenger operating licence issued in July 2002; Advenza applied for railway safety case in August 2001, certificate of acceptance issued in May 2002. Application for non-passenger operating licence made in March 2002, licence not yet issued

<sup>5</sup> This continued to be the case during the relevant period. The Railways Act 2005, which achieved Royal Assent on 7 April 2005, however, transfers responsibility for rail-specific health and safety regulation from the HSC/E to ORR

3. ORR expects to grant a licence within four weeks of receiving notification that the applicant has made the appropriate industry arrangements, outlined above. The time taken for the grant of a licence from application, however, will very much depend upon the knowledge and familiarity of industry procedures by the applicant and his access to finance. Published guidance by ORR on the licensing of operators of railway assets<sup>6</sup> indicates that a licence can be issued within 16 weeks of application. This is possible if the application itself is complete, a safety case has been issued and the applicant has addressed all the remaining requirements of the licence including industry wide agreements and insurance. In practice, however, putting those arrangements in place takes much longer than that. The critical factor in progressing a licence is in fact the procurement of the necessary safety case. The timescales for this generally determine the time frame for obtaining an operating licence.

4. Obtaining a safety case for train operation can take around 12 months to achieve even for an experienced train operator who wishes to establish a separate licensed operation (which Freightliner Limited did when it established FHH for entry into the bulk freight market). This is evidenced by other applications for train operation. Merlin Rail applied for a railway safety case in May 2001 and received its certificate of acceptance in May 2002. Advenza applied for a safety case in August 2001 and its certificate of acceptance was issued in May 2002.

5. Each application for a licence must be accompanied by a small application fee<sup>7</sup> of £250. There are also ongoing costs such as an annual licence fee which is levied to fund the activities of the ORR<sup>8</sup>. This is calculated by reference to turnover on licensed activities such that larger operators make a greater contribution to the work of regulation. An operator as large as EWS could pay in the region of £½ million, whereas a smaller operator less than £20,000.

6. There are other costs associated with the various licence conditions; for example, the premium required to purchase third party liability insurance (cover is £155 million - the current standard). Fastline, a potential new freight train operator, advised<sup>9</sup> that a tentative approach to its brokers on the type of work proposed and the number of locomotives, received a quote of an additional annual premium in the region of £½ million over and above that which it pays for its current activities as a rail contractor. Other examples of costs include the costs involved in becoming a signatory to CAHA and in reaching an agreement with the British Transport Police ("BTP"). The fee for CAHA<sup>10</sup> is based on the fee set by the ORR for the licence.

---

<sup>6</sup> Guidance on Licensing of Operators Of Railway Assets, Third Edition, September 1995 (to be revised)

<sup>7</sup> Prescribed in the Railways (Licence Application) Regulations 1994

<sup>8</sup> This remained as a requirement throughout the relevant period, however, from 1 April 2006, the full costs of economic regulation are borne by Network Rail. There is, however, now a requirement to pay a safety levy to fund ORR's health and safety activities

<sup>9</sup> Fastline response dated 19 June 2003 to a section 26 notice of 8 May 2003 [16/1538/4.6]

<sup>10</sup> Information gathered from a telephone conversation with a Mr Larry Walker of Crawfords and Company, the CAHA Registrar of 29 May 2003 [17/595.01 - .02]

The fee for the services of the BTP<sup>11</sup> is based on the size and characteristic of the activities of the undertaking – for the financial year ending 31 March 2003 EWS was liable for a fee in excess of £1,000,000, whereas a smaller operator's fee could be closer to £1,000.

7. The procurement of a safety case also incurs a cost for the potential operator of trains and can be in the region of £20-25k. Fastline has advised<sup>12</sup> that there is the additional project cost involved in reviewing an existing, or establishing a new, safety case which in its experience involved the employment of internal and external specialists.

### **Obtaining rights to operate trains on the UK rail network**

8. Before a train operator may run a service on Network Rail's infrastructure, he requires rights to have access to the track. An operator gains rights to operate trains on the network by virtue of entering into a track access contract<sup>13</sup> with Network Rail. Under the Railways Act, train operators may only enter into a contract giving them permission to use Network Rail's infrastructure, if ORR so directs. Hence, proposed contracts that have been negotiated by train operators and Network Rail require the approval of ORR under section 18 of the Railways Act as do subsequent amendments under section 22. Without this approval the contract has no effect in law. ORR gives that approval by issuing directions to Network Rail to enter into the submitted contract with or without modifications proposed by ORR<sup>14</sup>.

9. When ORR decides that access is to be granted and the form in which it is to be granted, it issues directions to Network Rail to enter into the contract in question. Under section 144 of the Railways Act, it is a statutory duty of a person to whom directions are given to comply with them. ORR expects to take a minimum of 18 weeks to reach and publish its conclusions on an application for a new or significantly amended contract and a minimum of 12 weeks for a simpler application with little potential impact on the rest of the network<sup>15</sup>.

10. Before submission to ORR, however, there can be a lengthy and time consuming negotiation between Network Rail and the train operator, sometimes taking over a year from initial contact between the parties. This process of negotiation between Network Rail and the train operator may be short circuited, however, should agreement fail to be reached, by a submission being made by the train operator to ORR under section 17 of the Railways Act (in the case of a new

---

11 Information gathered from a telephone conversation with a Mr Richard Hemmings at the British Transport Police of 2 June 2003 [17/595.01-02]

12 Fastline response dated 19 June 2003 to a section 26 notice of 8 May 2003 [16/1538/4.10]

13 Commonly referred to as an access contract during the negotiation, once the Regulator has issued his directions, these contracts become access agreements. References in this document are all to access contracts and proposed access contracts, unless specifically concerning contracts already directed by ORR

14 ORR may also reject an application

15 Criteria and procedures for the approval of freight track access contracts: second edition, March 2004

contract) and section 22A of the Railways Act (in the case of extensions to the services of an existing contract) asking ORR to direct Network Rail to enter into a new or amended contract. Schedule 4 of the Railways Act establishes certain mandatory elements of the process for such applications including some minimum fixed timescales. Article 30 of Directive 2001/14/EC<sup>16</sup> also requires ORR to make his decision on such applications within two months of receipt of the final piece of relevant information, which will usually be from the end of a consultation period or the end of a hearing. It is unlikely, however, that ORR would reach a final decision in a shorter time than that taken for the approval of applications under sections 18 and 22 of the Railways Act as described previously.

### *Provision of timetable slots*

11. The track access contract sets out what rights the train operator has to access the track, expressed in terms of an entitlement to have specified train slots incorporated in the compilation of the railway timetable in order to operate a train service or train services over a defined part of the network, within specific times, subject to a defined amount of flex<sup>17</sup>. These rights are known as firm contractual rights (“FCRs”) and should Network Rail not be able to honour them by accommodating those rights within the timetable, compensation would be due to the operator<sup>18</sup>.

12. Access rights expressed in contracts are converted into seasonal working timetable slots by means of a bidding process whereby in an annual cycle train operators make bids to Network Rail to accommodate those services which they wish to run during the following summer and succeeding winter timetable periods. The planning cycle is a long one and generally if an operator wishes to have first priority bidding rights in respect of new services it wishes to operate, for example, in the Summer 2006 timetable, it will need to be in a position to bid for the necessary train slots in Summer 2005. Given that only FCRs receive high priority in establishing a timetable slot it is desirable to have an approved contract prior to making a bid. Thus working backwards from the Priority Date<sup>19</sup> relevant to the timetable period in which the train service is intended to be run and taking account of the time taken for ORR to approve a proposed track access contract, a submission would generally need to be made to ORR for approval approximately 18 months prior to the service being run, to ensure priority for the service during that bidding process.

---

<sup>16</sup> To be implemented into domestic legislation by way of *The Railways Infrastructure (Access and Management) Regulations 2005*, in consultation June 2005

<sup>17</sup> Flex is the term used in an access contract to describe the flexibility or freedom on Network Rail to allocate train paths within a timing envelope, usually expressed in minutes. Thus a train operator may require a 10:00 (+/-15 minute) slot from a stated destination which Network Rail may then place within the timetable between 09:45 and 10:15

<sup>18</sup> This is separate to any compensation or penalty which may arise out of performance failure or cancellation of trains which are accepted by Network Rail and are granted timetable slots

<sup>19</sup> That is the date bidders must notify their rights to Network Rail

13. The operator may make a bid for timetable slots without benefit of an approved access contract. However, such a bid will not be given priority and will be accommodated (if possible and if there is sufficient network capacity) only after all other compliant<sup>20</sup> bids have been accommodated. That service will not be run until regulatory approval is secured.

#### *Short term access*

14. In recognition that, unlike passenger service providers, freight operators may not be able to plan their business needs 18 months in advance and moreover may win business and wish to operate trains with relatively short notice, ORR established STAGA (“Short Term Access General Approval”) in 1995<sup>21</sup>. STAGA gives a general approval for freight train operators to amend their existing agreements to incorporate, as and when required, short term rights sufficient for them to fulfil end-customer requirements at least in the short term. The terms of the approval are that, given certain conditions are fulfilled, the train operator may make a bid for a timetable slot for a period not exceeding 56 days, at any time during the timetable planning cycle. It is anticipated that during this period either short-term business will fall away or longer-term access rights will be sought. Thus, within the terms of STAGA, a freight operator can bid for spare capacity on the network midway through a timetable period, allowing it to run trains prior to agreeing longer-term firm contractual rights with Network Rail. These short term planning (“STP”) rights are essentially the residuum – those train slots for which other operators with firm contractual rights have declined to bid or excess capacity for which there exists no contractual right.

### **Obtaining the appropriate equipment and resources to become a train operator within the UK**

#### *Locomotives*

15. A provider of rail freight haulage services will need a suitable locomotive. Given that electric locomotives can only be used on electrified routes which account for less than 25% of the UK network, diesel locomotives are more popular with a prospective freight operator as they will ensure capability for a wide range of services. Coal trains typically weigh in excess of 1,100 tonnes, requiring a locomotive with a high power rating and a high starting tractive effect (“TE”)<sup>22</sup>, though not necessarily the ability to travel at high speed. It is theoretically possible to provide haulage services with older locomotive stock and entry into freight haulage has occurred following the purchase and refurbishment<sup>23</sup> of the Class 20 and Class

---

<sup>20</sup> A compliant bid is that which is consistent with the rights of the bidder under an access agreement

<sup>21</sup> Short Term Track Access (Freight) General Approval 1995, 1995 No 1. Came into force 11 May 1995

<sup>22</sup> TE is defined in kN (kilonewtons) and defines the ability of a locomotive to start heavy trains, as opposed to the horsepower which defines the rate at which a locomotive can maintain progress against the rolling, aerodynamic and gradient resistance of the trailing load

<sup>23</sup> By companies such as Brush Traction, Wabtec and Adtranz

37<sup>24</sup> locomotive by DRS. Freightliner also ran part of its container haulage business with the refurbished Class 57<sup>25</sup>. Access to second hand locomotive stock is, however, limited and is dependent upon release by existing operators. Indeed, even on release, these locomotives are sometimes little more than empty shells as it is common practice for a redundant locomotive to be used as a source of spare parts to keep other similar locomotives functional.

16. EWS acquired a significant number of diesel locomotives existing within the UK when it acquired the UK freight businesses following privatisation of British Rail. The EWS fleet at 31 March 1998<sup>26</sup> stood at 927 locomotives available for use on the national network, with circa 25% of that fleet capable of hauling coal<sup>27</sup>. In contrast, during that same period, MRL managed 8 Class 59 locomotives<sup>28</sup> and Freightliner owned fewer than 100 mainline locomotives, with limited capability to provide the full range of coal haulage services<sup>29</sup>. The new General Motors (Canada) ("GM Motors") Class 66 locomotive was introduced onto the UK network by EWS in 1998 and is capable of hauling coal. By end 2005, EWS owned 250 locomotives of that class, Freightliner Limited around 100<sup>30</sup> with just over 70 allocated to the heavy haul business and GBRf, 17<sup>31</sup>.

17. New locomotive purchase for freight operating companies can be via a leasing arrangement with a Rolling Stock Leasing Company ("ROSCO"). EWS and Freightliner entered into a direct purchase arrangement with GM Motors for the Class 66, however, subsequently funded that deal by means of a leasing arrangement with Angel Trains Limited, in the case of EWS, and with Porterbrook, in the case of Freightliner. GBRf has leased its Class 66 locomotives from HSBC Rail. DRS signed a leasing deal with Porterbrook and Fastline held discussions with a leasing company.

