
Anticipated acquisition by Lord Corporation of Certain Businesses of Henkel KGaA.

The OFT's Decision on reference under section 33 given on 26 May 2006. Full text published 23 June 2006.

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

PARTIES

1. **Lord Corporation (Lord)** is a US manufacturer and supplier of speciality chemicals, industrial adhesives and coatings as well as bonded elastomers, active systems, fluids and other devices for managing mechanical motion, noise and vibration for various end-use applications such as in the automotive industry.
2. The assets being acquired from **Henkel KGaA** relate to the manufacture and supply of speciality chemicals for bonding rubber to substrates and treating rubber surfaces (**Henkel Business**). Lord will acquire: the intellectual property and know-how and the existing supply and sales orders and contracts, together with any existing finished products related to the Henkel Business.¹ The Henkel Business's UK turnover in the year ending 31 December 2005 was approximately £[].

TRANSACTION

3. Lord proposes to acquire the Henkel Business. Lord notified this transaction on 7 March 2006 and the OFT administrative timetable expires on 26 May 2006.

JURISDICTION

4. As a result of this transaction Lord and Henkel Business will cease to be distinct. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met in relation to the supply of certain speciality chemicals for bonding rubber to substrates and treating rubber surfaces. The OFT therefore believes that it is or may

¹ []

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.

RELEVANT MARKET

Product scope

5. The parties' activities overlap in the manufacture and supply of speciality chemicals² for bonding rubber to substrates and treating rubber surfaces. The parties submit that the merger affects two relevant frames of reference: i) the supply of speciality chemicals for bonding rubber to substrates ('bonding agents'); and, ii) the supply of speciality chemicals for coating and flocking rubber surfaces (mainly for weatherstrip applications).³

Bonding Agents for Rubber-to-Substrate Bonding

6. Rubber-to-substrate bonding is a method of bonding to join a rubber component and a particular substrate such as metal, fabric or fibre glass. The process is carried out by coating the substrate with a thin layer of a non-tacky bonding agent and subsequently vulcanising the rubber. The bonding agent may differ depending on the application, but they are based on the same technologies and raw materials (such as halogenated polymers, silane and phenolic resins).
7. There are older technologies which have historically been used to bond rubber in some application areas. These include isocyanat bonding, ebonite bonding and brass rubber bonding. The parties contend that these technologies have limited functionality and have largely been replaced. According to Lord, at present, these older technologies account for a very small proportion of sales of rubber bonding systems and therefore the competitive constraint they exert on the parties is very limited. They are therefore not included in the relevant frame of reference for the purposes of this decision.
8. The parties submit that the relevant frame of reference is bonding agents for rubber-to-substrate bonding without differentiating further among different types of substrates or by field of application (e.g. bonding agents for anti-vibration or other applications, etc) or by industry, although it is noted that around [] per cent of supply of bonding agents goes to the automotive industry.

² Speciality chemicals refers to chemicals compounds with higher added value which have been engineered by the manufacturer to incorporate performance attributes desired for a specific end use, and can thus be distinguished from commodity chemicals.

³ Such as the rubber strips on car doors, windows, sun roofs and trunks.

