

Anticipated acquisition by Knauf Insulation Limited of Superglass Insulation Limited

The OFT's decision on reference under section 33 given on 17 June 2004

Please note square brackets indicate exact figures have been removed at the parties request

PARTIES

Knauf Insulation Limited (Knauf), a wholly owned subsidiary of Knauf Insulation Holdings Limited, is part of a group of companies owned by Gebruder Knauf Verwaltungsgesellschaft KG. Knauf is a producer of insulation materials for use in the construction industry and operates from four sites in the UK. **Superglass Insulation Limited (Superglass)** is a separate and autonomously run business within Encon Limited (a privately owned company backed by venture capital investors). Superglass is also engaged in the production of insulation material for use in the construction industry. It operates from one site in Stirling. Superglass's UK turnover for the year ending 31 August 2002 was £21.9m.

TRANSACTION

Knauf has agreed to purchase the entire issued share capital of Superglass for (see note 1) subject to certain adjustments. Knauf has informed the OFT that it wishes to purchase Superglass because the investment and technology transfer it can offer the business will improve its competitiveness. (see note 1). Knauf has also committed itself to honouring a (see note 1) year supply agreement entered into in September 2003 between Superglass and Insta, an insulation system designer. The administrative deadline for a decision expired on 27 May 2004.

JURISDICTION

As a result of this transaction Knauf and Superglass will cease to be distinct. The parties overlap in the supply of mineral fibre in the UK and the share of supply test in

section 23 of the Enterprise Act 2002 (the Act) is met. A relevant merger situation will be created.

RELEVANT MARKET

Mineral fibre

The parties overlap in the supply of mineral fibre, an insulation product. Knauf produces two types of mineral fibre: stone fibre (also known as rock wool) and glass fibre (also known as glass wool). Superglass produces only glass fibre. Insulation materials can be rated by their properties to insulate sound and heat as well as providing fire resistance qualities. The end use the insulation is destined for determines which types of insulation materials can be used.

When the Competition Commission (CC) examined in 1999 the proposed acquisition by Rockwool Limited of the stone fibre business of Owens-Corning Building Products (UK) Ltd,¹ the focus of the examination was stone fibre. Across most building applications the CC found that glass fibre and other plastic-based insulation materials were substitutes for stone fibre. However, the report also recognised that manufacturers could price discriminate against certain customers who were less able to switch to alternative materials. In assessing the present transaction, the OFT has drawn on this conclusion of the CC and considered the effect of the merger on specific product sectors.

Glass fibre (the type of mineral fibre manufactured by both Knauf and Superglass) is manufactured, processed and shaped to meet specific end-use applications (for instance, in compressed slab form for use in new build cavity wall insulation; as blowing wool for installation as cavity wall insulation; and in the form of a 'quilt' for loft insulation). Existing producers of mineral fibre all supply the material in all these forms. However, from the demand-side, depending on the end-use concerned, the range of insulation materials which could be considered as substitutes for glass fibre insulation varies. Customers themselves would appear to have little opportunity to re-shape the differing end products so as to allow arbitrage between them.

Consequently, on the evidence before us, we consider it appropriate to examine competitive constraints by the end-use to which the product is put.

¹ Rockwool Limited and Owens-Corning Building Products (UK) Ltd: a report on the proposed merger (Cm 4330/1999).

End-use applications for mineral fibre

The parties overlap primarily in the supply of mineral fibre (specifically glass fibre) insulation materials for use in cavity wall and loft insulation. These sectors are considered below. One third party raised concerns about the overlap in the supply of industrial cladding material and another third party raised concerns about material for use in acoustic insulation; these sectors are considered briefly below.

Cavity wall insulation

Building regulations require insulation in walls of new buildings which typically occurs in the cavity between the outer and inner wall. This can be installed when the walls are being erected (*built-in*), in which case plastic foam slab products, mineral fibre slab products or other forms of insulation can be used. Insulation can also be installed where a wall already exists (*retro-fitted*), in which case blown mineral wool or polystyrene beads can be used. While existing suppliers of mineral wool all supply both slab and blowing wool, the competitive constraints facing each of these types of products appear to vary.

