

Anticipated acquisition by Continental AG of Veyance Technologies Inc

ME/6440-14

The CMA's decision on reference under section 33(1) given on 1 October 2014. Full text of the decision published on 5 November 2014.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

Summary

1. The parties are Continental AG (**Continental**) and Veyance Technologies Inc (**Veyance**). Continental is active in auto, truck and industry parts manufacturing, and produces, among other products, tyres, brake systems, conveyor belts and airsprings. Veyance is a US-based company manufacturing and selling rubber products, including conveyor belts, airsprings, hoses and power transmission products.
2. The parties notified the merger to the Competition and Markets Authority (**CMA**) on 4 July 2014. The statutory deadline was subsequently extended under section 34ZB of the Enterprise Act 2002 (**the Act**). The CMA's statutory timetable now expires on 1 October 2014.

Frame of reference

3. The parties overlap in a large number of products including: conveyor belts, airsprings for utility vehicles, automotive hoses and power transmission products.
4. The CMA considered each of the above product categories separately. In relation to power transmission products and conveyor belts, including all possible narrow sub-segments, such as specialty conveyor belts, lightweight conveyor belts, heavyweight steel cord conveyor belts and heavyweight textile conveyor belts, the CMA did not find it necessary to conclude as no competition concerns arise even on the narrowest basis.

5. The CMA considers that airsprings for utility vehicles for original equipment manufacturers (**OEMs**) should be considered a distinct frame of reference because OEM customers may have higher specifications than those in the replacement/aftermarket channel. Third parties considered that there are more alternatives available to replacement customers than OEMs, and that barriers to entry to the OEM channel for new producers are high.
6. The CMA considers that hoses used for automotive purposes and hoses used for industrial purposes are distinct. Within the supply of automotive hoses, there are separate suppliers of raw hose to hose line assemblers and the assembly of automotive hose lines by assemblers. Veyance is active only in respect of the supply of automotive hoses, supplying the raw hose to hose line assemblers. Continental is active in both the supply of automotive hoses as stand-alone products and in the assembly of hose lines in Europe and elsewhere.
7. There are two different types of raw hose commonly used in automotive industry: barrier air conditioning (**AC**) hose and veneer AC hose. In the EEA, Continental is active in supplying veneer AC hose, while Veyance is active in barrier AC hose. We found that demand-side substitution is not possible between these types of hose and that, on the supply side, it is more difficult to move from one type of hose to another than to increase the quality of a particular type of hose. It does not appear that production can be switched quickly in response to a small rise in price. Based on the evidence available to it, the CMA considered that raw barrier AC hose and raw veneer AC hose should be considered separately.
8. The CMA also considered the appropriate frame of reference for the downstream market, hose assembly.
9. From the demand side, there is a need to produce specific hose assemblies for each OEM requirement. From the supply side, most hose assembly companies operate across a range of products (ie they are active in both barrier and veneer AC hose assembly). While third party respondents considered that it would be possible to switch resources to operate in a different hose assembly area, the CMA was not provided with evidence suggesting that they have the ability and incentive quickly to shift capacity, so as to widen the frame of reference based on supply-side substitution. Accordingly, the CMA has taken AC veneer hose assembly and AC barrier hose assembly as the appropriate downstream frames of reference.
10. The CMA found that the appropriate geographic market appears to be European for most of the overlap markets. However, the possibility of a global market was raised for raw hose, which third parties considered are relatively

less expensive to ship. On a cautious basis, the CMA examined supply in the EEA but did not find it necessary to conclude on this point.

Competitive assessment

11. The CMA assessed whether horizontal unilateral effects would arise in the supply of conveyor belts, specifically heavyweight steel or textile belts, as a result of the merger. The CMA found that Continental was the strongest player in this market and Veyance had a small presence with a share of supply of less than [0–10]% in the EEA. Moreover, the evidence indicated that there would be at least four credible competitors (Fenner Dunlop, Semperit, Cobra and Bridgestone) remaining in the market. Accordingly, the CMA found no realistic prospect of a substantial lessening of competition (**SLC**) as a result of a loss of competition between the parties in the supply of heavy-weight steel or heavyweight textile belts.
12. The CMA secondly assessed the likelihood of unilateral effects arising in the supply of airsprings for utility vehicles to OEMs. It considered bidding and switching data provided to it by the parties, as well as evidence submitted by third parties. The evidence, including bidding data, internal documents and feedback from market testing, indicated that the merging parties are not each other's closest competitors. The CMA also found that there were sufficient remaining credible suppliers which provide options for OEMs and other customers for airsprings. These include Firestone and Vibracoustic, who are active across the EEA including in the UK. Accordingly, the CMA found no realistic prospect of an SLC for UK customers as a result of the merger in the supply of airsprings for utility vehicles to OEMs in the EEA.
13. The CMA also assessed whether vertical effects would arise as a result of the merger following third party concerns. The merged entity would have a strong position in the supply of raw AC hose (particularly AC barrier hose) and third parties raised a concern that it would have the ability and incentive to restrict access by its downstream rival hose assemblers to raw hose.
14. The CMA therefore examined whether the merger might result in the foreclosure of independent hose assemblers, thus leading to a realistic prospect of an SLC. Assessing the ability to foreclose, the CMA found that there do not appear to be any close substitutes available for Veyance hose for existing models, although more supply alternatives appear available for new models. Assessing incentive, the CMA found that there would be limited incentive to foreclose as regards existing models, due to the negative reaction this would provoke from the industry and the relatively small size of the barrier AC assembly market in the EEA. In relation to both new and existing models, the CMA found that Continental would have to expand into barrier AC hose

assembly (where it is not currently active) and this would limit its incentive to engage in foreclosure strategies.

