Anticipated acquisition by Kingspan Group plc of CRH Insulation Europe, a division of CRH plc

ME/4807/10

The OFT's decision on reference under section 22(1) given on 21 March. Full text of decision published 13 April 2011.

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

PARTIES

1. **Kingspan Group plc (Kingspan)** is a manufacturer of a range of products for the construction industry, including insulation products, which it trades principally under the Therma brand. Kingspan is publicly listed in Ireland and operates internationally. It has manufacturing and distribution operations in Europe, the Far East and the US. Kingspan's global turnover was around £1.0 billion in 2009, of which around £450 million was attributable to the UK.

2. **CRH Insulation Europe (CIE)** is a business division of CRH plc, an Irish listed diversified building materials group, which manufactures and distributes a variety of building materials products. CIE develops manufactures and sells foam insulation products across eight European countries, principally through the **Ecotherm** brand, and has three production facilities and sales offices in the UK.[1] CIE has global turnover of around £248 million, of which [ ] was attributable to the UK.

[1] In the UK, CIE produces PIR at Basildon, and expanded polystyrene (EPS) at Newcastle and Glossop.

TRANSACTION

3. CRH announced in March 2010 that it was seeking to dispose of its insulation business following a strategic review. Kingspan and CRH entered into a sale and purchase agreement on 11 November 2010, and completed the transaction on 18 January 2011.

4. The transaction does not include all of the entities that formed part of the CIE business divisions of CRH, as some including the extruded polystyrene (XPS) insulation business and certain other operations will be retained by CRH. However, Kingspan acquired all of CIE's UK operations.

5. The transaction was subject to mandatory notification in Ireland, the Netherlands, and Germany, all of whom have cleared the transaction.

6. Kingspan notified the merger to the OFT on 22 December 2010, following receipt of a satisfactory submission the administrative deadline for a decision was 3 March 2011. The transaction was completed on 18 January 2011 and the statutory deadline is therefore 17 May 2011.

JURISDICTION

7. As a result of this transaction Kingspan and CIE's UK operations have ceased to be distinct. The parties overlap in the manufacture and supply of polyisocyanurate (PIR) foam insulation products, with a combined share in Great Britain of [35-45] per cent, increment [10-20] per cent. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is therefore met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RATIONALE

8. Kingspan believes the transaction will have a number of benefits, including:
   - The extension of its geographic presence in certain products currently focused on the UK and Ireland, into other European countries, since CIE is active in the Netherlands, Germany, Belgium and Poland.
   - [ ] and
   - The potential to reduce costs through [ ] and enhanced input buying power.

MARKET DEFINITION

9. In the UK, the parties overlap in the manufacture and supply of PIR foam insulation products for building or thermal applications.

Product scope

10. There are a wide range of thermal insulation product types. In the past the Competition Commission has found these can be categorised as those derived from organic (oil-based, otherwise known as plastic foams) or inorganic (minerals) materials and by form, be it rigid, flexible or amorphous. [2]

11. The parties are active only in certain rigid organic insulation types, which includes PIR, phenolic foam (PF), expanded polystyrene (EPS) and extruded polystyrene (XPS) foams, and rigid polyurethane (PUR). In the UK, Kingspan manufactures and supplies PIR and PF products and sells, but does not manufacture, XPS. CIE manufactures and supplies EPS, PIR and XPS, however, as noted above, Kingspan is not acquiring CIE's XPS production facilities.

12. Within the thermal insulation segment, there are a number of different applications or end-uses for foam insulation products. Substitution is generally driven by the intended application. Kingspan submits there are a wide range of substitution possibilities across all applications and there are no applications for which only one type of material can be used. Third parties confirmed that the different types of foam insulation products were technical substitutes for PIR in the majority of applications.

13. Insulation products are characterised by a wide range of different properties, including: thermal conductivity ('lambda') and insulating properties, water resistance, compressive strength, sound absorption, fire resistance, load bearing capacity, convection, weight, as well as production and insulation costs. Whilst the properties of the various types of insulation

[2] See *Rockwool Ltd and Owens-Corning Building Products (UK) Ltd: A report on the proposed merger*, CC, May 1999 (*Rockwool/Owens-Corning*).

material may differ, Kingspan submit all of them essentially perform the same function: to prevent loss of heat through the fabric of a building.