18. Adam Cunliffe of FHH has stated<sup>32</sup> that, "*in providing reliable diesel traction the Class 66 was really the only game in town.*". Further he has advised that because the tooling already exists for that class, the design specification stage only

---

24 Both the Class 37 and Class 20 are probably not suitable for coal traffic due to their power rating. It is possible to use multiple units but this increases the cost of the operation

25 2450hp main line diesel locomotive, refurbished from a class 47

26 Following the 1997 purchase of RfD and the 1998 acquisition of the National Power rail business

27 Information gathered from data provided by EWS in compliance with obligations contained within its operating licences

28 Operationally capable of hauling coal

29 Freightliner does own class 47 locomotives which capable of Merry Go Round ("MGR") traffic of shorter configuration running short distances direct from coal source to power station. The class 47 would not, however, be suitable for the full configuration of coal wagons running for long distances with a significant gradient

30 <http://www.freightliner.co.uk/heavyhaul/equipment.asp> and <http://www.freightliner.co.uk/heavyhaul/pooldetails.asp> (as at September 2005) [28/290]

31 [www.firstgroup.com/corpfirst/company/railfreight](http://www.firstgroup.com/corpfirst/company/railfreight) (as at 4 July 2005) [27/273H]

32 Meeting with Adam Cunliffe of FHH dated 28 June 2001 [22/2080.1]

takes in the region of 4 months with a further 6-8 months to final delivery. Depending on current orders at the plant and available capacity, an order can be fulfilled within 10-12 months. This has been confirmed by Fastline, a potential new freight train operator during the relevant period, who provided tenders from leasing companies which indicated a 10-12 month lead time for delivery of the locomotives<sup>33</sup>. FHH negotiated a purchase price<sup>34</sup> for the first batch of 37 locomotives at approximately £m[...] per unit<sup>35</sup>. This was subsequently financed by a leasing deal with Porterbrook at a monthly rental per unit of £[...] over [...] years and of £[...] over [...] years<sup>36</sup>. A letter dated 26 November 1999 from GBRf to SCCL<sup>37</sup> also referred to a potential purchase price of the Class 66 locomotive of £1.6m.

19. Fastline provided tender documentation from ROSCOs<sup>38</sup> that illustrate a range of lease periods for locomotive provision from 3 to 15 years.

**Table 1. Leasing company terms for locomotive lease**

Leasing company	3 years	5 years	7 years	10 years	15 years
Porterbrook <sup>39</sup>	£[...]	£[...]	£[...]	£[...]	£[...]
HSBC <sup>40</sup>	£[...]	£[...]	£[...]	£[...]	£[...]
GE Capital <sup>41</sup>	n/a	n/a	n/a	£[...]	£[...]

\* all rates are per month and exclude maintenance provision<sup>42</sup>. The omitted figures within the Table above fall within a range of £[...]-£[...] per month, with charges declining with lease period.

<sup>33</sup> Porterbrook response to tender dated 20 December 2002 refers to a contract award date of 1 June 2003 and a delivery period of April 2004 – the Fastline response dated 18 June 2003 to a section 26 notice of 8 May 2003[1538/18]

<sup>34</sup> Table supplied by Adam Cunliffe at the meeting with him on 28 June 2001[1/96.2 – redacted in entirety for confidentiality]

<sup>35</sup> Fluctuations in the price of the unit in part was contributed to by the \$ exchange rate over the period May 1999 to December 2000

<sup>36</sup> The FHH response of 29 April 2002 to a section 26 notice of 20 March 2002 [5/302/28]

<sup>37</sup> A letter in relation to a proposed grant submission to the Scottish Executive, provided by GBRf in its response of 3 May 2002 to a section 26 notice of 20 March 2002 [5/309/10]

<sup>38</sup> Porterbrook response to tender dated 20 December 2002 refers to lease terms of 3, 5, 7, 10 and 15 years (the Fastline response dated 18 June 2003 to a section 26 notice of 8 May 2003). [16/1538/18]. Similarly a tender response from HSBC provides lease terms of the same duration (the Fastline response dated 18 June 2003 to a section 26 notice of 8 May 2003) [16/1538/19.4]

<sup>39</sup> Information provided in a tender response dated 20 December 2002 the Fastline response of 18 June 2003 to a section 26 notice of 8 May 2003. Relates to the provision of [confidential] class 66 locomotives [16/1538/18.2]

<sup>40</sup> Information provided in an undated tender response of the Fastline response of 18 June 2003 to a section 26 notice of 8 May 2003. Relates to the provision of [...]class 66 locomotives [16/1538/19.2]

<sup>41</sup> Information provided in a tender response dated 23 December 2002, provided in the Fastline response of 18 June 2003 to a section 26 notice of 8 May 2003. Relates to the provision of [confidential]class 66 locomotives [16/1538/20.1]

20. A freight train operator advised that it considered a 3 year lease term would minimise the risk attached to entry into the market for coal haulage by rail given that power generators traditionally operate on shorter-term coal supply contracts, typically up to a maximum of 2 years. Thus a 3-year leasing deal would potentially match the underlying business.

### *Wagons*

21. Any entrant into provision of coal haulage by rail, also needs to secure access to suitable wagons. Access to such wagons as a potential barrier to supply-side substitution and entry is discussed in more detail in part I of this SO. The wagons used to transport coal are generally of the “hopper wagon” variety, typically used for carrying bulk solids such as coal and aggregate. Coal wagons allow bottom discharge of the product sometimes automatically while the train passes over bunkers and storage facilities. Older coal wagons are sometimes referred to generically as “MGRs”, which refers to the “Merry Go Round”<sup>43</sup> method of operation.

22. The coal hopper is a highly integrated wagon with facilities for loading/unloading coal at pits/power stations, for example, automatic locking/unlocking mechanisms, all designed to fit in with the ‘merry-go round’ system of coal delivery. This is a highly efficient way of handling coal, in particular, given the large-scale power stations that predominate in coal-fired electricity generation.

23. The hoppers themselves are manufactured to a higher quality than other wagons (for example with high quality steel interiors to cater for coal handling qualities such as its stickiness) to ensure smooth/efficient unloading. This investment is only economical on the basis of large-scale usage and where the capital costs can be defrayed over a long time period. Thus although in theory coal hoppers could be used for moving other bulks such as aggregates this is unlikely to be cost effective particularly given their over specification for other uses.

---

<sup>42</sup> ORR has been advised by [...] that maintenance costs for a new locomotive are likely to be in the region of £52,000 in Year 1, £57,000 in Year 2 and £89,000 in Year 3. ORR has also been advised that HSBC imposes a maintenance reserve payment as part of the lease rental agreement. This additional monthly payment covers the future value of major overhaul engineering works on the locomotive at the end of the leasing period. This is to mitigate a potential problem whereby HSBC cannot offer an attractive future lease deal nearing the time of a planned major overhaul. The maintenance reserve rental paid in the early part of the locomotive life (assumed as 30 years) would be used to charge a credit fund for later years to offset increased maintenance burden. This could amount to an additional £2k per month

<sup>43</sup> Merry-go-round coal refers to coal that has been transported using the Merry-go-round (MGR) method. This method of train operations was created to maximise the benefits of transporting coal over rail by treating the train (rather than the wagons) as the transport unit. The MGR concept comprises of: (1) A permanently coupled train of fully air-braked hopper wagons; (2) Rapid coal loading while passing at half a mile an hour under a large storage hopper at each colliery, with each wagon being automatically weighed before and after; and (3) Automatic discharge and weighing while passing over the power station's receiving hopper, located on a circular loop to avoid uncoupling the locomotive. The MGR system allows a huge reduction in the requirement for locomotives, wagons, train crew, ground staff and land for sidings, making rail traffic competitive even over short distances

24. The coal wagon types (and ownership thereof) registered for use on the UK rail infrastructure for the haulage of coal within the UK, as at June 2003, are listed in the Table below:

**Table 2. Coal wagon ownership within the UK**

	<b>Train operating Company</b>	<b>Leasing Company where appropriate</b>	<b>Number of operational wagons registered</b>	<b>Deregistered or Condemned (non-operational)</b>
HAA 33.5 tonne capacity	EWS	n/a	2559	29
HBA 32.8 tonne capacity	EWS	n/a	213	0
HCA 32-32.5 tonne capacity	EWS	n/a	50	10
HDA 32.8 tonne capacity	EWS	n/a	207	0
HEA 33 tonne capacity	EWS	n/a	551	55
HFA 32.2 tonne capacity	EWS	n/a	502	0
HMA 33.5 tonne capacity	EWS	n/a	1113	0
HNA 32.6 tonne capacity	EWS	n/a	51	0
HTA* 74.9 tonne capacity	EWS	Porterbrook	845	0
		GE Capital Rail Services	300	0
JMA 75 tonne capacity	EWS	n/a	85	0
	<b><u>Total Operational EWS</u></b>		<b>6476</b>	
HHA 74 tonne capacity	Freightliner	n/a	54	0
		Porterbrook	242	8
		HSBC	54	0
	<b><u>Total operational Freightliner</u></b>		<b>350</b>	

Data source: the Network Rail Rolling Stock Library ("RSL")<sup>44</sup>, June 2003

25. In the same way that EWS acquired the vast majority of diesel locomotives at purchase of the UK freight companies at privatisation, it also acquired a significant quantity of the wagon stock. At 31 March 1998 following acquisition of RfD and the

<sup>44</sup> The Network Rail Rolling Stock Library is currently managed by SchlumbergerSEMA. Data provided in an e-mail from SEMA dated 10 June 2003 [17/1627] requested by e-mail on 5 June 2003[17/1610]

National Power rail business, EWS owned 24,022 wagons<sup>45</sup>, 6674 of which were coal hoppers. By the end of the financial year 2001, (at the time when FHH was actively competing within the coal haulage market with a total number of wagons of between 127 and 200 out of a total order of 350<sup>46</sup>), EWS's wagon fleet stood at 21,428<sup>47</sup> which included 6,441 coal hoppers. In January 2001 EWS also took delivery<sup>48</sup> of the first batch of a £50 million order for 845 new coal wagons<sup>49</sup> which it placed with Thrall Europa in York, UK.

### *New build wagons*

26. A train operator considering entering into the business for coal haulage may purchase new build wagons and in order to finance that deal could enter into a leasing arrangement with a rolling stock leasing company. FHH has, for example, purchased wagons from Greenbrier in Poland and has financed this purchase with a lease back arrangement with Porterbrook and HSBC. Issues concerning lead times from purchase to final delivery and the suitability of new rolling stock for some traffic and routes are considered below in the supply-side substitution section of the product market definition.

### *Engineering and route acceptance (locomotives and wagons)*

27. Before a rail vehicle (e.g. a locomotive or wagon) can be operated on Network Rail's infrastructure it must have been registered with the Rolling Stock Library ("RSL"). In the case of new or modified vehicles, registration is conditional on the demonstration by the vehicle operator that any risks to safety have been controlled. This, in simple terms, involves showing that the vehicle complies with all relevant Railway Group Standards ("RGS") and that it fits within the loading gauge of those routes over which it will operate. The overall acceptance process is controlled by Network Rail's Rolling Stock Acceptance Body ("RSAB").

28. Assessment of compliance with RGS is known as engineering acceptance and is carried out by third parties: Vehicle Acceptance Bodies ("VABs"). EWS is itself a VAB offering services to itself and third parties. The process of checking that a vehicle fits within the loading gauge of a route is known as route acceptance and is undertaken by Network Rail itself. Route acceptance involves demonstrating that the vehicle, when operating at its designed capability (essentially defined by speed and load) will clear all lineside structures (overbridges, tunnels, platforms etc.) by a

---

<sup>45</sup> Information provided by EWS in compliance with data obligation requirements within its operating licences

<sup>46</sup> FHH response dated 8 January 2003 to an ORR letter of 27 November 2002 [22/2075.8]. The wagons arrived in batches, by September 2001 – 14 months after the initial order – FHH had taken delivery of 127 units, with completion of the order for a total of 350 wagons expected by February 2003. By February 2002 it had taken delivery of a total of 200

<sup>47</sup> Mainly due to disposal of old stock

<sup>48</sup> [www.ews-railway.co.uk/pages/displaynews.php3?storyid](http://www.ews-railway.co.uk/pages/displaynews.php3?storyid) (news story 10/06/2002, "EWS announces final stage of £200 million rail freight wagon order") [23/2177]

<sup>49</sup> Delivered in batches of 10 per week with effect from January 2001. This order formed part of a total order which EWS placed with Thrall Europa for 2,500 wagons of different types [23/2177]

safe margin. In the case of electric locomotives this process will also include showing that the locomotive does not electrically interfere with signalling and telecommunications systems.

29. The acceptance process is most commonly of a generic vehicle type, which will lead to acceptance being granted for a whole fleet, although each individual vehicle will require a construction conformance certificate, which is issued as part of the engineering acceptance process, and which effectively releases the vehicle onto the RSL (providing fleet approvals are complete).