9. Bonding agents are an input in the production of certain items (such as belts, gaskets and tank linings) which are then incorporated into the final product (e.g. a car). On the demand-side, many customers require modifications to bonding agents for specific applications (for example each time a new car model is designed). Bonding agents are commonly tailored to those specific requirements of the end-customer and all major bonding agent suppliers are capable of providing customers with such specifically tailored bonding agents across all fields of application. There is therefore limited demand-side substitutability between different types of bonding agents by field of application. However, on the supply-side, according to the parties, all bonding agents for bonding rubber to substrates are based on the same technologies, and all major competitors in this segment provide the entire range of bonding agents for rubber-to-substrate bonding.
10. The parties suggest that a further distinction could be drawn between 'high-end' and 'low-end' bonding agents, stating that high-end bonding agents are used in more technically demanding applications (e.g. cars) and therefore need to be of higher quality and more robust. As a result, there are significant pricing differences between these two types of bonding agents. Third parties did not recognize this distinction, but this might be due to differences in terminology. The parties are only active in high-end bonding systems and the market share estimates provided consider only high-end bonding agents. If low-end bonding agents were included in the frame of references, the merged entity's share of supply would be smaller.
11. The OFT does not need to conclude on the precise frame of reference for rubber bonding agents, as the outcome of our assessment does not change under any reasonable narrower frame of reference. The merging parties and their competitors operate in the whole range of 'high-end'⁴ rubber bonding agents, within which supply-side substitutability appears feasible. In addition, the shares of supply are similar if the market is sub-divided by application. Our assessment below focuses on high-end rubber bonding agents, referring to sub-segments (by field of application) where appropriate.

Flocking Adhesives and Coatings

12. Flocking and coating are techniques used to treat rubber surfaces to add a particular functionality⁵ or cosmetic appearance. The products manufactured and/or supplied by the parties are [] supplied to the automotive industry ([] per cent according to the parties) and its uses include door seals, window gliding supports, sun roof seals and hood to cowl and trunk seals.

⁴ If we accept the sub-division suggested by the parties.

⁵ For example to reduce friction and squeaking, protect the rubber from cleaning chemicals and increase environmental resistance.

13. The parties submit that the relevant frame of reference includes both the production and supply of flocking adhesives and coatings. While flocking adhesives and coatings are based on different technologies and manufactured by different companies, both the parties and third parties have told the OFT that they are interchangeable on the demand-side, in particular at the design and development stage of the product (for example each time a new car model is designed and each part for that car is designed). As noted above with respect to bonding agents,⁶ the speciality chemicals used for flocking and coatings are an input in the production of certain items (such as a window gliding support), which are then be incorporated into the final product, e.g. the car.

14. In any event the precise frame of reference in flocking adhesives and coatings can be left open since under any reasonable narrower frame of reference the merger would not raise competition problems in the segment.

Geographic scope

15. The parties submit that the geographic scope for both bonding agents and flocking adhesives and coatings is Europe. They have submitted to the OFT that transportation costs are low relative to the value of the products (below three per cent), there is no significant price difference between different European countries, suppliers are active throughout Europe and customers source their demand on a European-wide basis as preferences are driven by specific technical requirements rather than country of supply. In addition, data shows that while there are very high levels of trade between the UK and Europe, the levels of import/export between Europe and other global regions is very small (below five per cent).

16. While the parties each manufacture all their products at only one location in Europe, the OFT has considered whether price differentiation takes place geographically as UK customers negotiate with UK sales teams. The evidence the OFT has found shows that prices are not always comparable between customers as products are, according to the parties, largely bespoke. If this is the case, the fact that Lord is not currently a major alternative for UK customers may already be accounted for in prices (i.e. there is no constraint from Lord's activities in Europe).

17. The OFT has assessed this transaction on both a UK and a Europe-wide level, although it is not necessary to reach a final view on the geographic scope of the frame of reference because even on a narrow basis, no competition concerns arise.

⁶ See paragraph 9.