14. Kingspan therefore consider all other plastic foams, as well as some other, insulation types as substitutable for PIR and each other as they address the same needs of customers and the overall installed costs of each are broadly similar.

15. In previous cases, however, national authorities have considered a narrower frame of reference than all plastic foam insulation products, including a separate product scope for PIR and PUR and narrower product frames, dependent on the application.[3]

16. The OFT's approach is to consider if a narrow candidate product scope can be widened through substitution on the demand-side in the first instance, and then, if appropriate, to consider if substitution on the supply-side allows different products, which are not demand-side substitutes, to be aggregated.

17. In this case, the OFT considered whether the product scope should be widened to include both the supply of PIR, the overlapping product, and PF.[4]

18. The OFT's market investigation indicated limited actual substitutability between PIR and PF and/or PIR and PF and other insulation types. Customers stated that, in the event of a uniform price rise of five per cent in PIR or PF, they would likely accept the price rise, rather than switch to another insulation type. Some customers stated that alternative products can be considered technical substitutes but generally their different characteristics make them less attractive. PIR was highlighted as the most effective insulation type (in terms of thermal insulation per thickness) and a key input when building to regulations, such that switching away from PIR would have other consequences, such as for the size of the wall cavity.

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[3] See M/06/039 *Kingspan/Xtratherm*, Irish Competition Authority, October 2006.

[4] While there is no overlap in PF, Kingspan is a near monopolist in the manufacture and supply of PF, which may allow for the tying of sales of PIR to those of PF. This is discussed further below.

19. Competitors had more mixed views. Some generally supported the view of customers that switching was possible in theory but the greater effectiveness of PIR meant that customers would accept a price rise in PIR rather than switch. The example given was that to achieve the same thermal value as PIR, increasingly thick board of other products (for example, EPS) would be required. Other competitors, however, stated that customers would be likely to switch between product categories in the event of a five to 10 per cent price rise in PIR or PF. The most likely switch highlighted by some of the competitors was from PIR to either PUR or PF, although this was a minority view.

20. The OFT also notes the insulation type is determined in many cases by the architect at the design stage (particularly in new builds) rather than the actual purchaser of the insulation product. While the detail of the architectural specification can vary, Kingspan stated that the architect was likely to determine the insulation material to be used in the vast majority of cases; this was confirmed by third parties. The OFT considers this bifurcation of the decision-making process — whereby the purchaser does not determine the insulation type used but instead has to work within the design specification — limits the scope for demand-side substitution between insulation types since the architect, at the design stage, will not be subject to the same degree of price-sensitivity that the purchaser will be.

21. The OFT also considered the scope for supply-side substitution. Third party competitors all indicated that capacity or supply could not be readily switched between insulation types. Manufacture of the different types of foam insulation products requires different productions lines, machinery and skills. Further, the same firms are not active in supplying the different insulation types. The main competitors to the parties are active only in PIR supply or, in a limited number of cases, in PUR and PF as well. The potential for supply-side substitution between insulation types therefore seems limited.

GEOGRAPHIC FRAME

22. The European Commission in past cases has found that the geographic scope for the manufacture and supply of insulation products is likely to be regional, incorporating the UK, Ireland, and some northern continental

European countries.[5] However, national authorities have previously found the appropriate geographic scope for PIR to be, at the widest, the UK and Ireland, and possibly narrower.[6] The CC has also previously found the geographic scope to be only the UK, albeit in reference to different insulation types.[7]

23. Kingspan commented that both parties supply significant amounts of PIR outside the country of manufacture: Kingspan exports PIR manufactured in the UK, all over Europe and even further; similarly, CIE accounts for a significant share of PIR sales in Germany and Poland from a manufacturing plant in the Netherlands, while some of Kingspan's competitors supply the UK from manufacturing plants in the Republic of Ireland.

24. The OFT considered evidence submitted by Kingspan and gathered from third parties on the extent of trade flows into and out of the UK and transport costs in supplying different regions and countries. On the basis of this evidence, the OFT considers the constraint placed by non-UK manufacturers on UK supply of PIR to be mixed.