30. A freight train operator who wishes to have the capability to operate a network of services within the UK will wish to have equipment that can be operated over a wide range of routes. This issue will be addressed at the design stage by specifying vehicles whose dimensions (axle load and overall size) can be accommodated by the vast majority of routes. Some form of trade off may be required between the maximisation of vehicle capability over the majority of routes and restriction over a number of routes where particular structures limit axle load (e.g. weak underbridges) or vehicle size (e.g. overbridges). However, it may be possible for vehicles to operate over restricted routes by the adoption of operating restrictions such as loading vehicles below their capability or imposing speed restrictions. Clearly, utilising assets at less than optimum capability, however, will have an impact on cost efficiency.

31. EWS has estimated the total acceptance costs of introducing a new class of locomotive (in this case the Class 66) onto the UK network to be in the region of £[ ... ]<sup>50</sup>. FHH has advised<sup>51</sup> that the costs to it of introducing the re-engineered Class 57<sup>52</sup> onto the UK network in co-operation with Brush Traction to be between £60,000-£80,000.

32. For follow on orders of the same type of vehicle, the same process has to be gone through. However, if the vehicle is the same as previous orders, then all that is required is to be able to demonstrate to each of the acceptance bodies that the previous evidence gathered remains valid. An exception to this would be, for example, where an RGS had changed in the meantime. Where the vehicle has been modified in some way only the changed items would need to undergo the full acceptance process. FHH has advised<sup>53</sup> that it used the services of EWS at its facility at Newport for the checking and acceptance of its order of Class 66 locomotives at the charge of £7,000 per locomotive.

---

<sup>50</sup> EWS response dated 7 September 2001 (attached by fax from Freshfields) [2/140(a).2] a section 26 notice of 10 August 2001. This assessment of costs includes early design scrutiny costs by EWS, GM motors and commissioned consultants, and the internal resource costs of commissioning and running the project, including managing the contract with GM Motors

<sup>51</sup> FHH response dated 7 September 2001 to a section 26 notice of 10 August 2001. Includes the cost of a project engineer and ad hoc consultancy. Excluded the cost of design scrutiny and ride trials etc which FHH has stated are commonly accepted by the manufacturer [22/2076.11]

<sup>52</sup> The re-engineered class 47 locomotive

<sup>53</sup> In the FHH response dated 7 September 2001 to a section 26 notice of 10 August 2001[22/2076.9]

## Drivers

33. In order to operate a train on a particular route, the potential freight train operator must ensure that it has drivers with relevant route knowledge, which includes knowledge of the characteristics of the route itself<sup>54</sup> and who have the necessary route handling ability<sup>55</sup>. FHH advised<sup>56</sup>, “[i]t is completely critical to have drivers trained on routes as FHH secures new business. To utilise drivers on a particular route with[out] [sic] route learning would be a material breach of our safety case and not something we would ever consider under any circumstance whatsoever.”

34. If recruiting a driver who is already familiar with the relevant rolling stock, training him to haul coal on a new route could take as little as 2 months and is unlikely to take in excess of 6 months. Such route knowledge is generally learned by sitting in the cab of a train operating on that route. In this case, to learn the route by this method would most likely entail sitting in the cab of a rival company, and although this does happen, the incentives on the rival company to cooperate with their competitor’s need to learn the route would be minimal.

35. However, alternative methods of training are available. A press release by EWS in January 2002<sup>57</sup> referred to the recruitment and training of 144 new drivers, which it expected to train over the next 12 months. In support of that training programme EWS reported an investment of £500,000 in a new Class 66 driver simulator. The use of appropriate video, simulator training and classroom teaching may in some circumstances reduce the amount of time required within a cab. In some circumstances, where the routes to be learned are only short stretches within sidings, drivers sometimes learn the route by walking. Fastline has been provided with a quote from Catalis Rail Training<sup>58</sup> dated 27 May 2003 for the recruitment, assessment and training of [confidential [number]] drivers, at a total cost of around £180,000.

---

<sup>54</sup> The lay out of the track including the location of signals, points and line restrictions

<sup>55</sup> The ability to handle a train of the required characteristics on the new route

<sup>56</sup> FHH response dated 8 January 2003 to an ORR information request of 27 November 2002 [22/2075.7]

<sup>57</sup> [www.ews-railway.co.uk](http://www.ews-railway.co.uk) (“EWS to recruit more than 140 new train drivers in 2002”, press release 28 January 2002)

<sup>58</sup> “Proposal for the Provision of Recruitment and Assessment and Training for Jarvis” prepared for Jarvis rail in May 2003 provided in Fastline response of 18 June 2003 to a section 26 notice of 8 May 2003 [16/1538/4B.15]

# Annex C: Coal supply within the UK

---

## Indigenous coal

1. UK Coal, the largest UK coal producer, operates deep mines at Harworth<sup>59</sup>, Thoresby and Welbeck in Nottinghamshire, Rossington<sup>60</sup> in Doncaster, Daw Mill in Warwickshire, Ellington in Northumberland<sup>61</sup>, Kellingley in North Yorkshire, Maltby in Yorkshire. Its Prince of Wales colliery closed in August 2002, Clipstone Colliery ceased production in April 2003 and the Selby mine complex in Yorkshire closed in October 2004<sup>62</sup>. Following the March 2002 closure of its deep mine at Longannet, the entire output of SCCL is mined from opencast mine sites within the Fife and Ayrshire coalfields.

2. There are also a number of smaller deep mine undertakings including Goitre Tower Anthracite Limited who acquired the rail-connected Tower colliery in South Wales (its output of anthracite feeds Aberthaw power station and other non-ESI markets), Coalpower Limited who acquired Hatfield Colliery in Yorkshire in October 2001<sup>63</sup>, also rail connected, Blenkinsopp Collieries Limited who acquired Castle Drift Mine in Northumberland<sup>64</sup>, Betws Anthracite Limited who acquired Betws colliery<sup>65</sup> in Carmarthenshire, Hay Royds Colliery in Yorkshire owned by Hayroyds Colliery LLP and in production at 31 March 2006, Blaentillery Colliery, owned by Blaentillery Mining Ltd in Torfaen, Eckington Colliery, owned by Eckington Colliery Partnerships in Derbyshire, Nanthir Colliery, owned by M & W A Anthracite Ltd in Neath, Port Talbot and Aberpergwm Colliery, owned by Energybuild in Glyn Neath..

3. Open cast sites tend to be small in size and have a limited life and generally they are not rail connected<sup>66</sup>. Disposal points have been established to where coal from open cast operations is brought by road and stocked. Disposal points which are rail connected and in operation over the period included Butterwell in Northumberland, Wardley in Durham, Oxcroft in Derbyshire, Rufford in Nottinghamshire and Killoch, Knockshinnoch and Ravenstruther in Ayrshire. The open cast sector contains a group of operators, including Celtic Energy Ltd, SCCL, LAW Mining, H J Banks & Company Ltd and ATH Resources operating a portfolio of

---

<sup>59</sup> Mothballed in June 2006 - <http://Miranda.hemsscott.com>

<sup>60</sup> Ceased production in March 2006 - (<http://Miranda.hemsscott.com>)

<sup>61</sup> Not rail connected – ceased production in January 2005

<sup>62</sup> All coal produced at Wistow, Riccall, Stillingfleet and Whitemoor are brought to the surface at the rail connected Gascoigne Wood. The Selby complex closed on 26 October 2004 [http://miranda.hemsscott.com/ir/ukc/pdf/press/2004\\_10\\_26\\_production\\_ends\\_at\\_selby\\_coalfield.pdf](http://miranda.hemsscott.com/ir/ukc/pdf/press/2004_10_26_production_ends_at_selby_coalfield.pdf)

<sup>63</sup> Went into administration on 3 December 2003, closed in January 2004 (DUKES 2005)

<sup>64</sup> Closed August 2002

<sup>65</sup> Closed August 2003

<sup>66</sup> A notable exception is the Garleffan site operated by LAW mining

small open cast sites. As at 22 April 2003 there were 48 opencast sites in production<sup>67</sup>, 39 at 29 March 2004 and 35 as at 31 March 2006<sup>68</sup>.

4. A paper produced by EWS<sup>69</sup> in 2000, as well as referring to the two larger indigenous producers at that time of UK Coal (then RJB Mining) and SCCL, also refers to “a number of smaller, principally opencast, producers” and describes them as set out in Table 1.

**Table 1. EWS summary of the mining sector beyond RJB Mining, and SCCL, using rail for haulage of its output in 2000**

ATH	operate a large site at Skares Road in Ayrshire. The site has an annual production of 600kt. Nearly all of this is currently contracted to npower, EWS delivers this coal to Drax (AES) power station in Yorkshire. The coal is loaded at Scottish Coal's Killoch facility.
H J Banks	is one of the larger opencast producers with sites throughout the North East, Midlands and Scotland. EWS is currently working with HJ Banks at four sites: Doe Hill House, Renishaw, Woolley and Watsonhead. The annual tonnage moved by rail is in the region of 500kt contracted to npower and Scottish Power.
Hatfield Colliery	is one of the few smaller producers to operate a deep mine. This is situated in South Yorkshire with production of around 500kt per annum. Around 250kt is supplied to the power station market – both npower and Powergen.
LAW Mining	operates opencast sites in Scotland and currently despatching from 2 sites in Ayrshire to both npower and Powergen. Dispatches are at the rate of 3/400kt per annum. Powergen and npower usually sell the coal on to AES at Drax and Edison Mission at Fiddlers Ferry. Coal is loaded from Ayr Harbour and Killoch.
Miller Mining	operate one opencast site in Ayrshire with coal being loaded from Scottish Coal's Knockshinnoch facility. Tonnages are contracted to Scottish and Southern and TXU. The coal flows to Longannet and Drakelow at the rate of 200kt per annum.

5. In 2002 major power producers sourced approximately 26.8 million tonnes of their coal requirement from indigenous coal. During the financial year 2001/2002<sup>70</sup>, 23 million tonnes<sup>71</sup> of indigenous ESI coal were carried by rail as set out in Table 2.

<sup>67</sup> [www.dti.gov.uk/energy/inform/dukes](http://www.dti.gov.uk/energy/inform/dukes) (“Solid Fuel and Derived Gases” Main Table 2.11, “Opencast sites in production at 22 April 2003”)

<sup>68</sup> *ibid* as at 31 March 2006

<sup>69</sup> Business Plan Power Station Coal 2000-2003, Appendix 3 to EWS Minerals Business Plan 2000 provided at document 342 to file 3 of documents provided in response to a section 26 notice of 19 March 2002

<sup>70</sup> The major power producers in 2001 consumed approximately 26.2 million tonnes of indigenous coal

<sup>71</sup> Provided by Martin Hunt, Business Manager Coal, Network Rail in an e-mail dated 20 March 2003 following a telephone request of 7 March 2003 [16/1443.1-16/1443.3]

**Table 2. ESI coal rail traffic from deep and opencast mines, 2001/2**

Site Location	Million net tonnes
North Nottinghamshire ( <i>Clipstone</i> <sup>72</sup> , <i>Thoresby</i> , <i>Welbeck</i> , <i>Harworth</i> , <i>Maltby</i> , <i>Oxcroft</i> )	5.5
Gascoigne Wood loading and preparation facility for “The Selby Complex” <sup>73</sup>	5.0
Scottish Opencast ( <i>Chalmerston</i> , <i>Killoch</i> , <i>Knockshinnoch</i> , <i>New Cumnock</i> , <i>Ravenstruther</i> , <i>Ayr Harbour</i> , <i>Millerhill</i> , <i>Mossend</i> , <i>Thornton</i> , <i>Inverkeithing</i> )	5.0
Yorkshire ( <i>Kellingley</i> , <i>Rossington</i> , <i>Prince of Wales (now closed)</i> , <i>Hatfield</i> )	2.5
South Wales Local ( <i>Tower</i> , <i>Onllwyn</i> , <i>Cwmgratch</i> , <i>Cwmbargoed</i> , <i>Parc Slip</i> )	1.5
North East Opencast ( <i>Butterwell</i> , <i>Wardley (mothballed)</i> , <i>Widdrington</i> )	1.3
Daw Mill ( <i>Warwickshire</i> )	1.2
Total Midlands O/Cast and Other ( <i>Hicks Lodge</i> , <i>Swains Park</i> , <i>Codnor Park</i> , <i>Other</i> )	1.0
<b>Total</b>	<b>23 mt</b>

Table for illustrative purposes, tonnages are approximate

### Imported coal

6. New power generator owners and coal suppliers such as ECSL who require port facilities for imported coal and who do not wish to invest in new terminals need to negotiate third party access to existing facilities, which may already be owned by existing generating companies<sup>74</sup>. DTI statistics indicate that imports of coal and other solid fuel in 2002 amounted to 28.7 million tonnes, 20 million tonnes of which was used in electricity production<sup>75</sup>. During the financial year 2001/2002<sup>76</sup>, 16 million tonnes of ESI coal were carried by rail via UK ports, as shown in Table 3<sup>77</sup>.