15. Considering the evidence in the round, the CMA found that for existing models, although the merged entity may have the ability to foreclose, it lacks the incentive to do so. In relation to new models, the CMA found that both the ability and the incentive to foreclose is limited. The CMA therefore found that there is no realistic prospect of an SLC arising in the EEA from the merged entity's increasing price, or refusing to supply raw AC barrier hose to independent hose assemblers.
16. This merger will therefore **not be referred** under section 33(1) of the Act.

Parties

17. Continental is a German publicly listed company with global activities in the production and distribution of auto, truck and industry parts. The company has its headquarters in Hanover, Germany, and produces, among other products, tyres, brake systems, conveyor belts and airsprings. Continental is a global group and in the 2013 financial year achieved a worldwide turnover of approximately £[X]. It achieved EEA turnover of £[X], of which £[X] was achieved in the UK.
18. Veyance is a US-based company manufacturing and selling rubber products, including conveyor belts, airsprings, hoses and power transmission products. Veyance was formed when funds managed by the affiliates of the Carlyle Group purchased the Engineered Products Division of The Goodyear Tire & Rubber Company in March 2007. In 2012, Veyance generated total revenues of £1.3 billion worldwide. Its main production sites are located in the USA, Canada, Mexico, South America and China, ie outside of Europe. In the financial year 2013, Veyance's UK turnover was [X] (or approximately GBP [X]).

Transaction

19. Continental announced on 10 February 2014 that it had agreed to acquire Veyance. The merger agreement provides that Continental will acquire sole control of Veyance. It will do so via its indirect wholly-owned subsidiary South Acquisition Corp., Inc., a Delaware corporation. South Acquisition Corp., Inc. will be merged into EPD Holdings Inc. (EPD), the parent company of Veyance. EPD will be the surviving corporation. The shares of EPD will then be cancelled and the shares of South Acquisition Corp. will be converted into shares of the surviving corporation.

20. The completion of the merger is subject to merger control approval in China, Brazil, South Africa, Germany, Austria, Mexico, Canada, Australia and the UK. ^[Endnote 1]

Jurisdiction

21. The CMA considers that, as a result of the proposed merger, Continental and Veyance will cease to be distinct.
22. The parties overlap in the supply of original equipment airsprings for utility vehicles, with an estimated combined share of [30–40]%, increment [10–20]%, in the UK. The CMA considers that the share of supply test in section 23(2)(b) of the Act is therefore satisfied.
23. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation pursuant to section 23 of the Act.
24. The parties notified the merger to the CMA on 4 July 2014. The statutory deadline was subsequently extended under section 34ZB of the Act. The CMA's statutory timetable now expires on 1 October 2014.

Frame of reference

25. The parties have submitted and third parties have agreed that the parties overlap in a large number of products including: conveyor belts, airsprings for utility vehicles, automotive hoses and power transmission products (**PTP**).

Product scope

PTP

26. The parties overlap in PTP. PTP are used for the transmission of power where shafts are separated at distances greater than that for which gears are practical.
27. The CMA's approach to product scope is generally to start with narrow candidate markets and then consider whether these should be widened as a result of substitution on the demand side. If appropriate, the CMA then considers if substitution on the supply side allows several products, which are not demand-side substitutes, to be aggregated into one wider market.¹

¹ [Merger Assessment Guidelines](#), paragraph 5.2.11.

28. The parties consider that automotive PTP and industrial PTP form two separate product markets. They submitted that the following relevant product markets exist within the PTP segment:
- (a) industrial PTP;
 - (b) automotive PTP;
 - (c) automotive PTP independent aftermarket; and
 - (d) replacement products for automotive PTP.
29. The CMA considers the geographic market to be at least Europe wide (see paragraphs 65 to 67 below). The overlap between the parties in Europe is limited, as Veyance has a minimal presence in Europe in all four segments identified above. No third party raised objections to the market definition proposed by the parties. However, as no concerns were raised about PTP products during the CMA's investigation, it was not necessary for the CMA to conclude on this. PTP products are not therefore discussed further in this decision.

Conveyor belts

30. The parties overlap in conveyor belts. These are used to transport single items or bulk materials. They are made mostly of rubber or plastic and may be reinforced with textile or steel if necessary.
31. The European Commission has previously looked at this market.² The market definition that was used was:
- (a) specialty conveyor belts;
 - (b) lightweight conveyor belts; and
 - (c) heavyweight conveyor belts, distinguishing between:
 - (i) steel cord conveyor belts; and
 - (ii) textile conveyor belts.
32. The parties submitted that there exists a distinction between specialty conveyor belts and lightweight and heavyweight conveyor belts. However, in the view of the parties, steel cord conveyor belts and textile conveyor belts are substitutable on the demand side. This is because textile belts can be

² COMP/M. 3436 – *Continental/ Phoenix*, decision of 26 October 2004 (hereafter *Continental/Phoenix*).

used for the same applications as steel cord conveyor belts and can have an identical loading capacity.

33. The parties also submitted that a further distinction needs to be made for the service market for conveyor belts – that is, the installation of replacement belts, advice and the maintenance of metal parts such as rollers.

