Completed acquisition by Ardagh International Holdings Limited of Redfearn Glass Limited (previously Rexam Glass Barnsley Limited)

The OFT's decision on reference under section 22(1) given on 1 August 2005. Full text of decision published 8 August 2005.

Please note that square brackets indicate information excised or replaced by a range at the parties' request.

PARTIES

1. **Ardagh International Holdings Limited (Ardagh International)** is a subsidiary of **Ardagh Glass Group plc (Ardagh)**, which is incorporated under the laws of Ireland and is the ultimate holding company for **Rockware Glass Limited (Rockware)**. Ardagh is active in the manufacture and sale of glass containers in the UK, Germany, Italy and Poland. Through Rockware it operates four glass manufacturing sites in the UK, with a total of nine furnaces and 23 production lines. Ardagh's worldwide turnover in 2004 was €470.3 million (approximately £322 million). Its UK turnover was €260.5 million (approximately £180 million).

2. **Redfearn Glass Limited (Redfearn)** (previously Rexam Glass Barnsley Limited)[1] was a wholly owned subsidiary of **Rexam plc (Rexam)**, a leading European glass container manufacturer. Rexam's UK glass manufacturing activities were carried on by Redfearn prior to the acquisition. Redfearn's manufacturing plant is located at Barnsley, South Yorkshire, and comprises five furnaces and 13 production lines. The company's 2004 turnover was just over £101 million, around 97 per cent of which was achieved in the UK.

TRANSACTION

3. The parties entered into a sale and purchase agreement on 20 May 2005 and the acquisition by Ardagh International of the entire issued share capital of Rexam Glass Barnsley Limited was completed on the same day. A submission was received on 25 May 2005 and the administrative deadline is 25 July 2005.

[1] As a term of the acquisition, Rexam Glass Barnsley Limited has been renamed Redfearn Glass Limited.

JURISDICTION

4. As a result of this transaction, Ardagh International and Redfearn have ceased to be distinct. The UK turnover of Redfearn exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

Product market

5. Ardagh submits that the relevant product market in this transaction is that for the production of glass containers (excluding those used for pharmaceutical and cosmetic purposes).

6. A manufacturer considering whether to switch from producing containers for pharmaceutical and cosmetic uses to producing other containers would need to take account of additional considerations such as the fact that pharmaceutical and cosmetic glass has a different composition and higher specification to that used for other containers and that it needs to be handled, packed and inspected in a sterile environment. For these reasons, although switching production between manufacture of pharmaceutical containers or hand cosmetic containers and other types of glass containers for other uses possible and has occurred – to a limited extent - in the past, Ardagh does not believe pharmaceutical and cosmetic containers should be included in the relevant product market. Furthermore, neither party manufactures containers for the pharmaceutical or cosmetic industry. It is therefore considered to be appropriate to exclude glass containers for pharmaceutical and cosmetic purposes from the relevant frame of reference.

7. Having excluded glass containers for pharmaceutical and cosmetic purposes from the relevant frame of reference, it was considered whether it was appropriate to subdivide further the supply of glass containers according to different end use segments. On the demand side, there is little or no scope for substitution between glass containers for the various end use segments. On the supply side, although Ardagh submitted that there is a high degree of substitution, some competitors said that they do not supply certain types of glass containers and that it would be costly for them to switch production. The above analysis points towards taking, as a starting point for examining this case, the supply of glass containers excluding those used for pharmaceutical and cosmetic purposes. This is in line with the approach taken previously by the European

Commission.[2] However, it does not seem necessary for the purposes of this analysis to conclude on whether glass containers for different end uses should be considered separately.

Geographic market

8. In April 1998, the European Commission in *Case No IV/M.1109 – Owens-Illinois/BTR Packaging* found that, at its widest, the market included the United Kingdom and Ireland combined, but its investigation suggested that Great Britain constituted a separate geographic market. However, Ardagh argues that, since then, changes to the market suggest that the relevant geographic market is now wider than Great Britain alone and includes at least Northern Ireland, the Netherlands and probably other continental European countries.

9. Ardagh submits, and third party customers confirm, that sourcing from Quinn Glass in Northern Ireland (which opened shortly after the European Commission's 1998 decision) has been a real alternative to other glass manufacturers located within Great Britain. Quinn Glass currently, and successfully, supplies some customers in Great Britain from its plant in Northern Ireland (more recently, Quinn Glass has opened a new manufacturing facility at Ince, Cheshire). It is therefore considered to be appropriate to include Northern Ireland in the geographic frame of reference.

10. Despite the fact that there has been an increase in imports into the UK in the past few years, a number of factors leads to the conclusion that the UK is the most appropriate frame of reference for this case.