<sup>72</sup> Closed mid 2003

<sup>73</sup> Selby complex collieries closing spring 2004

<sup>74</sup> Hunterston is operated by the Clyde Port Authority with open access to all users. Portbury on the Bristol channel was developed for National Power, Powergen reached agreement with Mersey Docks and Harbour Company to build a Panamax port at Liverpool, and Humber International Terminal at Immingham (“HIT” or “Immingham HIT”, to be distinguished from Immingham Bulk Terminal or “IBT”) was developed out of a joint initiative of Powergen, National Power and Associated British Ports

<sup>75</sup> [www.dti.gov.uk/energy/inform/dukes](http://www.dti.gov.uk/energy/inform/dukes) (Chapter 2, Solid fuel and derived gases – Main Text)

<sup>76</sup> DTI statistics (see footnote above) show that 35.5 million tonnes of coal were imported in 2001 with 23.2 million tonnes of this being used by the ESI

<sup>77</sup> Information contained within an internal memorandum compiled by the SRA in February 2003 (“Freight track access rights – analysis of coal traffic”) [14/1290(A)]

**Table 3. ESI coal rail traffic through UK ports, 2001/2**

<b>Port</b>	<b>Operator/Owner of coal terminal</b>	<b>Million net tonnes</b>	<b>Main destinations</b>
Immingham (IBT) Immingham (HIT1) Immingham (HIT2 - planned)	Corus (IBT) ABP (HIT 1 and 2)	4.3	Drax, Eggborough, Ferrybridge, West Burton, Cottam, Rugeley
Bristol (Includes traffic through Avonmouth and Portbury)	Operated by the Bristol Bulk Company Limited with initial investment provided by National Power for the Portbury facility.	3.8	Didcot, Aberthaw, Ironbridge, Rugeley
Liverpool Bulk Terminal (LBT)	Powergen	2.7	Fiddlers Ferry
Hunterston	Clydeport Limited	2.6	Longannet, Cockenzie, Rugeley, Ironbridge
Hull	Operated by Fernwood Holdings with original investment by National Power	1.0	Ferrybridge, West Burton
Port Talbot/Newport	ABP/British Steel	0.8	Fifoots Point
Redcar	Corus	0.5	Eggborough, Cottam
Others (including Newbury, Tilbury and Kingsnorth)		0.3	
		16.0mt	

Table for illustrative purposes, tonnages are approximate

# Annex D: History of coal power station ownership post 1990

## Coal-fired power station ownership in 1990

**Table 1. Coal-fired power station ownership at establishment of the new electricity licensing regime 1990**

Powergen	National Power	Scottish Power
Cottam	Willington	Cockenzie
Ferrybridge	Eggborough	Longannet
Fiddlers Ferry	Drax	
Ratcliffe	Blyth	
Drakelow	Didcot	
High Marnham	Aberthaw	
Kingsnorth	Rugeley	
	Ironbridge	
	West Burton	

## Key developments from 1990 to March 2000

- (a) During 1996, Eastern Power & Trading Limited (EPET) acquired High Marnham and Drakelow from Powergen, and Rugeley, Ironbridge and West Burton from National Power;
- (b) June 1999, Edison First Power Limited (EFP) (a subsidiary of EME) acquired Fiddlers Ferry and Ferrybridge from Powergen;
- (c) November 1999, AES Drax Power Limited (AES Drax) acquired Drax from National Power; and
- (d) March 2000, BE acquired Eggborough from National Power.

**Table 2. Power station ownership at establishment of Enron Coal Transportation Limited (ECTL) in London in March 2000**

Powergen	National Power/ Innogy <sup>78</sup>	EME	AES Drax	BE	EPET	Scottish Power
Cottam	Willington	Ferrybridge	Drax	Eggborough	High Marnham	Cockenzie
Ratcliffe	Blyth	Fiddlers Ferry			Drakelow	Longannet
Kingsnorth	Didcot				Rugeley	

<sup>78</sup> In December 1999 National Power announced a proposed demerger within the company to create a UK integrated energy business and an international power business. The former became Innogy (now RWE) and the latter International Power

	Aberthaw				Ironbridge	
					West Burton	

### Key developments between March 2000 and February 2001

- (a) August 2000, a new coal fired station owned by AES at Fifoots Point commenced generation;
- (b) EPET began trading in the UK as TXU Europe Energy Trading (TXU); and
- (c) September 2000, Electricite de France (EDF)<sup>79</sup> acquired Cottam from Powergen.

**Table 3. Coal fired power station ownership at February 2001 (the date of the complaint)**

Powergen	Innogy	EME	AES Drax	BE	TXU	EDF/ LEG	Scottish Power
Ratcliffe	Willington	Ferrybridge	Drax	Eggborough	High Marnham	Cottam	Cockenzie
Kingsnorth	Blyth	Fiddlers Ferry			Drakelow		Longannet
	Didcot		AES Fifoots Point Ltd		Rugeley		
	Aberthaw		Fifoots Point		Ironbridge		
					West Burton		

### Key developments between February 2001 and December 2002

- (a) July 2001, TXU sold Rugeley to International Power under a tolling arrangement<sup>80</sup>;
- (b) December 2001, TXU sold West Burton to London Power Company (LPC), part of London Electricity Group;
- (c) 21 December 2001, AEP Energy Services UK Generation Limited (AEP) purchased Ferrybridge and Fiddlers Ferry from EME;

<sup>79</sup> Trading as LEG within the UK (in turn owners of London Power Company)

<sup>80</sup> "Under the terms of that agreement International Power was responsible only for receiving, storing and burning coal". (source: International Power response dated 14 April 2003 to a section 26 notice of 18 March 2003) [5/1394/1.1]

- (d) March 2002, AES Fifoots Point went into receivership and ceased operation; and
- (e) November 2002, TXU went into administration. Drakelow, High Marnham and Ironbridge acquired by Powergen.

**Table 4. Coal fired power station ownership at the end of 2002**

Powergen	Innogy	International Power	AEP	AES Drax	BE	LEG	Scottish Power
Ratcliffe	Willington	Rugeley	Ferrybridge	Drax	Eggborough	Cottam	Cockenzie
Kingsnorth	Blyth		Fiddlers Ferry			West Burton	Longannet
Drakelow	Didcot						
High Marnham	Aberthaw						
Ironbridge	Fifoots Point (see note)						

**Key developments between January 2002 and December 2004**

- (a) March 2003 E.ON closed the already partly mothballed stations of Drakelow and High Marnham
- (b) RWE Innogy leased and re-instated Fifoots Point power stations from its administrators to operate over the winter 2003 period
- (c) Scottish and Southern Energy (SSE) acquired Fiddlers Ferry and Ferrybridge from AEP in July 2004
- (d) Carron Energy reopened Fifoots (operating now as Uskmouth) in August 2004

**Table 5. Coal fired power station ownership at the end of 2004/2005**

E.ON (ex Powergen)	RWE (ex Innogy)	International Power	SSE	AES Drax	BE	LEG	Scottish Power	Carron Energy
Ratcliffe	Willington	Rugeley	Ferrybridge	Drax	Eggborough	Cottam	Cockenzie	Fifoots
Kingsnorth	Blyth		Fiddlers Ferry			West Burton	Longannet	
Ironbridge	Didcot							
	Aberthaw							

# Annex E: Next generation coal haulage contracts

---

1. This Annex provides a brief summary of the progress and chronology of the next generation of coal haulage contracts, or non-legacy contracts, which were negotiated with new power station owners Edison Mission Energy (“EME”), AES Drax and British Energy (“BE”).

## Edison First Power Limited or EME

2. Edison First Power Limited (latterly trading as “EME”) acquired Fiddlers Ferry and Ferrybridge power stations from Powergen in the summer of 1999. On 2 June 1999 it wrote to EWS with a request for indicative prices for coal supply to those power stations from Hunterston, Redcar and Liverpool Bulk Terminal and some indigenous Anglo-Scottish tonnage with coal movement potentially commencing in July 1999<sup>81</sup>.

3. On acquisition EME, however, chose to secure an E2E deal with ECSL for imported coal, with the remaining requirement being met by indigenous coal supplied via a Powergen divestment contract until 2003. It is at this stage that ECSL became a presence within the UK, seeking a framework coal haulage agreement with EWS in May 1999<sup>82</sup>. That initial approach by ECSL was for EWS to propose prices and services relevant to ECSL’s planned business within the UK:

- (e) Direct supply to Enron-owned Assets;
- (f) Tolling arrangements at third party stations; and
- (g) Direct third party supply.

4. In pursuance of its E2E deal with EME, ECSL on 27 July 1999 e-mailed EWS, indicating that it wished to pursue a 9 month contract as soon as possible covering Fiddlers Ferry and Ferrybridge traffic from LBT, Immingham, Hull, Hunterston and Portbury.<sup>83</sup> On 2 August 1999 EWS e-mailed ECSL to confirm agreed rates. It also confirmed that traffic moved prior to signing a contract would be moved under EWS’s standard conditions of carriage.<sup>84</sup> On 1 December 1999, EWS entered a “best

---

<sup>81</sup> Document 208 of volume 3 of supplemental documents provided by EWS in response to a section 26 notice dated 19 March 2002, following letter dated 25 September 2002

<sup>82</sup> A letter from ECSL dated 25 May 1999 provided at document 206 of volume 3 of supplemental documents provided by EWS in response to a section 26 notice dated 19 March 2002, following letter dated 25 September 2002

<sup>83</sup> Document 210 of volume 3 of supplemental documents provided by EWS in response to a section 26 notice dated 19 March 2002, following letter dated 25 September 2002

<sup>84</sup> Document 211 of volume 3 of supplemental documents provided by EWS in response to a section 26 notice dated 19 March 2002, following letter dated 25 September 2002

endeavours”, 7-month contract with ECSL for the supply of haulage services from ports to Fiddlers Ferry and Ferrybridge. This remained the only contract in existence between EWS and ECSL until the exit of ECSL in December 2001. It was extended variously by e-mail exchange<sup>85</sup>.

5. At expiry of the one year ECSL arrangement with EME, however, EWS was successful in securing a direct contractual relationship with the generator. An e-mail of 4 June 2000<sup>86</sup> confirmed a telephone call made on 3 June, “[w]e did the deal with Edison Mission yesterday morning for LBT-Fiddlers @ £[ ... ]/tonne as agreed. This rate until 16 September pending a contract. Enron are now off our hands so far as Edison are concerned...we have got them out of Fiddlers Ferry and Ferrybridge – a big step forward.”.

6. A letter from EWS to EME dated 7 June 2000<sup>87</sup>, confirmed rates from LBT to FF and stated, “This rate will apply until 16 September 2000...In the course of the next few weeks we will commence discussions on a longer term contractual arrangement.”.

7. On 26 June 2000, EME issued an Invitation to Tender for the longer term coal haulage arrangements into their power stations. On 3 October 2000, EWS formally responded,<sup>88</sup> a revised offer was made on 5 October 2000<sup>89</sup> and the contract was awarded to it. Contract negotiations commenced at the end of that year.

### **Drax Power Limited (previously, until August 2003, AES Drax)**

8. In November 1999, AES acquired Drax from National Power and on 18 April 2000 EWS and AES Drax met to discuss the new coal supply arrangements<sup>90</sup>. The notes of that meeting stated, “AES Drax are currently taking all their coal requirements from National Power as part of the divestment sale agreement. This arrangement will continue until September 30<sup>th</sup> 2001 though they may wish to trial limited tonnages of new coals in the months ahead. We [EWS] advised [AES Drax] that EWS would be prepared to move those coals on a direct AES/EWS agreement...From 1 October 2001 AES Drax would be purchasing all their coal

---

<sup>85</sup> E-mail to ECSL of 2 August 2000 (document 246 of file2 of documents provided by EWS in response to a section 26 notice of 11 May 2001) confirmed that the contract between EWS and ECSL that expired on June 30 would still apply until 30 September 2000. In an e-mail dated 28 November 2000 EWS extended the contract until 31 January 2001 or “the commencement date of a new contract – whichever is soonest” (document 287 of file 2 of documents provided in response to a section 26 notice of 11 May 2001)

<sup>86</sup> Document 447 of file 3 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>87</sup> Document 15 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>88</sup> Document 159-161 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>89</sup> Documents 162 and 163 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>90</sup> Document 227 of file 5 of documents provided by EWS in response to a section 26 notice of 11 May 2001

requirements directly and would also be sourcing their rail logistics on a direct basis. At this stage they intend to invite competitive tenders.”.