25. The OFT has therefore taken a cautious approach and considered the transaction on the basis of both GB supply and GB and the island of Ireland supply. Since the number of suppliers with the potential to supply the UK and Ireland is limited, where there may be additional relevant non-UK or Ireland competitors these constraints have been considered as part of the competitive assessment.

Conclusion

26. The OFT considers the appropriate scope to assess the transaction to be PIR insulation products in GB and GB and the island of Ireland and PF products in GB. No evidence, on the demand or supply-side, across any of the product applications suggests the product scope ought to be wider.

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[5] See, Case No. IV/M.735 *BPB/ISover*, para. 14, although no explicit conclusion was drawn.
[6] See M/06/039 *Kingspan/Xtratherm*, Irish Competition Authority, October 2006.
[7] See *Knauff Insulation Ltd and Superglass Insulation Ltd: A report on the proposed acquisition of Superglass Insulation Ltd and Knauf Insulation Ltd*, CC, November 2004 (*Knauff/Superglass*), paras. 2.34 and 2.35.

HORIZONTAL ISSUES

Market shares

27. Kingspan estimate that post-merger it will have a combined share of supply of PIR in GB by volume of [35-45] per cent, increment [10-20] per cent. Three competitors – Celotex, Recticel, and Xtratherm – remain post-merger that appear to represent a similar or stronger constraint as CIE's Ecotherm pre-merger. There are a limited number of additional suppliers, including one competitor based in Ireland, Quinn-therm, which accounts for an estimated [five-10] per cent of GB volume supply. This high level of concentration is confirmed by a post-merger HHI[8] of around 2,700 with a delta of around 670.

28. Kingspan provided share of supply information since 2006[9] that shows that the supply of PIR in GB has become [ ] less concentrated, mostly at the expense of Kingspan. Its share of supply has fallen [ ] from [40-50] per cent in 2006 to [20-30] per cent in 2010. Over the same time period; the main competitors to Kingspan have [ ] increased their share of supply, including: Celotex from [20-30] to [20-30] per cent; Recticel from [zero-five] to [10-20] per cent; Quinn-therm from [zero-five] to [five-10] per cent; while Ecotherm and Xtratherm shares of supply have remained [ ] over the period at [10-20] per cent.

29. Kingspan estimated the parties' combined shares of supply in GB and the island of Ireland as being broadly similar at [35-45] per cent with a lower increment of only [five-15] per cent. However, Ecotherm do not supply any part of Ireland.

30. These shares of supply and the lessening of concentration in recent years were broadly confirmed by competitors.

31. Kingspan argued that these shares of supply were not sufficient to raise *prima facie* competition concerns based on the UK Authorities' *Merger Assessment Guidelines*.[10] The guidelines indicate that in undifferentiated

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[8] Herfindahl-Hirschman Index

[9] The time of a previous proposed transaction prohibited by the Irish Competition Authority, see footnote 6.

[10] Joint *Merger Assessment Guidelines*, September 2010, paragraph 5.3.5.

product markets (such as in the present case) combined market shares of less than 40 per cent will not often give the OFT cause for concern over unilateral effects. However, the guidelines state that when interpreting information on market shares, the OFT may have regard to how widely the market is drawn (amongst other things):[11] a low combined market share on the narrowest market that satisfies the hypothetical monopolist test will be a better indicator of an absence of potential competition concerns than the same share of a market that is drawn more widely. Furthermore, where market shares and concentration are considered for the purpose of applying thresholds (that is, for assessing whether market shares and concentration are low enough to rule out concerns) the guidelines say that the narrowest market defined by the hypothetical monopolist test must be used.[12]

32. Here, the affected markets—though narrowly drawn—are not necessarily the narrowest satisfying the hypothetical monopolist test. In the light of this, the parties' combined share and the level of concentration (and increment to it) are not low enough to rule out concerns.

Limited barriers to switching

33. PIR is generally supplied through a tendering process, which third parties indicated is normally on an annual basis. Customers tend to multiple source, which was also confirmed by third party competitors. Third parties also confirmed that switching is relatively straightforward as the balance of supply can be switched between two or more different suppliers without ceasing to be a customer of any supplier. Kingspan submitted information for Kingspan's top [ ] PIR customers that showed that [ ] of these [ ] customers source from at least two suppliers.