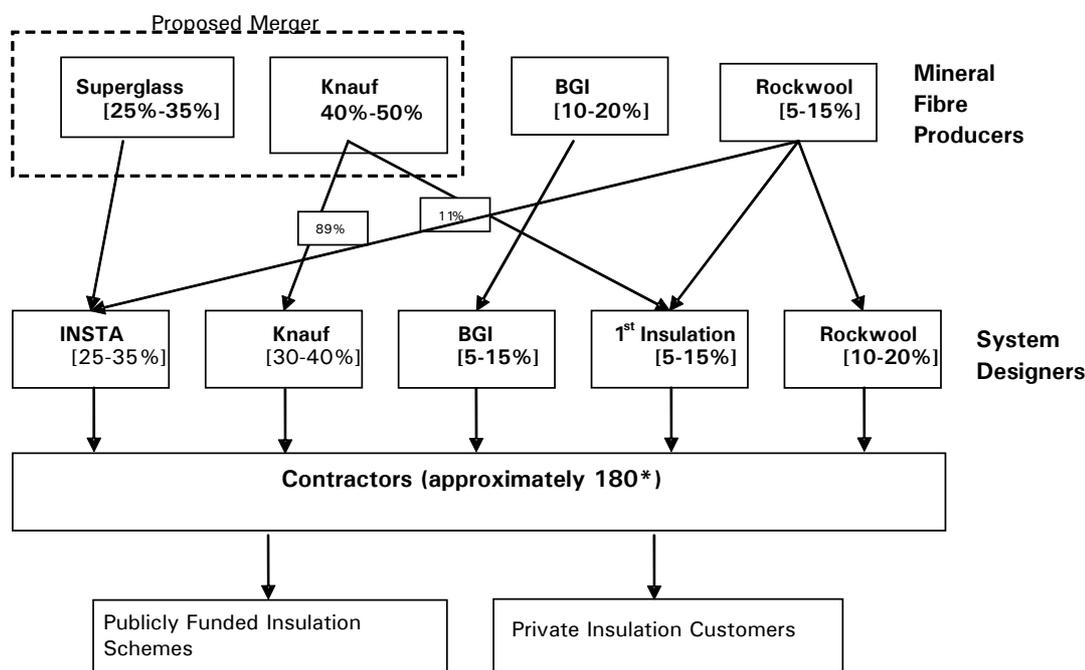
Built-in cavity wall insulation

On the demand side the potential substitutes to glass fibre insulation material appear to be wider where the cavity wall insulation is built-in. As noted, customers for new build cavity wall insulation can choose among insulation slab products made from mineral fibre, plastic foam and other materials. In these circumstances, this transaction does not raise any competition concern, so built-in cavity wall insulation is not considered further.

Retro-fitted cavity wall insulation

Retro-fitted cavity wall insulation requires the contractor to drill holes into the walls and then 'blow' balls of mineral fibre (the blowing wool) into the gap using specialist blowing machines. There are several parties involved in the supply of materials for retro-fit cavity wall insulation. Manufacturers of the blowing wool material supply systems designers with blowing wool (either glass or stone). The system designers in turn supply to contractors both the blowing machines which blow the material into the cavity and the wool. Both the system designers and contractors need to be trained and certified in the products they are using by the British Board of Agreement. The industry structure (with the participants' shares of supply at the various levels) is summarised in the table below:

Retro-fitted cavity wall insulation – industry structure



Source: the parties

*survey by Cavity Insulation Guarantee Agency in April 2003

An independent market research report provided by the parties² estimates that mineral fibre (glass and stone fibre) represents over 95 per cent of insulation materials used in refurbishments in Great Britain (GB).