11. The majority of UK-based customers source most of their glass from within the UK, even though they normally invite and receive tenders from suppliers based elsewhere. Indeed, imports represent only around 10 per cent of the total UK market.[3] One important feature of this market is the fact that transportation costs are very high due to the nature of the product. Furthermore, some customers suggested that there is a price differential (between 5-10 per cent)[4] between those prices quoted from UK glass manufacturers and those quoted from manufacturers overseas. In addition to price differentials resulting from high transportation costs, a number of customers mentioned that it is logistically difficult to source from overseas, and that imports are hampered by the fact that flexibility and continuity of supply is crucial. This conclusion is supported

[2] *Case No IV/M.1109 – Owens-Illinois/BTR Packaging*, 21 April 1998; *Case No COMP/M.3397 – Owens-Illinois/BSN Glasspack*, 9 June 2004.
[3] However, in their submission of 19 July 2005, the parties' estimates of customers sourcing from overseas in 2005 indicate that they represent a much smaller proportion of the total UK market. [Note: Ardagh has pointed out that these figures are for the year (2005) to date and do not reflect expected increases in imports in 2006.]
[4] Inclusive of transport costs - excluding transport costs European suppliers are up to 40 per cent cheaper than UK suppliers. The parties suggested that this range is slightly broader: 3-10 per cent.

by statements made by some non-UK based glass container manufacturers who submitted that it is important to have manufacturing capacity in the UK in order to win contracts with UK-based customers.

12. In view of the foregoing, it is considered appropriate to take the UK as the relevant frame of reference in this case.

COUNTERFACTUAL

13. Ardagh considers that the correct counterfactual to the merger is the scenario in which the Quinn Glass plant in Cheshire has replaced Redfearn as the third main supplier of glass containers (excluding those used for pharmaceutical and cosmetic purposes) sector in the UK. [ ]

14. However, Ardagh has not produced sufficient evidence to support the contention [ ]. [ ] It is not obvious from this data that Redfearn had ceased to be, or would cease to be, an effective competitor going forward. While some customers might have quality concerns with Redfearn, other customers seemed content to transfer their custom to Redfearn, including some from Rockware.

15. Regarding Quinn Glass, it appears to be accepted that production at the new plant in Cheshire commenced on 1 May 2005 (slightly before this merger was completed) although there is some difference of view as to when full capacity might be attained.

16. The OFT considers that the appropriate counterfactual against which to assess the effects of the merger is a scenario in which both Quinn Glass and Redfearn should be regarded as effective competitors within a UK wide market.

HORIZONTAL ISSUES

17. Taking the UK as the relevant frame of reference, the merged parties' aggregated market shares for the supply of glass containers (excluding those used for pharmaceutical and cosmetic purposes) in 2004 are high (50 per cent share of sales and 50.4 per cent share of capacity).

18. Ardagh submits that their share of capacity might be expected to go down in 2006 to 39.5 per cent due to the opening of Quinn Glass' new plant in Cheshire (and assuming output at that plant of 370,000 packed tonnes)[5]. However, Quinn Glass has informed the OFT that it does not expect to operate the Cheshire plant at full capacity until [ ]. Therefore this reduction in the merged parties' share of capacity might not happen in

[5] Rockware is challenging Quinn Glass' application to vary the existing planning consent.

the short to medium term. Nonetheless, even with the addition of this extra capacity the industry is concentrated and the HHI increment is significant.

19. Ardagh submits that excess capacity in the industry would prevent the merged entity from increasing prices. However, the information given by Ardagh and its competitors regarding spare capacity is strikingly different from the perception customers have about it. Whereas Ardagh submits that capacity across suppliers has been sufficient in recent years to ensure that tendering has been competitive, with customers having a real choice of suppliers, the vast majority of customers believe that capacity is tight. Furthermore, the total level of spare capacity that could be verified with third parties represents less than 2 per cent of current UK capacity excluding the Quinn Glass Cheshire plant and less than 20 per cent including it (assuming the production mentioned above). There are significant doubts over how quickly this excess capacity could be brought on line - responses from competitors indicate that it may be difficult and costly to do so. Furthermore, since firms tend to shut down their least efficient furnaces and it is difficult and costly to bring these furnaces on line quickly, there are doubts over what level of constraint on the merged entity this excess capacity would confer.

20. It is worth noting that, as mentioned above, many customers reported that they normally invite and receive tenders from suppliers based overseas; nevertheless, in most cases the price tendered after transportation costs is not the best one. Therefore, it does seem to be the case that overseas competitors may place at least an upper bound on UK prices. However, the comments from customers suggest that this price differential is substantial and therefore does not pose a sufficient constraint on UK producers.

21. Although the market for the supply of glass containers has not been segmented by end use (even though pharmaceutical and cosmetic uses have been excluded) for the purposes of this analysis, third parties have commented that the merged entity will have particularly high shares of supply to the dairy (93.4 per cent), soft drinks (69.7 per cent) and cider (80 per cent) segments. A snapshot of business won and lost by Rockware and Redfearn over the last five years coupled with the fact that both parties are strong in the same segments indicate that the parties may be each other's closest competitor. As a consequence, the merger may remove from customers the ability to switch to the best rival product in the event of a price increase. It is accepted, however, that customers' past experience would not have included the option to switch to the Quinn Glass plant in Cheshire.