34. The split in the purchasing decision between the architectural specification and the actual purchaser for certain applications does not materially affect the purchaser's ability to switch between suppliers of the same insulation product. The architect – while specifying the insulation product to be used - rarely specifies the specific manufacturer or, where this does occur, there is sufficient flexibility in the specification to allow a switch to other manufacturers.

[11] Joint *Merger Assessment Guidelines*, September 2010, paragraph 5.3.2, third bullet.
[12] Joint *Merger Assessment Guidelines*, September 2010, paragraph 5.3.1.

35. The majority of customers stated they would switch or consider switching in the event of a five to 10 per cent price rise by their current PIR supplier. Competitors also confirmed this was likely to occur. Third parties also stated that there are generally a range of alternative suppliers that submit tenders in customer negotiations. Some third parties commented that the merger would inevitably reduce the number submitting bids; but considered, however, there would remain sufficient suppliers to choose from post-merger.

36. Third party views were mixed as to the extent of the direct competitive constraint between the parties. Some customers did not consider the parties to be especially close competitors, either due to their experience of switching or because they considered they supplied different customer groups and segments of the market. However, others considered them to be close competitors.

37. In light of these mixed views, Kingspan provided details of customers (entire contracts) or significant volumes lost over the last two years for each of the merging parties and, where known, the competitors the contracts were lost to. Ecotherm lost [ ]. Only in a small minority of these [ ] was switching to Kingspan. Kingspan, on the other hand, lost [ ]. From the evidence provided, total switching away from Kingspan was [ ], of which only [ ] was to Ecotherm.

Sufficient spare capacity among rivals

38. Capacity is significantly more concentrated than current supply volumes, with the merger resulting in a combined share of total GB capacity of [50-60] per cent, increment [10-20] per cent. Spare capacity (total capacity less current sales) is therefore even more concentrated with the combined parties accounting for an estimated [60-80] per cent of spare capacity in GB.[13]

39. Kingspan submit that its competitors all have ample spare capacity to enable them increase production. Kingspan provided estimates of PIR production capacity for the parties and for each of their competitors.

[13] This lowers to around [55-65] per cent when the additional capacity of suppliers in the Republic of Ireland is taken into account.

40. Kingspan submitted that current estimated PIR capacity utilisation in the industry (at around [40-50] per cent), provides for sufficient spare capacity (of around [35-45] million m^2) that would more than meet current demand levels. Essentially, the industry has sufficient capacity to satisfy current demand at least twice over. Third party manufacturers account for an estimated [30-40] per cent of the spare capacity, around [12-16] million m,^{2} which is almost equivalent to the combined total current production of the merging parties.

41. The significant spare capacity, homogeneity of the products, and absence of switching costs, is sufficient, according to Kingspan, to mitigate any incentive to restrict output or raise prices post-merger. Kingspan submitted that existing competing manufacturers would easily be able to expand output and supply switching customers, and thus prevent competitive harm.

42. Kingspan also provided an estimate of critical spare capacity that rivals would be required to hold relative to their pre-merger output, based on the approach of the OFT in past cases.[14] This critical spare capacity reflects the proportion that rivals would be required to hold relative to their pre-merger output so as to constrain Kingspan from reducing output or raising prices post-merger. Using this estimate, Kingspan showed that under current levels of output, the aggregate spare capacity of rivals would be sufficiently high relative to Ecotherm's share of supply (and Kingspan's combined post-merger share of supply) to suggest that all of Kingspan's main competing suppliers would have capacity in excess of the critical capacity.

43. Further, Kingspan showed that rivals' current capacity would remain above this critical capacity both if demand were to return to the peak demand observed in 2007 or to meet an average annual growth of around five to six per cent from 2009 to 2015.

44. Further sensitivity analysis was carried out by Kingspan that showed that, based on current demand, even if one of Kingspan's major competitors, [ ], were to close its UK plant and no longer supply PIR in the UK, rivals' spare

[14] See, for example, *Anticipated acquisition by Prince Minerals Ltd. Of Castle Colours Ltd*, OFT, May 2009.

capacity still remain above the critical level required to constrain Kingspan post-merger.