9. Drax eventually issued an Invitation to Tender on 7 July 2000<sup>91</sup>. EWS responded on 4 August 2000<sup>92</sup> and provided a revised bid on 12 September 2000<sup>93</sup>. By the end of September 2000 it became clear that AES Drax had decided to split the contract between EWS and FHH.

## **BE-Eggborough**

10. In March 2000, BE acquired Eggborough from National Power and during the period November 1999 through Spring 2000 negotiated arrangements for a one year coal haulage contract into that power station. On 9 February 2000, EWS wrote to BE providing indicative rates for indigenous coal<sup>94</sup>. Through February to March various draft heads of terms were provided to BE by EWS in furtherance of this proposal. This contract was, however, awarded to ECSL. EWS started to haul coal to Eggborough on ECSL's account from March 2000 onwards.

11. On 5 October 2000, BE launched an Invitation to Tender<sup>95</sup> for the residual coal requirements not supplied under the National Power divestment agreement. EWS responded on 26 October 2000<sup>96</sup> and provided a revised bid on 27 November 2000<sup>97</sup>. By the spring of 2001, BE had awarded the contract to ECSL on an E2E and intermediary basis.

---

<sup>91</sup> Documents 214-220 of file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>92</sup> Document 207-210 of file 1 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>93</sup> Document 460 of file 5 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>94</sup> Document 238 of volume 3 of supplemental documents provided by EWS in response to a section 26 notice dated 19 March 2002, following letter dated 25 September 2002

<sup>95</sup> Documents 182-185 to file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>96</sup> Documents 206 to 210 to file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>97</sup> Documents 186 to 189 to file 2 of documents provided by EWS in response to a section 26 notice of 11 May 2001

# Annex F: Transcript of 15 March 2000 telephone call

---

1. This annex provides a transcript of a telephone call which took place between Nigel Jones ('NJ') and Tom Kearney ('TK') of ECSL<sup>98</sup> on 15 March 2000.

NJ: "Nigel Jones.

TK: Nigel, Tom Kearney here.

NJ: So you are still at work? I thought you would be.

TK: Yeah, we were just in a meeting. So I understand you gave your presentation today.

NJ: I did, yes.

TK: Still suffering the slings and arrows of outrageous fortune?

NJ: Well, what did George and Stuart think of it?

TK: Actually, I don't think they even had a chance to talk about it. I think they just informed me that you were there. {00.32}

NJ: Yes I was. I would be interested to know what they thought of it or what their reaction was. There weren't any questions, which kind of surprised me a little bit but most of the feedback I got was fairly positive, which was good.

TK: Definitely. We Haven't got comments or anything...

NJ: No you haven't. I don't know whether you are going get them [sic]. The two Davids are staying in London tonight as you know. They are working, obviously, they've been working for s'ome time on how we're going to respond on that, and they had meetings this afternoon which were involved on how we're going to respond on that, and they had meetings this afternoon which were involved in it. I've spoken to them within the last half an hour or so. I don't know whether they're going to get anything across or whether they'll come across and just table things first thing in the morning. But no we haven't sent you anything, I know. {1.20}

TK: Do you have an idea of what you think the agenda is?

NJ: Well I think they just want to get into more detail on how the thing's going to work. Particularly on things like the performance. If we're going to do this thing in 2-3 weeks we've got to really scope out what it is we're talking about.

---

<sup>98</sup> Provided in the Complaint [01/12/01-1/12/07]

TK: Absolutely.

NJ: And what are the volumes are [sic] and what are the commitments from us to you and vice versa and in the light of that what the terms are going to be. We've got to start that tomorrow because otherwise we're not going to make the end of March.

TK: Absolutely.

NJ: So, they've been looking at that. They were at the conference this morning but they left it mid-afternoon because they had a couple of things to do and they're staying in London tonight to get ready for an early start in the morning. But that [sic] where we're coming from. We've got to get into more detail. {02.25}

TK: OK, on a basic level, looking at this going forward, what do you see in terms of this proposed agreement. Say, for example, do we just go tomorrow and exchange our views?

NJ: Well No. I think we've got to get beyond the exchange of views. I think we've got to reach a fairly clear understanding as to term.

TK: Well, we've put that there.

NJ: Yes we've put that there but I think, let's be quite clear about whether this is just a one or two year agreement, whether this is something that is going to be part of a longer term business relationship. You see we're very conscious at the moment that you might for the sake of argument choose to do your own thing because you're doing that with the Wilton operation. And where does this sort of contract fit in alongside that? And a two-year thing might just be enough for you to set up and do it yourself. I think we want to get a fairly clear steer as to how this fits in to what might or might not happen afterwards.

TK: Well at a basic level there's only two things that are going to determine that and that's price and performance.

NJ: No. Maybe.

TK: Two things. Money my friend and Performance. On a basic level that's it, if you guys have concerns about that.

NJ: Well I don't think they're concerns. I think let's at least have some clarity...{4.07}.

The tape now breaks up and finishes at {4.20}.

Telephone conversation between Nigel Jones and Tom Kearney, part II March 15, 2000.

TK: Hello.

NJ: Hello. Sorry about that. It's just the rail route I'm on. The reception's not terribly good. So we're just trying to put it into its context. It does affect the

way in which we're going to approach the commercial terms. You understand that.

TK: Yeah. I would advise you to be very commercial about this. And that would be focussing on commercial terms. We'll make it clear that you get a longer term if you make it worth our while.

NJ: If we make it?

TK: Worth our well.

NJ: Well yeah. I understand that. In many ways maybe two years is a sensible term. But if its two years leading up to you doing your own thing then it's a different two years to the two leading up to you going out to tender or renegotiating or doing something else or whatever.

TK: Yeah on a basic level I understand, but I don't see anyone else entering the business right now, at least I don't think so.{1.20}

NJ: Well but you're about to.

TK: What does that mean?

NJ: You're about to set yourself up to do your Wilton operation.

TK: I'm not even going to answer that. That's something we're exploring because there is a four-mile rail haul and it would be crazy not to think about doing ourselves. [sic]. We've got a little shunting engine up there, I don't see how that's related. {.42}

NJ: No, but it might be.

TK: It's right next to our port up there.

NJ: But once you've gone through the process, you can set yourself up.

TK: Well we haven't got through the process. We're not planning to run it on a on [sic] on a Rail Track track, we'd be running it on a private track.

NJ: Well it's a different regime. If you put in the 300 yards or whatever it is and I'm not saying it's not a sensible thing to do.

TK: And finally there's no indication that we're going to ahead do it [sic], we just want to explore the opportunities. My idea is that it's significantly cheaper than what we're paying to you.

NJ: Yes. Oh, I know. Don't get me wrong I'm not...

TK: And besides, I would view that as a singularity and not necessarily as a statement of what we are planning to do.

NJ: Well no. But equally you might go and buy your own wagons, purely hypothetically.

TK: You know no one's done it to date, and obviously there's a reason for that. You know, we have to make it worth our while.

NJ: Yeah. Well that's precisely the sort of thing that we want to get out in the open so there's at least a common understanding between us and where that fits into the detail

TK: But I'll tell you one thing. Enron's a company that understands the full value of optionality.

NJ: Yes.

TK: and if we're meant to rule out options, then there's a cash value associated with that.

NJ: I don't think we're ruling out options I just think we need to be clear between us. I mean in the end you've got the free choice to do whatever you want but lets just make sure that we're both negotiating this agreement with what the common understanding what the options are and whats on the table. {3.24}.

TK: My understanding is that we are now offering you and [sic] significant amount of tonnage on commercial terms that last year you guys would have been falling over to get, so now...

NJ: We want your business but we just want to be quite clear the basis on which we're going to agree terms. We want to get into the detail so we can notch this one together. To be quite frank I'm going to have to go back to Philip Mengel and Alan Johnson and others and they are going to ask these questions. And they're going to say 'Are they going to do their own thing?' 'Are they going to buy wagons?' Because we know what's around on the market. I might not know the answer to those but...

TK: Like I said with prices and performance as they are now, I'm not going to rule it out. If you want [sic] offer us good prices with a good performance regime in order to incent [sic] us to stay the course, then, by God, we're all ears.

NJ: Yeah.

TK: If there's a deal to be done there, we're all ears. On a basic level, like I said, we'll give you full advance planning, like we always do. We're not going to be monkeying around with you. You know we said here 14 days because you're twice as good as the next guy. And we're ready to take obviously commitments to change it and if we change something we'll pay for it. If we much up your licence in some way we'll pay for it. But, by the same token, you'll have to step up to it.

NJ: Yes I agree. I do really agree with that.

TK: Because we're no longer the new kid on the block and basically we got 'stuffed' last year, we got 'stuffed' big time. Your rates are bad and your service is bad – but we were the new kid on the block and that's past,

whatever. Now we do have a sensible understanding what others are paying and we intend to obtain a service that is really good and you know, like I said, if you want to keep us happy, it's going to come down to price. {5.43}

NJ: OK.

TK: Then on the second issue: the two Davids are a good start. I don't know David Griffiths, so I don't know if he is familiar with our history. I know David White and have worked much more closely with him. At a basic level you're going to have to make a decision...so we're kind of one negotiation away, aren't w? You're going to have to come in at some point and make some rulings. How do we do this?

NJ: I don't know. I'm the one who's going to have to sell it internally so yeah I'm going to have to be exempt from what it is but to be honest it's more important that you meet, we meet or when the meeting goes ahead that we wait until I was available. So I'll be in tomorrow. They're not going to agree to anything that they know I've got a problem with. If they think they've got a problem they'll just...give me a call.

.....(interruption for station announcement).....

heading out of the town right now, right?

NJ: Yeah.

TK: We would have liked to invite you to dinner tonight.

NJ: No. After last night it's a shame you couldn't joint us last night but having got to be [sic] at about 10' clock then up at 5am this morning to get into London today. So thanks for the offer but we'll have to do it another time.

TK: Now realistically we're going to go through this stuff tomorrow so what messages are you guys going to give us? I mean their idea was just to do an agenda based on the term sheet.

NJ: Well as I said to you earlier we've got to get into the detail of this thing. We've got to understand the environment in which we're doing it. {8.08}

(Got off train)

And we've got to piece the detail of this together so that we can in the end sign up to a performance regime that we can deliver. Now is that going to be an iteration there, at yeah there probably is because I'm going to go back and I'm going to make sure and Philip will want me to make sure that Jim Ludban is going to sign for that with his life.

TK: Right.

NJ: Because he is going to have to deliver it. We do need to get a handle on where the coal is going to come from where the coal is going to go to and what the terms are going to be, whether we are going to go for tonnage or a minutes performance or whatever. Where are we now? Can we deliver? Is it

practical? We really have to get into the details of that and out of that comes the prices and terms.

TK: Absolutely. What I wanted you guys to do is at least come to us with numbers, and the base train plan that you have because, you know, the base plan is the basic minimum hurdle that you can meet.

NJ: Yeah.

TK: Obviously in places were [sic] situations [sic] the routes are constrained we would be willing to put in a tiered rate structure to incent [sic] you, which I think is appealing.

NJ: Yeah, I think that would have been interesting, I presume we are not doing anything at Fiddler's Ferry right now, but it would have been interesting to see how that worked.

TK: Yeah, we managed to do it without having to pay you guys more money!

NJ: Yeah that's kind of a shame (laugh). But yeah, it's a real shame. That's one way of doing it. I think the intention is to get the base plan actually right, yeah.

TK: I agree. And the base train plan has to be something you guys can deliver, not something ridiculous like 4 trains out of Redcar, you know, something meatier.

NJ: No, no, you know what we can do out of Redcar the bigger question is things like Hull, are we going to agree to do something better out of Hull than current performance in which case we have to change what we do. There is no reason why that won't happen, but that is where we really have to get into the detail of it.

TK: Sure, but the main point is that you guys tell us what you can commit to what you can do against our proposed performance criteria. We have indicated to you what we think the indicative base plan should be, and we think the indicative annual tonnage.

NJ: Yeah.

TK: and the rates accordingly, and if you have larger strategic concerns I would again, our company values optionality, above all, and we value options, some are high some are low. If you want to rule out options or because basically of piece of mind has its cost too.

NJ: Yeah, I understand the concept but let's just be clear and if you are thinking of doing things then just tell us and then we know where we are, but what I can't do is to, with all sorts of things floating around, whether its wagons purchase or, you know, setting up your own operations on Teesside, I can't negotiate something with you or be responsible for negotiating something with Enron which hasn't at least taken those into account, because I am going to get asked by them, because our board know about them.

TK: I'm a little unclear about that, but it sounds a little like a threat to me, but any way.