22. As a result of the above, it is possible that the merged firm might find it profitable to raise prices (or reduce them less than would have been necessary without the merger)

or to reduce output and/or investment as a result of the loss of competition between Rockware and Redfearn post-merger.

BARRIERS TO ENTRY AND EXPANSION

23. Barriers to entry in the sector of the manufacture of glass containers are high. These barriers encompass in particular obtaining the necessary consents and incurring in-plant building expenses. Notwithstanding these high barriers, entry has occurred in the recent past – the entry of Quinn Glass both in Northern Ireland and Cheshire is an example. However, it may be the case that the building by Quinn Glass of a new plant in the UK will itself act as a disincentive for any new entry.

24. Regarding barriers to expansion, Ardagh submitted that competitors were constantly increasing their production capacity in response to an increase in demand by investing in rebuilding furnaces and adding production lines. However, third party responses indicate that it is difficult to quickly expand production in the event of a reduction in output, and that re-activating existing spare capacity would take time and require incurring in significant incremental costs.

25. In sum, it is not considered that the likelihood of future entry and expansion would be sufficient to negate any concerns that might arise from the loss of Redfearn as an active competitor within this market.

BUYER POWER

26. Ardagh submits that its customers are large, well-informed buyers who exercise considerable buyer power. There are, it argues, low switching costs for customers wishing to change from one supplier to another. Customers concur that switching costs - mainly due to the cost of new moulds - would not prevent them from switching suppliers in order to achieve a better price and there are examples of actual switching. The tender process should also provide customers with a degree of buyer power.

27. However, large customers may face issues of ‘capacity headroom’. Some large customers mentioned that it is difficult to play suppliers off against each other since there is limited spare capacity and there are very few firms that can supply the volumes of product they require. Therefore, it is not considered that there is countervailing buyer power in this case.

VERTICAL ISSUES

28. There is no evidence to suggest that significant vertical issues arise in this case.

THIRD PARTY VIEWS

29. The majority of customers contacted are concerned that the merger will lead to a reduction in competition, which had been expected to increase with the entry / expansion of Quinn Glass, and to prices being higher than they would otherwise have been. In contrast, all competitors are unconcerned as they believe there is over-supply in the sector, particularly given the capacity at Quinn Glass's new plant.

ASSESMENT

30. The parties overlap in the manufacture and supply of glass containers (excluding those used for pharmaceutical and cosmetic uses). Post transaction, Ardagh has a share of supply of 50 per cent with an increment of 17 per cent. In addition, the parties' customer profiles were similar and switching data indicates that pre-merger the parties were close competitors and were likely to have represented each others' next best alternative for customers.

31. Ardagh presented two main arguments as to why the merger will not result in a substantial lessening of competition. First, it pointed out the existing overcapacity in the industry and the recent opening of a plant in Cheshire by Quinn Glass as factors indicating that spare capacity is likely to increase sharply. In its view, this has resulted in falling real prices over the past few years and will ensure that post-merger Ardagh will not be able to raise prices. Second, it maintains that UK suppliers are increasingly constrained by imports.

32. However, the results of our investigations are that Ardagh's assertions are not adequately supported. Customers in particular are of the view that there has been no spare capacity in the market. In addition, whilst competitors were generally of the view that there is overcapacity in the industry as a whole, the OFT could identify few competitors who could state that they themselves had excess capacity. Ardagh itself estimated share figures on the basis that supply and demand for 2004 had been in balance.

33. In addition to this, even if the OFT were to accept Ardagh's arguments on likely capacity increases, this does not allay concerns since even when these increases are included, Ardagh will still control almost 40 per cent of UK capacity and the HHI figures still indicate that the sector would remain concentrated and the increment would be significant.

34. Regarding the constraint offered by imports, again the views of third parties did not support this contention. Customers maintain that supplies from overseas carry risks in terms of interruptions to supply and that transport costs are significant. A number of

suppliers also noted that it was important to be located within the UK in order to supply UK customers.

35. Barriers to entry in this sector are high, with significant sunk costs and planning constraints among the more formidable barriers. Notwithstanding this there has been new entry and expansion, namely by Quinn Glass. However, Quinn Glass was already present in the market at the time of the merger and some customers indicated that this entry / expansion had been expected to lead to an increase in competition which had been denied by the merger. The potential constraint offered by the prospect of further new entry – which might be expected to be low - is not considered as being sufficient to allay the concerns that may be expected to arise from the loss of a substantial major competitor.

36. It is therefore considered that the merged firm may have the incentive and the ability to set prices at a level higher than they would have been without the merger or to reduce output and/or investment as a result of the loss of competition between Rockware and Redfearn. While it is accepted that Quinn Glass might provide some constraint, it is far from clear that this will be fully effective in the short to medium term. Even so, this does not avoid the conclusion that against the relevant counterfactual the merger reduces the number of substantial players in the UK from four to three. Moreover, a number of customers expressed substantial concerns.

37. Consequently, the OFT believes 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

38. This merger will therefore be referred to the Competition Commission under section 22(1) of the Act.