45. Kingspan used this information to assess the change to price incentives arising from the merger. In the event that rivals are entirely unconstrained, the price pressure resulting from the merger would be under three per cent. [15]

46. The OFT acknowledges that current competition appears to be characterised by significant spare capacity. Suppliers appear to operate at significantly below their capacity and therefore have an incentive to compete on price to increase capacity utilisation and the efficiency of their plants. The incentive of Kingspan to restrict output post-merger is dependent on the production capacities of competitors. The extent to which customers can switch away from Kingspan is dependent on the ability of competing suppliers[16] to increase production to serve those additional customers.

47. Nevertheless, the OFT does not fully accept Kingspan's characterisation of spare capacity and the changes to pricing incentives that have been estimated from this. The OFT considers that the specific modelling used in this case applies a number of assumptions which inevitably limit the inferences that can be drawn from it.

48. Assessing spare capacity in this way effectively assumes that no costs are incurred in expansion and all current capacity can immediately be used to supply additional output. Kingspan assert this is realistic since overtime could be added quite easily and an additional shift can be added within weeks: recruitment and training of limited additional labour is straightforward, and labour costs, in any case, are a small proportion, some [ ] per cent, of total costs.

49. However, this position was not entirely supported by third parties, some of whom, despite broadly confirming their overall levels of capacity, suggested that there would have some difficulty expanding output – both in recruiting and training personnel and sourcing raw materials – and such

[15] The parties apply a quantity-setting model which compares pre- and post-merger equilibrium prices where capacity is completely unconstrained; that is, marginal costs are horizontal in the short-run.
[16] In addition to their willingness to do so — coordinated effects are discussed below.

expansion, through an additional work shift, could take between three and six months to put in place. Further, Kingspan itself stated that there have been difficulties in recent years obtaining the primary input for PIR, methylene diphenly diisocyanate (MDI) — MDI represents some [ ] per cent to total input costs.

50. The OFT considers that this would increase Kingspan's incentives to raise prices post-merger using Kingspan's own framework for analysis.[17] Kingspan has effectively assumed a limiting extreme where all capacity can immediately be used to expand output and capacity constraints are never binding. Although it is unlikely that the costs incurred in expanding output would be significant, and when any initial costs are incurred further continued expansion may be more straightforward, the OFT considers, based on the evidence available, that the incentive to raise prices would be somewhat higher than Kingspan submit, under their own analytical framework.

51. Finally, the OFT notes that the size of the price pressure figure referred to in paragraph 45 depends on how demand varies with price. The figure in paragraph 45 assumes that demand decreases by the same absolute amount for each absolute increase in price (so-called 'linear demand'). If instead, a non-linear demand was assumed, the figure in paragraph 45 would need to be adjusted upwards. This also, therefore, points to the need to adopt a cautious approach in interpreting the figures.

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52. [ ].

53. [ ].

54. [ ].[18]

55. However, in this case the modelling carried out on Kingspan's behalf demonstrated that the volume of spare capacity in the hands of competitors was such that third parties would still be able to cover the current total output of the merged entity. Further the significant amount of

[17] Effectively, contrary to the parties' assertions, marginal cost would likely be upward-sloping in the short-run and the capacity of rivals the parties point to would not be immediately 'usable'.
[18] [ ].

spare capacity in the hands of competitors and the market as a whole would be more than sufficient to meet the historically high levels of demand faced in 2007.[19]

Conclusion on Unilateral Effects

56. The supply of PIR is relatively concentrated. However, there appears to be significant switching between competing suppliers. Very little of this appears to be between Kingspan and Ecotherm, indicating that the parties do not necessarily represent as strong a constraint to each other as other competitors do. Further, there is significant spare capacity held by competitors, which limits the extent to which Kingspan could benefit from reducing output and/or raising price post-merger, as competitors could expand output to serve additional customers.

57. A number of issues with the analysis undertaken by Kingspan were raised, and as such the OFT does not consider that heavy reliance can be placed on the parties' estimates of pricing incentives. However, the degree of switching of suppliers, and multi sourcing by customers, and the number of effective competitors, all of whom have substantial excess capacity and consequently the potential ability to expand, suggests an absence of competition concerns.