NJ: A threat?

TK: Yeah.

NJ: I don't think it's a threat, it wasn't meant as a threat, it's just, well I can say it's the other way around, you know, your proposal, your idea of buying your own wagons or doing your own thing or using Freightliner, you know,

TK: You don't see us out there in the market place for tenders for wagons, do you? {12.15}

NJ: Well I do see people out there in the market place talking to wagon manufacturers, yeah.

TK: Well, they talk to everyone and we will certainly talk to everyone too. But, by the same token we are offering right now to you a base of business, which is significantly more in tonnage terms with better notifications terms than we gave you last year. At a basic level what we are looking for is an incremental that makes sense in this business environment. Given the current situation in the coal market, we would be crazy to take a long position on rail...and we would ask you to take a view of that too.

NJ: Yeah, that is one of things that has been talked about today, I understand that.

TK: There is [sic] no guarantees

NJ: No, I understand, in Stuart's presentation, he made it clear that you were a company who was prepared to come in and may be take a risk where others aren't.

TK: But you have to understand the business environment that we work in too. If Selby gets subsidies, the value of imports goes down, if RJB goes bust, then the value of imports go up. We are talking a series of binary eventualities that have a huge impact on the number of tons that we will move. You have to understand the business environment we are up against.

NJ: Yeah, I understand that, and I understand that within two years you could absolutely be the number one major player with a massive percentage of the volume or it may not work out like that and I do understand that and you can't commit to the former because you have know [sic] way at this stage of knowing if it is going to happen or not.

TK: But I mean two years of significant volume through your system

NJ: Yeah, we want to do business, we want to reach agreement with you, but you know, we just need to get the position on where we are clear.

TK: OK

NJ: and that does involve coming to a clear understanding of what you want and what the implications of that are and what the level of commitment you are able to enter into and the base train plan that we will offer back and out of that is going to come the price.

TK: Yeah, at a basic level, as I said, we are offering 2 years.

NJ: Yeah, we understand the terms, but I think we have to be very clear about what it is that you are going to want us to do and what we are going to do and the standards to which we are going to do it and out of that will come a price and we will reach agreement on the price or we won't reach agreement on the price, but we know where you are coming from and you can probably guess where we are coming from on the price and we can have a negotiation on that.

TK: Yeah. Alright sir, next week then, how are [sic] set for schedule.

NJ: Can I take notice of that one, only because I haven't got my diary in front of me. I'm in Scotland Tuesday/Wednesday, mmm (pause) I can't for the life of me, I have got meetings but I must have some time next week but off the top of my head I don't know what that is.

TK: Can you make some time?

NJ: Yes

TK: Because at a realistic level are the two David's really going to come to some closure on this stuff or are they just going to take stuff away?

NJ: Well, there are levels of discussion and agreement which, you know, they are better handling than I am, ok, the detail of some of this, the prices and that, no, they are going to come away with that because they are going to come to me and I am going to go higher within EWS, because different layers are involved and we are going to have to get the appropriate agreement on that, and that's not difficult. I'm with Alan [sic] Johnson, our marketing director tomorrow morning.

TK: So, are you in London tomorrow?

NJ: No. The meeting was the reason I couldn't join you tomorrow, he is seeing me for ½ hour and then he is actually joining in a meeting with Alan [sic] Johnson, so I'm seeing him then and this is one of the things he needs to be brought up to speed with. He's going to be interested, he is not going to take over, but he is going to be involved from our side. You might never see him but he will be there.

TK: The point is are these guys going to put prices back to us?

NJ: I want to get all of the facts of this clear before we start talking about prices. We have had this debate before, yes, it's good to have prices on the table but lets be quite clear about what you are expecting of us and what we are expecting to deliver to you and out of that is going to come the terms. I don't want to start talking about prices before we have got that clear.

TK: Have we got the base train plan? I mean this is one of these meetings where we circle around the other? We are going to commit according to prices, so you know.

NJ: Yeah, I understand.

TK: We can move more tonnes by train if the price is competitive.

NJ: Yeah, ok, but that's the reason why the base train plan and the specification getting that sorted out tomorrow.

TK: Are we going to get a real base train plan from you guys:

NJ: That's what they are coming for tomorrow..

TK: OK, but at a basic level though do you understand our position?

NJ: I understand your position Thomas.

TK: We have the shittiest service of any other customers and.....

NJ: I think there are plenty of other customers who would dispute that.

TK: Not your big ones.

NJ: Pardon!

TK: Not your big ones

NJ: We, ok, but we understand where you are coming from.

TK: Alright, I'm sure we will probably have a chance to talk tomorrow.

NJ: Yeah, I'll be around later on in the day.

TK: Are you in London tomorrow?

NJ: NO, I'm not in London the rest of this week.

TK: OK, but we need to sort something out where we get some closure on this as soon as possible.

NJ: You'll be seeing the two Davids, but we have got get the real detail agreed between us of what we are talking about and they are perfectly empowered to do that, don't worry about that, they are empowered. They are not a couple of toothless little fairies being sent along on a time wasting exercise!

TK: I know, I understand, I have great respect for Mr White anyway. He knows the rail system very well.

NJ: Yes, he knows his stuff, he knows the details. David is here to try and make sure we get an appropriate – you know – David is the deal maker,

alright, and he's here to help, to take that sort of knowledge and get it into a format that we're happy with and you're happy with and get it done quickly.

TK: Good, good. You know we are still aiming for the 31<sup>st</sup>.

NJ: Yeah, you want it done by the 31<sup>st</sup> March and that is what we are setting out to do.

TK: Excellent.

NJ: Alright Tom.

TK: Have a good evening and I'm sure we will talk tomorrow.

NJ: I'm sure, alright then.

TK: Bye.

NJ: Bye.

# Annex G: Understanding EWS's pricing: the nature of the EWS response

---

## Summary

1. ORR has, since May 2001, been persistent in its pursuit of contemporaneous documents which might assist in understanding the relationship between EWS's prices and costs.
2. In its first section 26 notice of 11 May 2001, ORR notified EWS that it was investigating a complaint from ECSL, which amongst other things, alleged that EWS had adopted a strategy of discriminatory pricing as between purchasers of coal freight services so as to disadvantage ECSL. The numerous spreadsheets provided, contemporaneously created from a cost model, which variously showed the anticipated return from a range of input prices were not possible to interpret without explanation and it was not possible to deduce from the various coal market strategy papers provided, that any difference in price for the haulage of coal over the same route arose out of a difference in the product being offered or any identified difference in the contract or service terms.
3. The section 26 notices and letters from ORR sent after that date (chronologically listed at Annex A) were designed to further ORR's understanding in this regard. EWS did not provide, however, any detailed explanation of how for any specific quote over a specified route, what particular factors were actually taken into account in setting the quoted rate, other than general statements as to the context in which certain quotes were given.
4. ORR, in a section 26 notice of 19 March 2002, extended the search to documents created prior to 1 March 2000, in order to disclose documents which might have established EWS's pricing strategies and methodologies during the investigatory period. The final file of documents was not provided until 4 December 2002. ORR, at that stage, concluded that there was likely to be no further value in pursuing this line of questioning and decided that its assessment of price differences would need to rely on explanations created by EWS in response to section 26 requests already received.
5. Further to the site visit in October 2002, the cost models referred to as the EWS Standard Cost Model and the Frontier Model were supplied to ORR.

## The relationship between cost and price

### *Inquiry into EWS price setting and cost-modelling prior to introduction of the Frontier Model*

6. In a section 26 notice of 11 May 2001, ORR requested all documents<sup>99</sup> created and received by EWS on or after 1 March 2000 in any way relating to the rail carriage of coal used in the production of electricity, including (though not exclusively) the negotiation of terms, the agreement of contracts and internal papers relating to EWS's pricing strategy. The document request was intended to capture all papers relating to the carriage of coal to power stations, in order that any pricing data received could be interpreted in a contemporaneous context<sup>100</sup>.

7. The first ten files of documents were sent by EWS under cover of a letter dated 20 June 2001. Also provided with this response was a spreadsheet giving rates quoted in relation to power station coal, setting out the price, the date the price was requested and the route<sup>101</sup>. That spreadsheet indicated that over 300 price quotes had been given over a period of 15 months. The contemporaneous documents provided were marked, however, by the absence of internal papers relating to pricing methodologies, for example, any general guidance or methodologies for marketing managers on how costs should be factored into rates quoted or conversely any recommendations to the EWS Board on how prices would be calculated.

8. EWS has provided numerous spreadsheets contemporaneously created from a cost model, which variously showed the anticipated return from a range of input prices. Within the documents provided there were various general statements in relation to pricing strategies. For example, a "Business Plan, Power Station Coal, 2000-2003", created in June 2000<sup>102</sup>, referred (in document 154) to an "EWS

---

<sup>99</sup> To include information in any form, for example though not exclusively, electronic mail, notes of meetings and records of telephone conversations

<sup>100</sup> The section 26 response date was 12 June 2001. EWS at a meeting with the ORR on 24 May 2001, indicated that it wished for an extension of the response date particularly with regard to data stored in electronic form. This was formally requested by letter on 25 May 2001 and consented to in a letter from ORR on 4 June 2001. The date for the production of information which was archived on e-mail was at that stage extended to 24 July 2001. A revised timetable was confirmed in a further letter from ORR dated 5 June 2001 in which it was agreed that documents available in hard form would be provided in advance of that date with the first instalment due on or before 20 June 2001. In a letter dated 3 July 2001 and a subsequent meeting of 12 July 2001, EWS expressed concern that the documents produced with the initial response of 20 June 2001 already included a number of documents stored electronically and expressed concern at the additional time and expense involved in reviewing the entire "archives" of e-mails. In a subsequent notice of 10 August 2001, ORR, in order to assist compliance, focussed the archived electronic document search to copies of any correspondence with, and all communications (both internal and between EWS and third parties) which made reference to, ECSL, with a revised response date of 7 September 2001. This date was later further extended to 14 September 2001, confirmed within a telephone call to ORR on 4 September 2001

<sup>101</sup> Referred to as "Table 8(a)"

<sup>102</sup> Provided at documents 134-159 of file 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001

Marketing Strategy” to “[i]ncrease rates by 10% where expedient and whenever possible to deliver L3+15%.” An internal note<sup>103</sup> referring to the Drax coal tender of July/August 2000 stated, “[t]he base line for pricing, before applying commercial judgement, is the cost of operating each flow and the price required for each flow to make our standard rate of return on capital of [ ... ]%.” There were also general statements in relation to pricing strategy, for example, in the Coal Business Budget Commentary dated 5 February 2001<sup>104</sup> (document 55):

“EWS now has the opportunity of restructuring its contracts – having tiered prices for instance – in its contracts to encourage coal shippers to smooth demand across the year to core flows. This could work in two ways:

- (h) Offer different prices for unplanned/unusual flows
- (i) Different prices as demand increases
- (j) In this way we have the opportunity to protect the “cherries” with lower rates of return and larger incomes on other flows.”

9. However, it is not possible to deduce from the spreadsheets or from the coal market strategy papers provided, that any difference in price for the haulage of coal over the same route arose out of a difference in the product being offered or any identified difference in the contract or service terms. The six files of archived electronic documents received in response to a further section 26 notice of 10 August 2001, provided no further assistance in this respect.

10. In a letter dated 21 November 2001 ORR pursued this point and asked for “clarification of the factors that were actually taken into account in setting certain rates...” A response by EWS of 20 December 2001 provided commentaries on the context in which various prices were quoted.

11. In a covering letter to a further section 26 of 19 March 2002<sup>105</sup>, ORR pursued this point again and explained that “[i]n some cases, the general requests previously made have not produced documents which we would expect to exist, and so it is necessary to make a further more focused request to clarify the position.” ORR also asked more general questions about how costs may affect price. It asked, for example:

- (a) For “the financial and operational effects on EWS of including a performance regime in a contract for haulage of coal...”
- (b) In relation to a particular spreadsheet, “...the basis for the categorisations of costs in these spreadsheets as variable or fixed and,

---

<sup>103</sup> Documents 345 to 346 of file 5 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>104</sup> Provided at documents 43 to 65 of file 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>105</sup> A response was requested by 26 April 2002, an extension is requested and granted in a letter from the Regulator dated 26 April 2002 to 24 May 2002

*if any of the costs figures for particular categories of cost are dependant upon a cost apportionment exercise...[to] clarify how the common costs concerned have been allocated and any assumptions made.”*

- (c) To “*explain precisely what is included in the costs items shown under the heading “Capital Employed...” and*
- (d) To “*explain in particular the measures by which the returns on capital employed and the profit margins are or have been assessed by EWS.”*

12. In a meeting with EWS on 26 March 2002, ORR stressed that the requests were focussed on documents concerned with the setting or shaping of EWS’s strategies and stated that it would expect such documents would be relatively easily identifiable within EWS and did not believe that electronic searching of archived e-mails would necessarily be required in order to locate them. Graham Smith (Planning Director, EWS) explained at that meeting that, in the past, EWS management and employees might not have committed as much to paper as ORR might expect. He further stated that the [ ... ]% rate of return, for example, was a hurdle for new business rather than a target, i.e. that EWS would take new business if it could provide a minimum [ ... ]% return. He also explained that the [ ... ]% hurdle rate was not specific to any particular customer or any particular part of the business. EWS indicated at the meeting that further time might be required in which to respond.