Further segmentation for low-end and high-end heavyweight belts

34. The CMA notes the wide range of specific types of conveyor belts that exist. For example, both textile and steel belts can be produced in various thicknesses, resistances to oil or heat and durabilities. Further, several third parties believed that various qualities exist within the market.
35. One customer and one competitor believed that there was a distinct segment for high-end products within the heavyweight belt divisions, accounting for the fact that a small percentage of products exist which are of high specification, and which it was claimed could not be replaced by lower-specification products. Examples were provided, including high-durability products for lignite mining applications, a pipe-design product to reduce scattering of lightweight materials and a product capable of conveying highly abrasive materials, such as iron ore.
36. However, three customers and one competitor thought that the market was more accurately described by a spectrum of quality. Further, a number of third parties believed that trade-offs between price and quality were common for many customers across the types of belts within the heavyweight textile and heavyweight steel segments.
37. There was broad consensus that most firms produce products that are competitive at both ends of the market, and also that the higher end is significant in size. One customer thought that, broadly speaking, higher-end products were sold as frequently as lower-end products, and another that higher-quality products would become an increasingly significant part of the market in the future.
38. Overall, the CMA considers that the evidence received in the current case suggests that a further segmentation is not necessary. It has taken the submission about potential distinctions for a high-end segment into account directly as part of the competitive assessment.

Airsprings

39. The parties are both active in the supply of airsprings for utility vehicles to OEMs. The CMA has therefore taken this as its starting point when considering the appropriate product scope.³ The parties also overlap in the replacement market. However, as third parties confirmed that a wide variety of options are available to them in the replacement market, and as no concerns were raised, it is not therefore discussed further in this decision.

Rail and industrial airsprings

40. The parties suggest that automotive airsprings are distinct from airsprings for rail vehicles and industrial airsprings.
41. The CMA's market testing found that the majority of third parties agreed that airsprings for utility vehicles were different from other solutions (eg steel springs) or to airsprings used in other sectors such as rail, and were not demand-side substitutes. On the supply side, several suppliers in these markets (including Veyance) appear to specialise and there is no evidence that moving between product categories would be possible within a relatively short time frame. For example, a competitor was only active in airsprings for rail vehicles and not for utility vehicles. On this basis, the CMA has not widened the product scope of airsprings for utility vehicles to OEM to include rail or industrial airsprings.

OEM and replacement market

42. Within airsprings for utility vehicles, previous European cases have distinguished supply to OEMs and supply to the replacement market.⁴
43. The parties submitted that airsprings for utility vehicles have a different competitive offering depending on whether they are for OEMs or for the replacement market. The OEM customers may have higher specification and suppliers may develop sales in the replacement market before gaining OEM contracts. While one third party considered that this distinction was not necessary, all other respondents agreed that OEM customers had fewer alternatives. Customers in the replacement market confirmed that they had more varied choices and appeared to find it easier to switch sources of supply.

³ [Merger Assessment Guidelines](#), paragraph 5.2.11.

⁴ *Continental/Phoenix*, paragraph 52.

44. Third parties commented that there are high barriers to entry; for example, as a result of the vetting process to supply products to the OEM channel and the quality and reliability standards that needed to be met (compared with those in replacement). Although customers in the replacement segment can buy from suppliers active in the OEM channel, this is not necessarily true in the reverse.
45. The CMA has considered the merger on the basis of airsprings for utility vehicles to OEMs.

Hoses

46. Hoses are flexible connections which can be used for the transport of liquids, gases and solid materials. They can be made from rubber or synthetic rubber as well as from plastics and are used in industrial and automotive applications.
47. The parties submitted that the following five product markets exist within the hoses segment:
 - (a) industrial hoses;
 - (b) automotive hoses⁵ (OEM);
 - (c) automotive hoses⁶ (aftermarket/replacement);
 - (d) automotive hose assemblies (OEM); and
 - (e) automotive hose assemblies (aftermarket/replacement).
48. The parties overlap with regard to the supply of hoses used for automotive purposes; and hoses used for industrial purposes. The parties' combined market shares for the industrial hose segment are low, an estimated [0–10]% with an increment of around [0–10]%. Third parties did not raise concerns about the parties' activities in industrial hoses. Therefore, given these factors, this segment is not considered further.

Automotive hoses and hose assembly

49. Veyance is active only in the supply of automotive hoses, supplying the raw hose to hose line assemblers. Continental is active in both the supply of automotive hoses as stand-alone products and in the assembly of hose lines

⁵ ie 'raw', unassembled hose.

⁶ As above.

in Europe and elsewhere. The parties submitted that currently, Continental assembles hose lines using:

- (a) automotive hoses it manufactures itself (ie self-supply); and
- (b) automotive hoses of third party suppliers.

Raw automotive hoses – barrier and veneer AC hose for OEMs

- 50. There are a large range of elastomer hoses produced for automotive uses. These include brake hose and AC hose, and hoses supplied for the OEM and replacement markets. The parties are both active in supplying raw AC hose for assembly for the OEM market; in Europe Veyance is active in supplying raw barrier AC hose, while Continental is active in supplying raw veneer AC hose.
- 51. Third parties in response to the CMA's market investigation considered that it was appropriate to distinguish between these types of AC hose.
- 52. From a demand-side perspective, third parties have said that the type of hose to be used in a particular model of car will be chosen during the design process, and that once the model has been released it will not be possible for OEMs to use a veneer AC hose in a car that has been designed to use a barrier AC hose. Third parties indicated that both the OEM and the hose assembler supplying that OEM will have a particular demand for each type of hose for a particular model of car and will not be able to change to a different type of hose in response to a small price rise. The parties submitted that switching components by an OEM would 'not be done lightly' and that competition 'tends to be for business for new models'. OEMs responding to the CMA's market investigation confirmed that they would only switch supply at the initial design phase of a new model or in response to severe supply problems related to quality or bankruptcy, and that this would not involve switching between barrier and veneer hose. They told the CMA that validation of a new raw hose from a new manufacturer would take more than six months and cost up to \$250,000 (approximately £152,000).
- 53. Regarding the supply side, the parties submitted that [X] is needed to be able to produce a different type of hose. However, third parties considered that supply-side substitution is not possible in elastomer or automotive hose production. The parties both appear to specialise to some extent, with Continental focusing on veneer AC hose in Europe and relying on purchases from Parker for barrier AC hose in the USA. Veyance does not sell veneer AC hose at all in Europe. It supplies barrier AC hose in Europe and North America. Third parties commented that it is more difficult to move from one

type of hose to another than to increase the quality of a particular type of hose. It does not appear that production can be switched quickly in response to a small rise in price.