HORIZONTAL ISSUES

Bonding Agents for Rubber-to-Substrate Bonding

18. In the manufacturing and supply of bonding agents for rubber-to-substrate bonding, Henkel has a UK share of supply of [70-80] per cent and a Europe-wide share of supply of [40-50] per cent. While Lord's share of supply in the UK is very small ([less than 10] per cent) its European share is much larger ([10-20] per cent).
19. On the basis of a narrower product scope, differentiating by application, the parties' UK and European combined share of supply post-merger would be very similar to the above figures. However, as regards bonding agents for rubber-to-fabric bonding, the post-merger combined share of supply is higher ([80-90] per cent and [60-70] per cent respectively) albeit with smaller increments ([less than 10] per cent in the UK and [less than 10] per cent in Europe).
20. According to the parties, the merger complements Lord's existing activities in rubber chemicals from a geographic perspective. Lord contends that as a result of a licensing agreement currently in place between the parties,⁷ the parties do not (and will not) compete strongly (in particular in the UK) and their operations are complementary from a geographic perspective. The licence contains []. According to the evidence the OFT has seen, including the parties' internal documents, churn data, purchasing/supply data, it appears that the parties may find themselves competing against each other more often than expected. Nevertheless there are a number of other factors that lead the OFT to believe that this merger does not give rise to concerns.
21. The OFT considers that high market shares are not necessarily indicative of market power because the demand-side is highly concentrated (with Henkel's major customer accounting for around [] per cent of sales in Europe and [] per cent in the UK). Customer switching is infrequent once a product has been commissioned, because of the product validation and testing processes that are required, in particular in the automotive industry. The evidence the OFT has seen indicates that competition takes place during the design and development of a product. The OFT also believes that there are sufficient credible alternative suppliers to the merging parties which could offer their services at that stage of the design-supply chain. Furthermore, the OFT has not seen any evidence to suggest that there are capacity constraints in the industry.

⁷ By which Lord provides the necessary know-how for and authorises the production of Henkel's bonding agents and receives as various royalties in exchange.

22. Input costs represented by these products are relatively small within the total costs of the final products (although not necessarily for 'tier 2' automotive suppliers who purchase from the parties and sell on to the automotive industry). The parties have argued that some large customers are able and are in fact already producing the products internally. However, the OFT has not found evidence to support this contention.

Flocking adhesives and coatings

23. The merger would result in a minor increment ([less than 10] per cent in the UK and [less than 10] per cent if the geographic scope is considered to be Europe) to Henkel Business' share of supply of flocking adhesives and coatings, which gives rise to combined shares of supply of [less than 10] per cent in the UK and [20-30] per cent in Europe. This suggests that the merged entity will be a relatively small competitor in the UK (with other companies having much larger market shares) and a competitor at European level with market shares similar to at least two other companies. Other smaller players also remain in the market at both UK and European level.

Countervailing buyer power

24. The sectors to which the parties supply bonding agents and flocking adhesives and coatings are very concentrated on the buyer side. For example, in the UK, one bonding agents customer accounts for over [] per cent of the merged entity's total sales. Another customer accounts for an additional [] per cent. In the EU, the largest customer accounts for [] per cent of the merged entity's sales. The loss of one customer could therefore change the competitive landscape substantially.

25. This high level of concentration on the demand side provides significant countervailing buying power which is further facilitated by dual/multiple sourcing, according to the parties. The OFT has found evidence which shows that several large customers already source from different suppliers, including from both parties. However, third parties have said that the product safety testing and validation procedure which are particularly necessary in the automotive industry makes switching expensive and unusual (as switching to a new product would involve repeating those procedures for the new product, which parties told us is time consuming and costly). Partly because of these stringent testing procedures, and because products are sourced at the design or development stage (as products are tailored to a customer's individual needs), competition takes place at that early stage. Once a 'tier 2' supplier has been certified as an approved supplier, it is costly and time-consuming to repeat such a certification process. Data supplied by the parties show that there are at least two large alternative suppliers in the segment of bonding agents for rubber-to-substrate bonding and at least three credible

alternatives in flocking and coatings. While switching appears to be infrequent, switching data provided by the parties shows that customers have switched between the parties and their competitors, for both price and technical reasons.

26. Furthermore, pricing pressure derives from the end-user, mainly the automotive industry where margins are traditionally small. According to data provided by Henkel, prices were constant between 2000 and 2003 and then only increased in 2004 and 2005 around [] per cent despite the fact that Henkel's input costs increased by more than this amount (there were substantial increases in the price of oil, a key raw material).