58. On the basis of all the evidence set out above, the OFT does not consider there to be any likelihood of a substantial lessening of competition arising from unilateral effects.

CONGLOMERATE EFFECTS

59. Kingspan is active in the supply of phenolic foam (PF) products in the UK, another type of plastic foam insulation. There is no horizontal overlap between the parties, since Ecotherm is not active in the supply of PF. However, third parties indicated that Kingspan's near monopoly in the UK in PF may have an effect on the supply of PIR, particularly for those customers that require both PF and PIR products.

60. The OFT therefore considered it appropriate to assess the possibility that Kingspan may leverage its position in PF (the leveraging product) to that of

[19] See paragraph 43

PIR (the leveraged product), through either tying or full-line forcing. That is, where Kingspan require customers of PF to purchase PIR to a greater extent from Kingspan; and/or through mixed bundling, whereby Kingspan offer both PF and PIR combined at a cheaper price than they do separately.

61. The effectiveness of a leveraging strategy would be dependent on there being a sufficient proportion of overlapping customers of the two products. The strategy must be capable of affecting demand (or Kingspan's supply position) for PIR, otherwise attempting to link (or expand current linkages between) the two products would be ineffective. PIR and PF do not appear to be complementary goods. Nonetheless, there are a significant proportion of customers that source the two products together.[20]

62. Kingspan do not currently impose any customer purchasing obligations linking the supply of PIR products to PF products. It submitted a list of twelve of Kingspan's current PF customers that purchase either all or the vast majority of their PIR requirements from third party manufacturers.

63. While rebate arrangements exist that are structured by reference to the sales value of a customer's total purchases (that is including both PIR and PF), these vary between customers as they are determined through bilateral negotiations. In many cases, according to Kingspan, the rebates available to the customer for PIR products will be completely separate to those for PF products. In a number of cases, however, Kingspan currently offers rebate arrangements where the rebate covers both PIR and PF.[21] In such cases, a customer could obtain a higher rebate for PF products by increasing purchases of PIR products (or vice versa).

64. Kingspan submitted that until relatively recently, Kingspan had been the only UK-based supplier of PF products for thermal insulation applications.[22] This monopoly position has changed recently, with Xtratherm developing and marketing its own PF insulation product. Kingspan stated that it was aware of the new entry into the PF market and would not want to take any actions that might upset its existing customers. Such that there are no circumstances where customers would be either directly (contractually) or

[20] Although not economic or technical complements, those customers with the highest demand for PIR (for example, specialist insulation distributors) will likely also have the highest demand for PF; that is the two products will likely be stochastically dependent.
[21] [ ].

indirectly (through economic incentives) obliged to obtain a higher rebate by increasing its purchases of PIR products. A customer of PIR would always be able to obtain the same level of rebate by increasing its purchases of PIR products.

65. Third party customers confirmed that this leveraging conduct was not currently pursued by Kingspan. Although, when prompted a number indicated that it may be possible. One competitor indicated that Kingspan would always be preferred supplier for the major specialist suppliers due to their position in PF (amongst other factors). The same competitor indicated that customers switching between suppliers may be difficult due to the threat from Kingspan of withdrawing PF supply. However, this view was not supported by other evidence the OFT received.

66. The merger does not increase Kingspan's market position in PF. Until recently Kingspan has been the only UK manufacturer of PF, it follows, therefore, that customers requiring PF would already be purchasing it from Kingspan. Further since Ecotherm only supplies PIR, any customer of Ecotherm requiring both PIR and PF would already be a customer of Kingspan. In such circumstances the incentive for Kingspan to pursue a leveraging strategy is likely to be the same, or greater, before the merger (since the merger brings Ecotherm's PIR customers within Kingspan). The merger therefore does not increase Kingspan's incentives in introducing such behaviour post merger. Since Kingspan did not pursue this strategy prior to the merger when incentives would have be greater, the OFT has therefore concluded that such conglomerate effects are unlikely to arise as a result of the merger and therefore are not considered further.