54. Therefore, the CMA considers that raw barrier AC hose and raw veneer AC hose should be considered separately.

Hose assembly for OEMs

55. In Europe, Continental is active in assembling veneer AC hose. It is active in assembling barrier AC hose in North America, but not in Europe. Veyance is not active in hose assembly.
56. From the demand side, there is a need to produce specific hose assemblies for each OEM requirement. From the supply side, most hose assembly companies appear to operate across a range of products (ie they are active in both barrier and veneer AC hose assembly), although some firms, including Continental, are specialised. Many hose assembly respondents to the CMA's market investigation considered that it would be possible to switch resources to operate in a different hose assembly area. However, they did not provide the CMA with evidence indicating that firms would have the ability and incentive quickly⁷ to switch production between barrier and veneer AC hose assembly in the event of a small increase in price.
57. On this basis, the CMA has defined separate product frames for barrier AC and veneer AC hose assembly for OEMs.

Conclusion on product scope in hoses

58. The CMA has considered the merger for:
- (a) the supply of raw barrier AC hose for OEMs;
 - (b) the supply of raw veneer AC hose for OEMs;
 - (c) the assembly of barrier AC hoses for OEMs; and
 - (d) the assembly of veneer AC hoses for OEMs.

⁷ ie within a year ([Merger Assessment Guidelines](#), paragraph 5.2.17).

Geographic scope

59. The parties submitted that all overlap markets were at least pan-European. This is because the parties mainly supply to car or vehicle manufacturers that tend to source inputs and supply into, at a minimum, a Europe-wide market.

Belts, airsprings and hose assemblies

60. In relation to belts, airsprings and hose assemblies, the CMA noted that while third parties did not have operations in every country to which they sold products, many of the large competitors appeared to split production in order to have suitable sites in each of the major global regions. Often these firms relied on national or more localised distributors to provide a more tailored service or maintenance. With respect to hose assemblies, third parties told the CMA that assemblers needed a regional presence as the assembled hose is expensive to transport.
61. The CMA notes that all of the parties' internal documents make reference to a geographic market that [REDACTED].
62. There are [REDACTED] and in the EEA context the UK does not seem significant enough to warrant a special strategy from any of the major firms in the industry. In terms of the supply options available, conditions of competition appear to be very similar in the UK to across the rest of Europe.
63. The CMA therefore considers that a national market for conveyor belts, airsprings and hose assemblies does not seem appropriate.
64. Equally, a global market does not seem appropriate for these products. Some customers referred to additional transport costs of 15% or more when buying airsprings from the USA. Others referred to additional delays incurred when buying from further afield, that the EEA has very different product requirements or that these customers need a distributor based in the EEA. These views from third parties appear to be supported by the parties' internal documents, [REDACTED]. Several of the third parties have referred to competitors that they consider are only or mainly in one or a few global regions, including some that have confirmed the parties' suggestion that in certain segments (not discussed here in detail) Veyance is not particularly active in the EEA compared with its position elsewhere.
65. In terms of the geographic market definition, the distinction between the EU and EEA does not appear particularly significant (due to the location of the major customers and competitors). In addition, transport costs from countries close to the EEA (such as Turkey) do not appear to be a particular barrier to the use of these firms for customers in the EEA.

66. As most parameters of competition appear to be set at a European level or in some cases there is adjustment on a customer-specific basis, the CMA considers that the geographic market should be defined as the EEA, with account given to potential suppliers in areas close to this (such as Turkey). The CMA considers that this approach is appropriate for the airsprings, conveyor belts and automotive hose assembly markets. The CMA has, however, focused its analysis on the possible impacts of the merger on customers with operations in the UK.

Raw hose

67. While third parties generally considered that the market was no wider than the EEA for most of the overlap markets, there was less consensus with respect to raw hose. Customers and competitors agreed with the parties' submission that transport costs in respect of raw hose were lower than that for hose assemblies; the CMA was provided with some examples of hose assemblers sourcing raw hose from suppliers located in a different region. However, the CMA notes that customers in Europe made the vast majority of their purchases from within the EEA, which may indicate that suppliers located elsewhere are not suitable alternatives such that they should be included in the frame of reference. On a cautious basis, the CMA examined the merger with a geographic scope of the EEA. However, the CMA has not needed to conclude on this point, as it finds no concerns even on this narrowest plausible basis.

Unilateral horizontal effects

68. Horizontal unilateral effects can arise where a firm merges with a competitor that previously provided a competitive constraint, and are more likely where the merger firms' products compete closely.⁸

Conveyor belts

Loss of current competition

69. The parties submitted that Veyance has no presence in the UK in any market segment within conveyor belts and therefore that horizontal unilateral effects cannot arise from the merger. This was in contrast to one third party who believed that 'Continental, Veyance and Bridgestone are the only reputed conveyor belt manufacturer[s] in [the] "High End" market segment'.

⁸ [Merger Assessment Guidelines](#), paragraphs 5.4.2 and 5.4.6.

Specialty belts and servicing

Shares of supply

70. In specialty belts, the parties submitted that Continental had a share of supply of [20–30]%, with an increment of [0–10]% due to Veyance in the EEA in 2012. The parties submitted that Veyance had no sales in the UK. No concerns were raised by third parties in respect of specialty belts.
71. Similarly, in servicing the parties submitted that Continental has a share of [0–10]%, with Veyance on [0–10]% in the EEA. Again, the parties submitted that Veyance had no UK sales. No concerns were raised in respect of servicing.
72. The CMA found no evidence that Veyance was active in the UK in either segment and received no customer concerns. Accordingly the CMA finds no realistic prospect of an SLC in relation to specialty belts or belt servicing in the UK.