Barriers to entry and expansion

27. According to the parties, the barriers to entry are low as the basic chemistry for the bonding agents and flocking adhesives and coatings is not protected by patents and/or other intellectual property rights and is relatively easy to apply. There is only one intermediate⁸ for bonding agents, which is used mainly in the area of [one type of application], which requires tailor-made production with specific know-how ([]). The parties argue that this intermediate is not an essential compound to produce other comparable bonding agents and that in any case, there is a tendency to replace the intermediate.
28. A third party competitor named a non-EU company, which though already present supplying bonding agents in Spain for several years, is expanding its activities throughout Europe on the back of its customer base in its country of origin, Brazil. The parties said that this company is involved in product approval procedures with several European customers. Some of the largest buyers in Europe are customers of the entrant in Brazil. This company's website also confirms that this company has the potential to supply to the European market. The OFT considers that this entrant may be in a good position to compete with the parties across Europe. The parties also submitted that future entry is likely to be from (i) companies active in the rubber or lacquer industry, as these companies have the knowledge of the required production formulas and procedures; and (ii) customers that are active in low-end (less technically intensive) bonding systems.

COORDINATED EFFECTS

29. Although the sectors in which the parties operate have high levels of concentration, the OFT has not found any evidence which could indicate that the risk of anticompetitive coordinated effects could increase as a result of this merger. These are differentiated products and prices, and although some price lists are public, the

final prices of those mostly bespoke products are individually negotiated and therefore not transparent. Further, as there is low customer switching once a product has been approved, there are limited opportunities for competitors to 'punish' deviating firms. In addition, although the OFT has considered whether coordination could take place through market sharing, we have found no evidence in this regard and no third party has complained of the existence of any alleged coordinated activity.

VERTICAL ISSUES

30. Lord currently supplies a very small amount of raw materials (primarily rubber curing accelerators for bonding agents) to third parties, including Henkel. The OFT has considered whether the merged entity could cease supplying those third parties which compete with Lord for final product sales. The OFT has assessed whether Lord would have the incentive and the ability to foreclose or raise rivals' costs by ceasing to supply them and therefore reducing the non-captive capacity available. The evidence the OFT has found, including third party responses suggests that this is not the case as there are alternative suppliers and their customers (who are competitors for final products e.g. bonding agents) could also produce in-house.

THIRD PARTY VIEWS

31. Most third parties were unconcerned. Concerns raised by third parties have been dealt with above.

ASSESSMENT

32. The parties' activities overlap in the manufacture and supply of speciality chemicals for bonding rubber to substrates and treating rubber surfaces.

33. As regards, flocking adhesives and coatings, the incremental shares of supply are relatively small, both in the UK ([less than 10] per cent) and in Europe ([20-30] percent) with increments of [less than 10] and [less than 10] per cent respectively.

34. In relation to bonding agents for bonding rubber to substrates, the OFT believes that although there is a licensing agreement between the parties this does not prevent them from competing with each other entirely. The parties' UK combined share of supply is very high ([70-80] per cent) but the increment is minimal ([less than 10] per cent). The parties' combined European share of supply is [50-60] per cent with an increment of [10-20] per cent.

⁸ Substance formed as a necessary stage in the manufacture of the desired end product.

35. However, the OFT considers that high market shares do not necessarily mean market power because the sectors to which the parties supply are highly concentrated on the buyer side and the parties' customers tend to be 'tier 2' suppliers to the automotive industry, who themselves face pricing pressure from automotive manufacturers. The OFT therefore believes that there is significant countervailing buyer power. Furthermore, the customer switching rate is low once the products have been commissioned, because of product validation and testing processes. The OFT also considers there are sufficient credible alternative suppliers to the merging parties and the OFT has not found any evidence to suggest that there are capacity constraints in the industry.
36. While the OFT does not agree with the parties that barriers to entry and expansion are low, the OFT believes that there is at least one entrant who is well placed to compete with the parties and entry is also possible from companies operating in similar industries.
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37. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

38. This merger will therefore **not be referred** to the Competition Commission under 33(1) of the Act.