COORDINATED EFFECTS

67. Kingspan submit that the constraint imposed by other insulation products and by imports of PIR products, as well as countervailing factors do not point to conditions conducive to sustaining coordinated effects. In particular, PIR suppliers would be unable to reach and monitor the terms of coordination, would not find it in their individual interest to adhere to a coordinate outcome, and coordination would be undermined by competition from outside any collusive agreement.

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[22] Note the product frame also dismissed the ability of customers to switch to alternative insulation types.

68. The OFT notes that the European Commission and the US Department of Justice both recently began cartel investigations of the polyurethane foam sector. [23] However, this is a sector that neither Kingspan nor Ecotherm have any activities.

69. Evidence provided to the OFT in this case does not suggest there has been a recent history of coordination on headline price, output, or capacity levels. Shares of supply, output, capacity and price have all changed significantly in recent years. While evidence was also provided [ ]. Capacity expanded significantly following a period of excess demand in 2005 to 2007. The increased demand saw existing GB manufacturers expand their capacity, continental European manufacturers open GB plants, and additional manufacturers begin importing from continental Europe. However, since this period, GB/Ireland demand has declined and suppliers in GB and Ireland have been left with significant spare capacity. In particular, Kingspan's share of supply has fallen [ ] (from [40-50] per cent in 2006 to [ ] [20-30] per cent in 2009), as competitors have gained sales volumes and shares, indicating that suppliers have been actively competing for customers. Further, Kingspan provided significant details of instances where customers have actually switched between the main PIR suppliers.

70. In addition, a number of other factors indicate that collusive agreement may be difficult to reach and maintain. First, as far as pricing is concerned, this is non-linear and occurs through bilateral negotiations with customers. Customers also tend to multiple source so switching, at the margin, would only involve shifting the balance of product sourced from one existing supplier to another. These both point to a lack of transparency that would make it difficult for competing suppliers to monitor each other's behaviour and detect cheating. Multiple sourcing also gives customers an added ability to disrupt any attempts at coordination.

71. These factors do not suggest a likelihood of any tacit collusive agreement that would result from or be enhanced by the merger using overall price, output or capacity as reference points, and therefore coordinated effects are not considered further.

BARRIERS TO ENTRY AND EXPANSION

72. Kingspan submit that barriers to entry are low, since there are no technical or economic barriers, the manufacturing process is not protected by patents, and suppliers can readily obtain the required know-how.

73. Kingspan submitted that to enter PIR production would require a lead time of up to 12 to 18 months in order to commission and build a new plant and a capital investment of up to £14 million. Such a facility would be capable of gaining more than 20 per cent of current PIR sales in GB, with a less ambitious facility costing less. Furthermore, on exit a firm should be able to recoup at least half of the initial plant investment, in addition to being able to sell the land and buildings. Leasing would also be a lower-cost entry option (but the lease would need to be bought out on exit).

74. According to Kingspan, companies that are active in the supply of other insulation materials can add PIR insulation to their existing product portfolio, as can companies with no experience in the manufacture of insulation materials. Kingspan consider these claims to be supported by a recent history of entry into PIR over the last five years, both in the UK and other countries, responding to additional demand and increased prices. However, a number on the list of recent entry examples provided by Kingspan reflect expansion by existing PIR producers, already active in GB or just outside, for example in Ireland or the near continent, rather than actual new entry.

75. Third party competitors' views were mixed. While there were some that indicated they had entered with relative ease in recent years and achieved significant scale, in each case the firms were existing PIR manufacturers. Other competitors stated that entry was not easy with significant capital investment costs required (estimates ranged from £12 million to £25 million), know-how barriers, and market barriers to build up a brand name, sales organisation and customer base. In addition, firms would require certification for the product, which can also take some time.

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[23] A press release from the Commission confirmed unannounced inspections – a preliminary step into suspected cartel activity – were carried out at the premises of companies active in the sector in several Member States in July 2010. The investigation is ongoing.