13. Following this meeting, EWS wrote to ORR on 12 April 2002 questioning the legal basis for ORR’s requirement that EWS disclose documents created prior to 1 March 2000, and asked for a further month in which to respond. It also drew an incorrect conclusion from the meeting that it was not now required to undertake a search of archived e-mails.

14. In a response of 26 April 2002, ORR provided an extension for the production of documents until 24 May 2002, corrected the misunderstanding about the requirement to search archived e-mails and stated, “...*many of the documents specified [in the notice] relate to apparently important descriptive or “thinking” papers that were circulated by e-mail. Generally, the material so far produced indicates that certain relevant internal discussions and papers were primarily conducted via e-mail, rather than in hard copy, and it is quite possible that they may be stored exclusively in that format by EWS...*” ORR also asked that EWS explain how the e-mail search had been conducted up to that date.

15. This explanation was provided in a response by EWS of 10 May 2002. In a letter of 25 September 2002 ORR noted that EWS had confined its searches of all current e-mail folders solely to the e-mails of those individuals who indicated that they “*do not keep paper files*”. ORR also stated, “[*t]his is a matter of concern, since it is clear from the material supplied in response to each of the section 26 notices that EWS conducts a great deal of its relevant internal thinking via e-mail and not by means of physical paper.*”

16. ORR, also within this 25 September letter, expressed concern that EWS had failed to address certain requests for information. ORR further noted that the response failed to:

- (a) “specify any time periods during which spreadsheets of these types have been used”;
- (b) “draw any distinction between the types of spreadsheets identified”; or
- (c) “identify the circumstances in which the spreadsheets are or have been used, save to say that they are used in connection with “proposed new rates”. Are the proposed new rates for spot business, for business under an actual or proposed contract or all of these? Are they rates proposed in response to a request from a customer, or potential customer, or are the rates volunteered by EWS (or a mixture of the two)? Are spreadsheets of these types used only in relation to EWS’s coal business, or across all cargo types?”

17. In its response of 4 October 2002 EWS refuted that it had failed properly to comply with the notice. It stated, “[i]t is clearly in the interests of both ORR and EWS that any further requests for documents or information, both in terms of making the nature of the requests, and in terms of proportionality, are explicit and precise...” At a meeting with EWS on 16 October 2002, ORR clearly explained that the basic question that needed to be answered was “[h]ow does EWS set its prices and how do those prices relate to its costs?”, and noted that this relationship is “not clear from the material EWS had supplied thus far.” In a letter of the same date ORR stated:

“We do not accept your suggestion that the requests in our Notice of 19 March 2002...not sufficiently explicit or detailed. On the contrary, as already indicated in our letter of 25 September 2002, we believe that the answers to some of the questions posed did not properly address the request. We can refer to your reply to paragraph 18(d) of the Fourth Notice as an obvious example. The request was that you should “explain in particular the measures by which the returns on capital employed and the profit margins are or have been assessed by EWS.” The reply was: “Return on capital is calculated by taking the profit per train (or tonne) and dividing this by the capital employed by train (or by tonne). There was no specific profit margin target for pricing decisions.”

18. ORR did, however, agree to restrict the *archived* e-mail search to certain key words and agreed to an extended date for receipt of those archived documents of 8 November 2002<sup>106</sup>. ORR extended the date of receipt of other documents until 1 November 2002.

---

<sup>106</sup> EWS wrote on 25 October 2002 regarding the archived e-mail search stating that the proposed searches have “so far identified 28,000 e-mails that are potentially responsive.” EWS ask to omit the keyword “strategy” and omit Allen Johnson (Chief Operating Officer) from the scope of the searches. In a response of 5 November 2002 ORR did not agree to remove Allen Johnson from the scope of the search. It suggested, however, that only those documents be produced which contained the word “strategy” and one or more of the key words, “coal”, “minerals”, “ESI”, and/or “Electricity”, and extended the response date for these archived e-mails to 20 November 2002. In a letter of 19 November 2002 EWS expressed concern that it would not be able to meet that deadline and asked for an extension (which ORR agreed to in a letter of the same date), until 4 December 2002

19. The four volumes of supplemental documents provided in response to the letter of 25 September 2002 on 1 November 2002 and the one file of documents produced from the key word search agreed in the ORR letter of 16 October 2002<sup>107</sup> provided no documents which progressed understanding of this relationship between prices and costs.

20. In a letter of 20 December 2002, which referred to the EWS response of 1 November 2002, ORR stated that it noted EWS's:

“[...]statement that no documents can be found that establish how the figure of [ ... ]% return on capital was derived or when it was communicated as the internal target. Your answer to both the [notice dated 19 March 2002] and paragraph 9(j) does not clarify whether any other source of information still in existence, (other than written documentation), has, in fact, been considered. It seems implausible that no one within EWS should be aware of how this significant figure was decided upon at the relevant time. If this is the case, please specifically confirm that no-one within EWS is aware of why the figure of [ ... ]% was adopted as a threshold for coal marketing managers. Please also explain what relationship this [ ... ]% threshold figure has with the [ ... ]% WACC now included within the Frontier Model. Would you confirm for us whether this [ ... ]% now represents a revised threshold and if so on what basis has this revised return now been adopted.

“In relation to your response to paragraph 8 above and in the context of setting the figure of [ ... ]% for return on capital, please explain fully the meaning and purpose for which document 106 was prepared (provided in response to the section 26 notice dated 19 March 2002), in which it appears the Audit Committee agrees with William Sunnocks' recommendation in his memorandum of 10 January 1998 (provided at document 107) “that the weighted average cost of capital, estimated at [ ... ]%, would be similar to that of WCTC.” Please also explain how the document was used and its relation to the [ ... ]% return on capital figure previously referred to. Similarly, please explain fully the meaning and purpose for which document 459 was prepared (also provided in response to the section 26 notice of 19 March 2002), which appears to be an agenda (written by Mr Bob Kendall) for a costing meeting to be held on 30 May 2000, where it is stated in paragraph 3.1 of that document that “the CEO has stated that using [ ... ]% Return on Capital Employed is the best measure.” Please confirm when and by what medium the CEO made such a view known to EWS employees.”

21. EWS responded on 5 February 2003:

“For the avoidance of doubt, EWS has not stated that [ ... ]% ROCE was a ‘threshold’ for coal market managers. EWS has stated, consistent with the documents that [ ... ]% ROCE was a baseline for pricing before applying commercial judgement...

---

<sup>107</sup> Refined in the ORR's letter of 5 November 2002

“Taking the question as if it referred to a ‘baseline’ instead of a ‘threshold’, it is not EWS’s position that no-one within EWS is aware why the [ ... ]% ROCE figure was adopted [...]. It was applied by the Coal Team because it was a direction from senior management...

“When Philip Mengel assumed the role of CEO of EWS in January 2000 it was indicated to him, although he cannot recall by whom, that EWS’s then current estimate of its WACC was [ ... ]%. EWS has not been able to find documentation which underlie this calculation at that time.

[...]

“By June 2000, however, in a presentation to the EWS Board it is recorded that EWS’s then estimate of its WACC had fallen to [ ... ]%....This reduced estimate of EWS’s WACC was not communicated to the EWS Senior Managers or the Coal Team and there was no revision in the expectation of the EWS Board as to the expected level of return on capital employed from EWS’s business overall.”

22. ORR did not respond to these specific explanations.

*Inquiry into EWS price setting and cost modelling following the complaint from FHH*

23. On 22 October 2002, following the complaint by FHH, alleging predatory conduct in relation to London Electricity contracts for coal haulage, ORR used its powers under section 27 of the Act to visit EWS, with notice, at its Customer Service Delivery Centre in Doncaster (“CSDC”). A consideration in using these powers, on this occasion, was the continuing resistance by EWS to provide explanations which would assist ORR’s understanding of how costs were allocated to specific traffic flows. ORR considered that it would likely be more effective to ask direct questions of EWS whilst assessing the required documents on site. As a result of questions asked at that visit EWS provided its newly commissioned Frontier Model<sup>108</sup>, which was identified within the documents provided at the site visit. In response to a section 26 notice dated 27 November 2002 asking for information about the documents received on site, including specific detail about the spreadsheets provided, EWS provided ORR with its standard cost model<sup>109</sup>. Subsequent exchanges between ORR and EWS arising out of ORR’s assessment of the cost models and the responses to questions about the documents provided at the site visit assisted ORR in understanding the spreadsheets provided previously.

24. The Frontier Model has been used by ORR to evaluate EWS’s pricing on the flows to Cottam and West Burton since, if a new model was introduced to the cost team it was presumably because this model was considered more accurate than its predecessor. However, as stated under the sub-heading *EWS ex-post revisions to price-cost analysis* (within part II C, *Predation on flows to Cottam and West Burton*) it is not clear that there was agreement within EWS about how and when the model

---

<sup>108</sup> Provided electronically on 28 October 2002

<sup>109</sup> Provided electronically on 6 December 2002

was to be used and about its robustness more generally. In light of these concerns, ORR has attempted to obtain from EWS contemporaneous documentation which would reveal how the Frontier Model was developed and how it was to be used.

25. ORR's first letter to EWS on this subject was sent on the 3 May 2005, to which EWS responded by letter dated 11 May 2005 requesting that the letter be framed by way of a section 26 notice and indicating that it considered documents (namely communications between Freshfields and Frontier Economics, and between EWS and Frontier Economics) to be protected by litigation privilege (this claim made without prejudice to any claim for legal advice privilege that may also exist). ORR accordingly issued its 6<sup>th</sup> section 26 notice on 17 May 2005, with a covering letter providing the basis for this information requirement and challenging the claim to litigation privilege. An extension was also granted for provision of Frontier documents until 10 June 2005 – extended until 7 days after the resolution of the matter, by recourse to the court if necessary. Following that initial exchange, there then followed a number of exchanges between ORR and EWS, recorded in the chronology of the case at Annex A to this Notice.

*Objective justification for differences in prices quoted*

26. In the section 26 notice of 10 August 2001, ORR asked EWS to provide, in relation to 16 specified routes<sup>110</sup> (where it is noted that ECSL has been offered a higher price for traffic over the same route), reasons “*why price discrimination has occurred in each of the instances identified [...]*.” ORR also asked for information “*as to whether EWS operates, or has operated at any time since 1 March 2000, a policy of charging a higher price to ECSL than to other customers for equivalent rail haulage operations.*” EWS responded on 7 September 2001 that it, “*has no policy of offering Enron a higher price than to other customers...*” and “*rejects the assertion by ORR that price discrimination has occurred*” EWS also stated that this was “*contrary to the evidence submitted in response to the [notice of 11 May 2001].*”

27. This response was not borne out by the documents at that time already provided by EWS, for example:

- (a) An internal budget review layout created in January 2001<sup>111</sup>, “The prices we currently charge Enron are higher than others on most flows [...]” and.
- (b) An internal briefing paper dated 15 May 2000<sup>112</sup>, “Our *current contract with Enron expires after 30<sup>th</sup> June. The rates in our contract were agreed last July and all are higher than the rates agreed before then with existing power companies.*”

---

<sup>110</sup> A revised table of routes was attached to a letter from the Regulator dated 11 October 2001 taking account of EWS responses, a further 8 routes were identified in a section 26 notice of 19 March 2002

<sup>111</sup> Document 219 of file 7 of documents provided by EWS in response to a section 26 notice of 11 May 2001

<sup>112</sup> Document 20 of file 6 of documents provided by EWS in response to a section 26 notice of 11 May 2001

or documents provided thereafter:

- (c) An e-mail from Nigel Jones to Ed Burkhardt and other internal parties on 10 June 1999<sup>113</sup>, advised that it was confirmed that day that ECSL had been appointed as EME's agent for all fuel handling and logistics in the UK. Nigel Jones went on to say: *"I am also developing proposals for a different and far more structured set of commercial arrangements that will at the very least ensure that Enron earn their management fee whilst protecting and strengthening our position! The one plus point out of this is that we might just have the scope for some slightly higher prices."*
- (d) An internal handwritten brief from Nigel Jones to Ian [Braybrook, Managing Director][undated]<sup>114</sup> which stated: (page 3): "Enron are still angry at the prices agreed for this winter's deliveries. They know they are higher than comparable prices in other contracts although they can't prove it without other parties being in breach of contract (Enron's prices are 30% higher than others);" and
- (e) Nigel Jones comments in an e-mail dated 13 September 1999<sup>115</sup> referring to obligations to move anything anywhere in existing generator contracts: *"The only new customer, Enron, is the one where we do not have these sort of obligations and where I have put the prices up by 35%!"*

28. In a letter of 11 October 2001, ORR noted that the statement provided by EWS did not answer *"whether EWS has operated any such policy at any time since 1 March 2000 [...]"*. ORR also referred and attached the documents identified above and noted further that table 8a (referred to previously) did not confirm EWS's statement that price discrimination had not occurred.