Heavyweight belts

73. The parties suggested shares of supply as follows:
 - (a) **Heavyweight textile:** Continental with [20–30]% and Veyance with [0–10]% in the EEA in 2012. Veyance does not sell into the UK.
 - (b) **Heavyweight steel:** Continental with [20–30]% and Veyance with [0–10]% in the EU in 2012. Veyance makes minimal sales to the UK.
74. Evidence from third parties suggested that Continental has by some margin the largest share of supply in the UK. Market share estimates varied substantially: one customer estimated Continental to supply [50–60]% of the UK market for heavyweight textile belts and a slightly higher level for heavyweight steel cord belts, whilst another thought the figure would be around [20–30]%. This compares with the estimate submitted by Continental that it supplies less than [0–10]% of the heavyweight steel belt market in the UK.
75. The CMA received a concern related to the existence of a ‘high-end’ segment within heavyweight textile and heavyweight steel belts, and the loss of competition in these segments. However, the CMA found very little evidence that Veyance has any material presence in the supply of heavyweight belts in the UK/EEA market. Third parties did not generally consider that it was appropriate to distinguish the high-end segment, and even if it was appropriate to do so, the CMA found no evidence that Veyance supplies to the UK heavyweight textile belt, speciality belt or belt servicing markets. Whilst the firm is present in the heavyweight steel market, the evidence received by the

CMA indicates that it has a share of supply of less than [0–10]%. The fact that share estimates for Continental varied significantly is not therefore significant, as the evidence received by the CMA suggests that the increment attributable to Veyance is minimal.

76. Further, many firms remain in the market that are bigger than Veyance. Third parties considered that there would be least four credible competitors remaining in the market (Fenner Dunlop, Semperit, Cobra and Bridgestone). Three customers which responded to the CMA’s market investigation also viewed manufacturers from China as credible competitors in the UK.
77. Accordingly, the CMA finds no realistic prospect of an SLC for UK customers as a result of loss of current competition between the parties in the supply of heavyweight steel or heavyweight textile belts.

Airsprings

Shares of supply

78. The parties submitted the following estimated shares of supply. The market testing that the CMA has carried out broadly supports the parties’ estimates, although the parties submitted that [0–10]% of the parties’ market share may relate to sales that Daimler will move to Vibracoustic in 2015.

Estimated shares for utility vehicles – OEM segment, 2014

<i>Competitor</i>	<i>Sales – Europe €m</i>	<i>Market share – Europe %</i>
Continental	[X]	[50–60]
Veyance	[X]	[0–10]
Combined	[X]	[60–70]
Vibracoustic/Blacktech	[X]	[10–20]
Firestone	[X]	[0–10]
CF Gomma	[X]	[0–10]
Aktas	[X]	[0–10]
A&B	[X]	-
Others	[X]	[0–10]
Total	[X]	100

Source: Parties.

79. The parties provided internal documents which refer to competition from the suppliers in the above table. These documents also make some general references to additional or potential competition from Asian and Turkish suppliers.

Closeness of competition

80. The parties submitted that Continental and Veyance are not close competitors. They submitted that Continental competes for and wins large

contracts, whereas Veyance is only competitive for smaller, niche contracts. Further, the parties suggested that Continental competes for high-volume parts, whereas Veyance, lacking the capacity to produce these, and lacking the requisite economies of scale to produce high-volume parts efficiently, competes for small-volume parts. They submitted that this is reflected in the RFQs it receives. The parties also pointed out that Veyance is excluded from a material proportion of tenders because it only uses natural rubber, and provided some examples of where synthetic rubber had been specified. The parties submitted bidding data, detailing tenders the parties had taken part in as well as the identity of the other suppliers the parties perceived they faced.

81. The CMA learnt from its market testing that all main customers tend to use a single source for each product requirement, but that tenders can be split, and several suppliers will be considered for each tender (mostly for new products or vehicle models). The parties pointed out that there could be multiple winners of a tender because different suppliers focused on different elements of the bid.
82. The CMA considered the bidding data supplied by the parties. It indicated that Continental received RFQs from a large number of OEMs ([REDACTED]), while Veyance received RFQs from only [REDACTED] OEMs, and most business came from only [REDACTED]. In particular, the bidding data indicated that Continental and Veyance bid against each other primarily for [REDACTED], with one RFQ issued to both for [REDACTED]. At [REDACTED] and [REDACTED], for Continental, the average value of tenders won is larger than the average value of tenders lost. The opposite is true for Veyance. The parties submitted that this indicates that the parties are competing for different types and different elements of contracts even at OEMs where they bid against each other.
83. The parties' bidding data indicates that Continental only perceived Veyance to also be present in [REDACTED] out of [REDACTED] bidding events⁹ that it participated in over the past five years. It suggested that Veyance was not posing a competitive constraint for business from any customers that it was not currently supplying because it had maintained a narrow customer base over many years (the parties submitted that this was a result of Veyance only using natural rubber). The data also indicated that despite the parties sometimes bidding for and winning the same RFQs, any switching of volume was not between the parties. Prices are based on detailed negotiation and the CMA could not find any examples where the parties had been the next best alternative for a

⁹ Although the majority of these bidding events do not relate to UK customers, the CMA has nonetheless considered them as they provide evidence of the nature of the competitive interaction between the parties.

customer and had clearly imposed an actual constraint on commercial terms. This was also the case for their most important customers.