76. As discussed above, all competitors are operating with significant spare capacity. Therefore in comparison to the situation in 2006/07 where expansion was largely through putting in new production lines, which are now largely sitting idle as a result of the downturn in construction; Kingspan submitted that expansion of output would be easy for its competitors and would consist of offering overtime and/or adding shifts to current operating levels. Labour costs were only some [ ] per cent of operating costs and as a result it was very easy for all participants in the market to react to demand by increasing the number of shifts to a maximum of a 'continental' shift pattern of lines running for 24 hours over the full seven days with one shift out for maintenance purposes. Competitor views on how quickly such expansion could be put in place were mixed, but in general expansion, through the addition of shifts, was considered relatively easy.

BUYER POWER

77. Kingspan submitted that both Kingspan and Ecotherm were heavily reliant on a small number of customers for a large proportion of their PIR sales. [ ]. [ ]. [ ].

78. Even without actually switching, the credible threat of switching, given the ease with which customers can switch suppliers is, according to Kingspan, such that the bargaining position of Kingspan's customers is very strong and will remain so post-merger.

79. Third party views on the negotiating power of buyers were very mixed. Customers indicated they can generally negotiate volume discounts and use their scale to negotiate lower prices. However, there were exceptions with one customer indicating that Kingspan were generally inflexible on price and rebate negotiations. One large buyer commented that they could not switch their entire supply and therefore could only switch smaller volumes between suppliers. Competitors also indicated that buyers were concentrated and most buyers can use their scale and volume of purchases to negotiate lower prices.

THIRD PARTY VIEWS

80. Where relevant third party comments have been included above. The majority of competitors had no competition concerns, although one commented on the possibility that switching might be discouraged due to Kingspan's position in PF (not merger specific). The majority of customers were also largely unconcerned by the merger. One citing the current over capacity in PIR supply as keeping competition healthy. However, one customer raised concerns about the concentration of supply; in particular as it applied to flat roofing applications, however, in general it was considered that the PIR market to be very competitive.

ASSESSMENT

81. In the UK, the parties overlap in the manufacture and supply of PIR foam insulation products for building or thermal applications. Post-merger the parties will have a combined share of supply in GB of [35-45] per cent, increment [10-20] per cent. Three GB competitors – Celotex (with [20-30] per cent), Recticel ([10-20] per cent), and Xtratherm ([10-20] per cent) – remain post-merger that represent a similar or stronger constraint than CIE's Ecotherm pre-merger. There are also a limited number of additional suppliers, for example Quinn-therm based in Ireland, which accounts for an estimated [five-10] per cent of GB volume supply.

82. Third parties indicated that there was limited demand side substitution between PIR insulation products and other insulation products, and supply side substation is not possible. Therefore the product scope is restricted to PIR insulation products. On the basis of evidence provided by the parties and third parties on the extent of trade flows the OFT considers the constraint placed by non-UK manufacturers on UK supply of PIR to be mixed and has therefore taken a cautious approach and considered the transaction on the basis of both GB supply and GB and the island of Ireland supply.

83. Kingspan has seen its share of supply fall [ ] from [40-50] per cent in 2006 to [20-30] per cent in 2010; while its main competitors have [ ] increased their share of supply over the same time period.

84. While the supply of PIR is relatively concentrated, there appears to be significant switching between competing suppliers by customers. Very little switching appears to be between Kingspan and Ecotherm, which indicates that the parties do not necessarily represent as strong a constraint to each other as their rivals do. Further, there is significant spare capacity held by competitors, which effectively limits the extent to which Kingspan could benefit from reducing output and/or raising price post-merger, as its competitors could expand output to serve additional customers.

85. Kingspan is also active in the supply of phenolic foam (PF) products, another type of plastic foam insulation, in the UK. There is no horizontal overlap between the parties, since Ecotherm is not active in the supply of PF. However, third parties indicated that Kingspan's near monopoly in the UK in PF may have an effect on the supply of PIR, particularly for those customers that require both PF and PIR products.

86. Third party customers confirmed that this leveraging conduct was not currently pursued by Kingspan. The merger does not increase Kingspan's market position in PF. Ecotherm only supplies PIR, therefore any customer of Ecotherm requiring both PIR and PF would already be a customer of Kingspan. In such circumstances the incentive for Kingspan to pursue a leveraging strategy is likely to be the same, or greater, before the merger (since the merger brings Ecotherm's PIR customers within Kingspan), and the merger does not increase Kingspan's incentive in introducing such behaviour.

87. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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