29. EWS's response of 19 October 2001 stated:

*"2.4. EWS does not dispute that on some routes ECSL may have been quoted or even charged a higher price than other customers. However, this does not amount to price discrimination.*

By definition, ORR's allegation of a "policy of price discrimination" requires that EWS has systematically quoted higher prices to ECSL than to other customers for equivalent transactions. While EWS does not dispute that some examples of higher quotes may be cited from table 8(a), the table clearly demonstrates that there is no systematic quoting of higher prices. Moreover, the quotes selected by ORR do not apply to equivalent

---

<sup>113</sup> Provided by EWS at document 209 to Volume 3 to documents provided in response to a section 26 notice of 19 March 2002

<sup>114</sup> Document 272 of Volume 3 of documents provided by EWS in response to a section 26 notice of 19 March 2002

<sup>115</sup> Document 270 of Volume 3 of documents provided by EWS in response to the section 26 notice of 19 March 2002

transactions...It will be apparent therefore that we do not consider that price discrimination against ECSL has occurred.”

30. Various contextual reasons why prices may be different to different customers at different times over the same routes, were provided, however, no cost based objective justification were been proffered. ORR responded on 21 November 2001 seeking further clarification in particular regarding:

(a) potential cost- based explanations for different price quotes:

“In the second bullet point under paragraph 2.10, you state that if a potential customer does not pursue a negotiation (for instance, where they have found they have no need for the service because they have not won the coal supply contract to which the haulage relates) it is to be expected that the last price quoted to that customer will be higher than the last price quoted and agreed in a concluded negotiation. If you are saying, as appears to be the case, that EWS would be prepared to offer a lower rate to Enron once Enron has won a coal supply contract than it would otherwise be willing to offer Enron for traffic over a particular route, then we need to understand your justification for this. Can you, for example, point to cost savings, which accrue to EWS in these circumstances?”

(b) The full list of factors taken account of in the setting of specific prices to different customers:

“In paragraphs 2.11 to 2.17 you describe various factors which you say may go to explain differences in prices quoted. From paragraph 9.1 onwards you set out “some of” the specific factors which you say explain the differences in quotes on the 15 routes we have identified. What I asked you to provide (originally by the section 26 notice of 10 August 2001 and again in my letter of 11 October 2001) was an explanation of why price discrimination had occurred in each of the 16 (now 15) instances identified in our table. We therefore require the full *list of those factors that were actually taken into account in setting the respective rates in each case...*”

31. In its response of 20 December 2001 EWS refused to accept that price discrimination had arisen – and deployed much the same arguments as set out in its Response (see in particular paragraph 7.17). Annex 1 to the letter again attempted to justify why the prices compared were not prices relating to equivalent transactions and further contextual detail was given.

# Annex H: Electricity generation by fuel type

Electricity generation (gross supplied) by fuel type in TWh by the major power producers<sup>116</sup>

	2001	2010		2020		
	DUKES <sup>117</sup>	EP68 CH	Consistent with IAG (A) <sup>119</sup>	EP68 CH	Consistent with IAG (A) <sup>120</sup>	Consistent with goals in the 2003 Energy White Paper <sup>121</sup>
Coal	121	83	74	49	40 to 45	20 to 25
Oil	2	0	0	0	0	0
Gas	124	173	138	264	220 to 250	170 to 200
Nuclear	83	66	66	27	27	27
Renewables	10	41	41	41	40 to 45	70 to 85
Imports of electricity	13	8	8	6	6	6
Total	354	371	328	387	320 to 370	290 to 335

Note to table: DTI has confirmed that any anomaly in the total reflects a rounding to nearest 5 Mtoe and that figures are in ranges to reflect uncertainty

<sup>116</sup> Estimates of primary energy demand – DTI note.  
[www.dti.gov.uk/energy/whitepaper/est\\_energy.pdf](http://www.dti.gov.uk/energy/whitepaper/est_energy.pdf)

<sup>117</sup> Digest of UK energy statistics 2002, Table 5.6, gross supplied

<sup>118</sup> Annex 2 to the Energy White Paper at [www.dti.gov.uk/energy/whitepaper/annexes](http://www.dti.gov.uk/energy/whitepaper/annexes) As part of the energy White paper published in February 2003 the DTI had carbon projections drawn up by an interdepartmental Analyst group (IAG) in which alternative projections were derived. The projection considered most appropriate to represent a "business as usual" baseline projection after 2010 is referred to as IAG (A). This estimates total UK carbon emissions of 135MtC in 2020 rising to 145MtC in 2050

<sup>119</sup> EP 68 CH adjusted for the full impact of the Climate Change programme measures not included in EP 68. Data rounded to the nearest 5 Mtoe

<sup>120</sup> EP 68 CH adjusted for the full impact of the Climate Change programme measures not included in EP 68. Data rounded to the nearest 5 Mtoe

<sup>121</sup> Achieving the carbon savings as outlined in chapter 2 and around 20% renewables. Range shown represents uncertainty as shown by the IAG (A) World market and Global Sustainability scenarios from IAG report. Data rounded to nearest 5 Mtoe

# Annex I: Structure of EWS Coal team

---

1. This annex provides a summary of the structure of the EWS Coal team and its chain of management from the period July 1999 to January 2003.

2. **The EWS Executive Team** comprises the Chief Executive Officer, the COO, the Finance Director, the Planning Director, the Legal Director, the Engineering Director, the Chief Information Officer, the Human Resources Director, the Safety and Risk Director, the Corporate Communications Director, the National Engineering Manager, the General Manager, Operations and Director General, Euro Cargo Rail.

3. **The General Manager, Coal** heads the EWS Coal Division. The General Manager Coal reports to Mr Allen Johnson (Marketing Director from 13 March 2000<sup>122</sup> to October 2000, retitled Commercial Director from that date until April 2001, then retitled Chief Operating Officer from April 2001 until 31 May 2005, when he left the company). He is responsible for three main functions:

- (a) the commercial arrangements with customers in relation to coal, in which he is responsible for the Market Managers/Business Managers in the Coal team;
- (b) since August 2000, the operational and planning requirements to satisfy these arrangements, in which he supervises the coal Customer Service Delivery Centre (CSDC) team; and
- (c) the revenue performance of EWS's Coal division, in which he obtains assistance from the Finance Manager, Coal, who reports to him.

4. **The Coal Marketing Managers**<sup>123</sup> are the interface between EWS and its customers. Each manager is responsible for one or more customers or contracts. His responsibilities broadly consist of day-to-day conduct of account/customer relationships, facilitating problem solving and providing rate quotations, agreeing service level specifications with customers and communicating those specifications to EWS's service delivery and operations teams to enable EWS to perform the agreed services.

---

<sup>122</sup> Previously General Manager, Coal reported to Mr Johnson's predecessor Julien Worth, Marketing Director.

<sup>123</sup> EWS response of 3 June 2005 advises that "[a]lthough there was some difference over time between the precise job titles of the Market Managers, there were no significant differences of role or responsibility between the various titles of Market Manager, Minerals; Market Manager, Coal; or Business Manager, Coal. In practice, all such Managers within the Coal team, regardless of precise job title from time to time, were engaged in the same activities of managing relationships between EWS and its coal haulage customers."

5. **Coal Marketing Managers** are involved in close liaison with:
- (a) EWS's Regional Managers who are responsible for managing train crew, ground staff, yards and other facilities and ensuring EWS operates trains safely according to its Safety Case; and
  - (b) EWS's service delivery and operations teams (including, from the creation of this position in April 2001, The General Manager Resources) who are responsible for the provision of locomotives, wagons, train crew and ground staff to, amongst others, the General manager Coal,

to ensure that trains are delivered to customer specification. The Marketing Manager also seeks the support of the customer in improving train operations, particularly with regard to loading and discharge times.

#### *Discretion of Market Managers*

6. In relation to the addition of further routes under the contracts agreed between 1997 and 1998 with Powergen, National Power and Eastern (the Legacy Contracts), Coal Marketing Managers had discretion, within the terms of those contracts, to provide quotes/rates.

7. From 1 March 2000, all new written contracts, estimated as having a value of £[ ... ] million over the term of the contract, required authorisation by the Marketing Director<sup>124</sup>, (a position held by Julian Worth until the appointment of Allen Johnson on 13 March 2000). This in practice meant that the Commercial Director/COO authorised those rates quoted to Edison Mission, AES Drax and British Energy in response to the tenders in 2000, in relation to the ECSL rate requests in 2001, EWS advise in its response dated 3 June 2005 that Mr Johnson's authorisation was not required before EWS could quote rates.

8. Contracts falling below this £[ ... ] million threshold did not require the approval of the Commercial Director/COO.

#### **EWS Coal Management Team from March 1999**

9. The coal team members set out in the Table below are classified as being part of the management team, reporting via the General Manager Coal to the Commercial Director/COO.

---

<sup>124</sup> As explained previously this position was retitled Commercial Director from 13 March 2000 to April 2001, and retitled Chief Operating Officer from April 2001

**Table 1: EWS Coal management team since March 1999**

<b>General Managers, Coal</b>	
Nigel Jones	(General Manager – Minerals) March 1999 to 4 August 2000 <sup>125</sup> . Became General Manager, Minerals and Metals in late 1999 until July 2000.
Post Vacant (David White, as Business Manager, Coal, had responsibility on an interim basis for the Coal team during this time)	Between 5 August 2000 and 11 April 2001 <sup>126</sup>
James Wilson	12 April 2001-3 November 2002 (supervised the handover to Mr. Purves between 15 July and 30 September 2002)  Reappointed General Manager, Coal with effect from on or around 12 December 2002 to end of period
David Purves	15 July 2002 – on or about 12 December 2002
<b>Finance Managers</b>	
Tim Bilby	Finance Manager, Coal from 22 July 2002- 15 October 2003 when he became Joint Sector Finance Manager, Bulk Commodities
Neil Cawood	22 July 2002 – date
<b>Market Managers, Coal (known as Business Managers, Coal from August 2002)</b>	
David Israel (Market Manager, Coal (Wales))	12 August 1996 – 20 May 2003
David White	4 January 1994 – date (Marketing Manager, Electricity and Coal, from 7 September 2004, Marketing Manager Coal)
David Young (Market Manager, Non-ESI) <sup>127</sup>	11 June 2001 – date
Andrew Martin (Business Manager, Scotland)	June 2001 - present
Shaun Pheasey	Market Manager, Drax from August 2000. Market Manager, Minerals/Business Manager Aire Valley from August 2002
Martin Wilks (Market Manager, England)	March 2000-31 December 2000
<b>Consultant</b>	
David Griffiths	Since 1999 – date

10. ORR uses the following as reference for this summary. First, the EWS response dated 10 May 2002 to a section 26 Notice dated 19 March 2002 in which at paragraph 10 ORR asked EWS:

<sup>125</sup> Succeeded Roger Pettit who held the position of General Manager, Minerals from 16 December 1996 to March 1999

<sup>126</sup> During this period the Marketing Managers reported directly to Allen Johnson

<sup>127</sup> Corrected information provided by EWS in an e-mail dated 8 June 2005 to a section 26 notice dated 17 May 2005

”For the period since 1 March 2000, please describe, by reference to an organogram, EWS’s organisational structure (including reporting chains) in relation to its business in the sale of carriage of coal by rail. Please explain the **role of the marketing managers**, in particular specifying the amount of discretion that they possess in negotiating prices and other terms and conditions of supply with customers, saying to whom in EWS they report, and identifying the coal team marketing managers employed by EWS since 1 March 2000, please provide this information in respect of each different structure that has operated since that date”;

11. Second, the table headed “dramatis personae”, provided as Table 1 in section 2 of the Response (the Table). Third, paragraphs 7.94 – 7.107 of section 7 of the Response. Fourth, EWS’s response dated 17 June 2005 to a section 26 notice of 16 May 2005.

# Annex J: Map of power stations, coal sources and port locations



# Annex K: Supporting information to ORR cost analysis

---

[...]