84. However, the CMA is also mindful of the limitations of the bidding data provided by the parties. Some tenders were omitted because of data issues, the Continental and Veyance data sets could not be matched properly, and the information was supplied at an insufficiently granular level to comprehensively assess, in the case of split tenders, which supplier won what parts of the contract. Further, the data on other suppliers who bid was based on the parties' perception and was collected specifically for the purpose of merger assessment. The CMA therefore considers that only limited weight can be placed on the bidding data, but overall, the bidding data is not inconsistent with other sources of evidence examined by the CMA below as part of its investigation, and points toward Veyance not imposing a strong competitive constraint on Continental and Veyance not losing business to Continental. This is particularly so for UK customers, where the evidence available indicates that the parties rarely face each other.

Competitive constraints from other suppliers

85. The parties submitted that Vibracoustic and Firestone, like Continental, are set up to exploit low-cost production and economies of scale, and focus on the largest contracts based on high-volume parts. They therefore pose a strong competitive constraint on Continental. The parties submitted that Vibracoustic has been increasingly successful in recent years in shifting supply shares of larger production contracts away from Continental, even at the latter's major established customers. In addition, the parties submitted that Firestone appears poised to move into a more competitive position due to increased investment in and commitment to Europe (both in terms of production facilities and R&D). The parties considered that for straightforward production contracts, where cost advantages can make a material difference, Turkish manufacturers such as Aktas are also becoming more credible competitors and have had some initial success in competing for supply contracts with OEMs.
86. The CMA notes that Continental's switching data lists a number of contracts where Continental lost all or part of a contract to competitors. The other competitors mentioned in the bidding and switching data provided by the parties were Vibracoustic, Firestone, and to a lesser extent Turkish manufacturers such as Aktas. The parties submitted that in particular, Continental has recently been losing more substantial shares of larger tenders to rivals at OEMs where it used to have a strong historical position. In most cases such losses have been to Vibracoustic. Losses have been either

outright or partial, with Continental losing the role of sole supplier at a number of OEMs, including Daimler.

87. In the bidding data detailing perceived competition from other bidders, Vibracoustic was mentioned as a competitor in [X] out of [X] bids (in all tenders, with the exception of two small-value tenders), and Firestone in [X] out of [X].
88. As noted above, the CMA has placed only limited weight on the bidding data. However, it notes that the general picture suggested by the bidding data is consistent with third party responses; virtually all third parties considered that the leading three firms, Continental, Firestone and Vibracoustic, were suitable suppliers, and that Vibracoustic was the closest competitor to Continental. The CMA considers that both Vibracoustic and Firestone are likely to pose a strong competitive constraint on the merged entity.
89. The parties also submitted that other suppliers present a competitive constraint. Overall, third parties were less convinced on the suitability of other suppliers, including CF Gomma and Aktas. Only one third party considered that each of CF Gomma, Gart, Aktas, Pega/Mekpa, Dunlop and Toyo were suitable suppliers. However, these rivals did appear in the bidding data.
90. Three customers in the airsprings market were unconcerned, while a further five raised concerns. Some of the unconcerned respondents raised doubts over whether Veyance currently actively supplied in Europe, while all of those raising concerns had recently received competitive bids from Veyance (but not necessarily from Continental). Customers that raised concerns generally said that it depended on the product specification as to which of the current four suppliers was cheapest.
91. The parties argued that tender processes can protect against limited competition, for instance through price benchmarking and the ease of switching. Third parties considered that head-to-head competition could be fierce in airsprings. However, the concerned customers commented that a reduction in the number of suppliers would lead to price rises, as Veyance had reached important stages in their tenders. The CMA notes that often these firms inviting bids from Veyance were not inviting all of Continental, Firestone and Vibracoustic to their RFQs. No third party provided an example tender where the parties were ranked first and second.
92. Based on the evidence above, the CMA considers that the merging parties do not appear to be the two closest competitors in tenders. They seem to participate in different tenders or parts of tenders. This is supported by the fact, as noted above, that third parties considered Continental, Firestone and

Vibracoustic to be the three leading suppliers, with Vibracoustic as Continental's closest competitor. In addition, even in the limited examples the CMA has seen where the parties have bid in the same tenders, the evidence does not indicate that they were the two closest bidders. Further, the CMA considers that other suppliers are available (Firestone or Vibracoustic) and could be validated in the future even if specific OEMs have historically chosen not to do so.

93. Based on a lack of evidence indicating that the parties are close competitors for UK customers, and the strong constraint the merged entity will face from Vibracoustic and Firestone and further constraints from other suppliers from outside the EEA, the CMA finds no realistic prospect of an SLC as a result of the merger in the supply of airsprings for utility vehicles to OEMs in the EEA.

Vertical effects

Hoses

Shares of supply

Raw barrier AC hose and veneer AC hose

94. The parties estimated that Veyance has a [70–80]% share of upstream raw barrier AC hoses supplied in the EEA and has around [80–90]% share of raw barrier AC hoses supplied to independent hose assemblers (ie without their own in-house supply).
95. Continental has a [40–50]% share of upstream supply of raw veneer AC hose in the EEA, a significantly larger market.¹⁰
96. Accordingly, considering all raw AC hoses, the parties would have a combined share of supply of around [40–50]% in the EEA, with an increment of [0–10]%.

Hose assembly

97. Continental has a [25–35]% share of AC hose assemblies in the EEA and, considering automotive hose assembly overall, it has a share of [20–30]%. Continental only currently assembles AC veneer hose in the EEA^[Endnote 2] but is a significant operator in AC barrier hose assemblies in North America.

¹⁰ Downstream, the size of the European barrier AC hose assembly market is only [0–10]% of the size of the veneer hose assembly market.

98. Veyance is not active in hose assembly in the EEA.

Foreclosure of downstream rival hose assemblers

99. Harmful vertical mergers typically involve the merged firm harming the ability of its downstream rivals to compete post-merger, for example by raising the input prices charged to its rivals (partial input foreclosure), or refusing to supply them completely (total input foreclosure). Such actions may harm the ability of the merged firm's rivals to provide a competitive constraint in the future.¹¹ The CMA received a number of concerns from third parties, relating to the strong position the merged entity would have in raw AC hose (particularly AC barrier hose) and the possibility that it would seek to exploit this position by restricting access to raw hose by its downstream rivals in AC hose assembly. These third parties pointed out that the parties are important validated suppliers of raw hose and hose assemblies and post-merger the parties will control two key raw hose suppliers.
100. The CMA examined whether the merger might result in the foreclosure of independent hose assemblers, thus leading to an SLC.
101. As noted above, Continental is not currently active in AC barrier hose assembly to any material degree in the EEA. However, Continental is active in the wider market for AC hose assembly through its presence in AC veneer hose assembly. The CMA therefore assessed the possibility that, post-merger, the merged entity might have an incentive to expand into AC barrier hose assembly and restrict the access to raw AC barrier hoses by independent AC hose assemblers downstream, with the aim of diverting sales from these independent assemblers to its own assembly business.
102. The CMA typically analyses non-horizontal mergers by reference to the following three questions:
- (a) *ability*: whether the merged firm has the ability to harm rivals, through raising prices or refusing to supply;
 - (b) *incentive*: whether the merged firm would find it profitable to do so; and
 - (c) *effect*: whether the effect of any action by the merged firm would be sufficient to reduce competition in the affected market to the extent that it gives rise to an SLC.¹²

¹¹ [Merger Assessment Guidelines](#), paragraph 5.6.5.

¹² [Merger Assessment Guidelines](#), paragraph 5.6.6.

103. The CMA has assessed two possible input foreclosure strategies: total input foreclosure and partial input foreclosure:
- (a) Total input foreclosure occurs where the merged firm stops supplying its downstream rivals altogether. This has the effect of reducing the set of suppliers available to rival manufacturers, which might in turn effectively reduce competition in the input market leading to higher input prices for rivals.¹³
 - (b) Partial input foreclosure occurs where a merged firm increases the price it charges for the input to downstream rivals. This in turn would make it harder for rivals to compete by increasing their costs, making them less competitive.¹⁴

Ability

104. The CMA first considered the merged entity's ability to engage in foreclosure strategies. In assessing the ability of the merged firm to engage in input foreclosure, the CMA will consider, among other things, the extent to which rival manufacturers can avoid a price increase by switching away from this input.
105. As is evident from the shares of supply, the merged entity (through Veyance) will have a strong position upstream in AC barrier hose in Europe. Alternative suppliers of AC barrier hoses include both vertically-integrated (into hose assembly) and non-vertically-integrated firms. The parties submitted that other non-vertically-integrated suppliers represent around [X]% of the market and vertically-integrated suppliers around [X]% of the market. The CMA confirmed that some hose assemblers are vertically integrated and supply to OEMs, although it was unable to confirm how much of the market such suppliers represent.
106. As regards non-integrated suppliers, the parties submitted that Hutchinson, Maflow and Tokay-Daytech are the largest and most important competitors to Veyance in supplying raw barrier hose in Europe.
107. Third parties responding to the CMA's market investigation considered that Parker (a US company) was their next best alternative to Veyance. However, Parker [X].¹⁵ Other than Parker, only two other suppliers were named as credible alternatives to Veyance by third parties, Maflow/Codan and Yokohama; the CMA found two examples where these suppliers had been

¹³ [Merger Assessment Guidelines](#), paragraph 5.6.13.

¹⁴ [Merger Assessment Guidelines](#), paragraph 5.6.9.

¹⁵ [X]

used previously or were in the process of being validated to replace Veyance business.

108. However, most third parties were unable to say with confidence that alternative suppliers would be able to meet their needs. OEMs responding to the CMA's market investigation perceived that there were some alternative suppliers available, but hose assemblers were more sceptical that they would be able to meet their needs from other suppliers. In particular, hose assemblers which are current customers of Veyance commented that the quality of the alternative suppliers named by the parties is either low, unsuitable for European OEMs, or that the suppliers might be unwilling to commit to the quality required without very high prices.
109. Further, Veyance's customers noted that, as regards existing models, other suppliers are not validated for the OEM customers for current models on a global basis. The parties submitted that all that was required for validation of a new hose was a 'general release' providing for a release of liability in the event of damages claims. However, third parties did not support this view; they noted that both the new raw hose and the new hose assembly require validation and that each stage takes about four months. Although it is possible for a new supplier to test its own hoses to the OEM's standard, it would be slower to gain validation using a new hose (and, as a consequence, a new assembly) than it would be to gain validation for a new assembly only, using an already validated hose. However, some customer-specific R&D would nonetheless be required to get to the stage of having an assembly to validate.
110. As regards new models, the CMA notes that the increased lead time on new models (up to four years in some cases) may give independent assemblers an opportunity to seek out other sources of supply; OEMs told the CMA that they were keen to encourage competition in the input market and would encourage their independent assemblers to seek alternative suppliers in the face of price rises or supply issues. While the CMA's market testing found that alternatives to Veyance hose are currently limited, as noted above, it was provided with examples of OEMs validating or seeking to validate new suppliers with a view to encouraging competition going forward.
111. Accordingly, although there is some evidence that alternative suppliers may be available, particularly as regards new models, other evidence suggests that other suppliers' products are not close substitutes for the Veyance hose for existing models. The CMA therefore considers that the merged entity may have the ability post-merger to increase the price of (or refuse to supply) raw AC barrier hose to independent assemblers, which would therefore face an increase in their input costs.

Incentive

112. The CMA therefore considered what incentive the merged entity would have to engage in total or partial input foreclosure. To assess whether the merged firm would have an incentive to increase the prices charged for the input to its rival manufacturers, the CMA considers the factors affecting the profitability of such an increase in the input price, and the extent to which these factors change as a result of the merger. In particular, the CMA may assess the following:
- (a) loss of profits in the input market (as rival manufacturers switch to alternatives);
 - (b) gain in profits in the market for the final product (which is reduced if customers do not react strongly to changes in prices for the final product, or the merged firm's final product is a poor substitute for those made by rival manufacturers); and
 - (c) the relative level of variable profit margins on the input and the final product.¹⁶
113. The CMA was not provided with reliable data allowing it to assess the relative level of variable profit margins on raw hose and hose assemblies, although third parties suggested that margins are higher for hose assemblies than for raw hose.
114. To assess the incentive for the merged entity to increase the price for raw hose to independent assemblers, the CMA considered the likely effect on profits in the downstream market as regards existing models and new models separately.
115. In relation to both existing models and new models, the CMA notes that in order to benefit from foreclosure strategies, the merged entity would first have to enter AC barrier hose assembly, which would require some time and costs, including the cost of the expansion, and the time and cost required to research and develop the new assemblies.
116. As regards existing models, OEMs indicated that they would be unwilling to switch the hose assembly in use for models currently in production as this would be disruptive. If the merged entity refused to supply independent assemblers or increased the price to them with the aim of diverting OEM

¹⁶ [Merger Assessment Guidelines](#), paragraph 5.6.11.

demand to its own AC barrier hose assembly business, additional validations and time would be required.

117. Further, OEMs did not consider that the merged entity would engage in strategies which resulted in a notable supply disruption. OEMs which responded to the CMA's market investigation considered that such a strategy would be highly visible to the industry and would have long-term negative consequences for a supplier attempting to engage in it. Continental currently supplies OEMs on a global basis across a very wide range of products; it may not make commercial sense to jeopardise these relationships for increased profits in AC barrier hose assembly in Europe, a comparatively small market (particularly in the UK/EEA).
118. As regards new models, customers told the CMA that they have very specific R&D and design requests, which would not necessarily be easy to fulfil even with Continental's expertise in AC veneer hose assembly.
119. Finally, the CMA notes that despite having a strong position both upstream and downstream in veneer AC hoses in the EEA, Continental is still active in supplying the raw hoses to independent assemblers. The CMA did not receive any complaints as to its behaviour in this regard. This may be an indication that Continental does not have an incentive to engage in foreclosure strategies, as it has not done so previously in veneer AC hose. Nor did Continental's internal documents indicate that it plans to begin supplying AC barrier hose assemblies post-merger. The CMA further considers that AC barrier hose assembly is a small market in the EEA, whereas veneer assembly is significantly larger. This may in itself limit Continental's incentive to carry out foreclosure strategies in the barrier AC assembly market.
120. Taking these factors into account, the CMA finds that the merged entity would not have the incentive to engage in total or partial input foreclosure.

Effect

121. As the CMA has found that the merged entity would not have the incentive to engage in foreclosure strategies, it has not been necessary to conclude on the effect of it doing so.

Conclusion on foreclosure

122. On balance, the CMA considers that for existing models, although the merged entity may have the ability to foreclose, it lacks the incentive to do so. In relation to new models, the CMA considers that both the ability and the incentive to foreclose are limited. The CMA therefore considers that there is

no realistic prospect of an SLC arising from the merged entity's increasing price, or refusing to supply raw AC barrier hose to independent hose assemblers.

Buyer power

123. In some circumstances, an individual customer may be able to use its negotiating strength to limit the ability of a merged firm to raise prices. The CMA refers to this as countervailing buyer power.¹⁷
124. As the CMA has not found an SLC in relation to any market, it has not been necessary for it to conclude on whether sufficient buyer power exists to prevent an SLC.

Barriers to entry and expansion

125. Entry or expansion of existing firms can mitigate the initial effect of the merger on competition, and in some cases may mean that there is no SLC.
126. As the CMA has not found an SLC in relation to any market, it has not been necessary for it to conclude on whether entry or expansion would mitigate any effect on competition. Expansion has been considered above in the competitive assessment where appropriate (eg Aktas and suppliers based in Turkey expanding in airsprings).

Third parties

127. The CMA spoke to a variety of customers of both Continental and Veyance. As a result of its market testing, the CMA received complaints about air-springs and hoses from a total of six third parties. These concerns are dealt with above.
128. One third party suggested that the merged firm will have significant economies of scale in the conveyor belt market. No third parties supported this concern and the CMA considers that other suppliers will remain strong constraints.
129. One third party also suggested that Veyance may also have a strong position with respect to a particular type of brake hose in the EEA. The third party could not give details of the alternatives and no other market participants during our inquiry (including those that should be most affected by this issue)

¹⁷ [Merger Assessment Guidelines](#), paragraph 5.9.1.

raised concerns. The market share of Veyance with respect to brake hose in the EEA is very low, and there is no indication of particular market power in this product.

Decision

130. This merger will therefore **not be referred** under section 33(1) of the Act.

Sheldon Mills

Senior Director – Mergers

Competition and Markets Authority

1 October 2014

Endnote 1: The parties noted that the Transaction was also notified in the USA, Argentina and COMESA and that the competition authority in Chile also initiated a review of the Transaction.

Endnote 2: The parties noted that Continental does have a very minor presence in AC barrier hose assemblies in the EEA, with a share of approximately [<1]%.