From the demand-side, the potential substitutes to the glass fibre blowing wool in which the parties overlap are stone fibre blowing wool and polystyrene beads. The evidence on whether stone fibre is a substitute is mixed. On one hand, there are examples of customers switching (and threatening to switch) between glass and stone fibre, and it appears to be the case that previous attempts to increase the price of glass fibre have been constrained to some extent by switching (or the threat of switching) to other mineral fibre products. On the other hand, some third parties commented on stone fibre's greater bulk having implications with regard to transportation costs, and wear and tear on machinery. Although polystyrene beads are used extensively in Northern Ireland, there has been limited take up in GB. Polystyrene beads require specialist blowing machines which cannot be used for mineral fibre and also require larger holes to be drilled in the wall. Some third parties have suggested beads are more bulky to transport than mineral fibre.

While there is evidence that stone fibre does compete with glass fibre product to some degree and that at least some blowing machines can use both types of mineral fibre blowing wool, the potential constraint offered by polystyrene beads appears more limited. While polystyrene beads have proved popular in Northern Ireland this may reflect the fact that there is no mineral fibre production in Northern Ireland – but there are polystyrene manufacturing plants and thus mineral fibre faces additional transportation costs. An alternative explanation may be that customers simply favour domestic suppliers. We have also taken note of the representations made by contractors, who in the main did not consider polystyrene beads to be an alternative.

Accordingly, the OFT has taken as the appropriate frame of reference the supply of mineral fibre retro-fit cavity wall insulation material.

Geographic market for retro-fit cavity wall insulation

The parties maintain that imports of mineral fibre retro-fit cavity wall insulation material from the US or the continent are viable. While recognising that this material is not readily manufactured on the continent, they believe that the investment to begin manufacture would be relatively modest (at [£50,000 - £250,000] and point to Insta who initially imported from Belgium in 1999. However, system designers (who by purchasing in bulk would be most likely to import) have raised concerns about continuity of supply from overseas manufacturers. Other customers have also pointed to the higher price levels currently existing on the continent for mineral fibre and to the fact that, in those EU countries close to the UK, over 70 per cent of mineral fibre insulation material production is represented by companies already present in the UK (Knauf, Rockwool and BGI).

In the light of this evidence, the OFT, contrary to the parties' submissions, and noting the possible distinction in usage in Northern Ireland, has taken as the appropriate frame of reference the supply of mineral fibre retro-fit cavity wall insulation material in Great Britain.

Loft Insulation

Mineral fibre is also used to insulate lofts within new and existing buildings and this appears to be the largest single use for glass fibre insulation material. The requirements of the loft space to be insulated can determine the potential substitute materials that could be used to insulate that space. Prior to the introduction of new building regulations (see below) the main factors influencing the selection of insulation

² The Market for Building Insulation, Great Britain 2002 to 2004, table 17.

method and material have been as follows.

- If the loft is to remain empty, mineral fibre rolls (or quilts) can be laid on the loft floor between the joists as can loose materials such as cellulose fibre (which is a form of shredded newspaper), blowing mineral wool or sheep's wool.
- If the loft is to be used as storage space then mineral fibre rolls can be laid on the loft floor between the joists, or insulation (usually foam plastic products) can be installed between the roof rafters (known as a 'warm roof').
- If the loft is to be used as a living space then the insulation must be installed between the roof rafters (creating a warm roof), again usually in the form of foam plastic products.

At the present time, if industrial and flat roofs are excluded, mineral fibre represents around 85 per cent of material used for loft and roof insulation of which approximately 90 per cent is glass fibre and 9 per cent is stone fibre. Within warm roof insulation, mineral fibre represents approximately 5 per cent of materials used.³

The decision whether to insulate the roof or the loft floor appears to have a large bearing on the potential for using other materials (given a reported large price differential between mineral fibre products and the more expensive foam plastic products). Nevertheless, warm roofs are forecast to represent an increasing proportion of insulation installations due to:

- new building regulations requiring a greater depth of mineral fibre insulation in the loft space (250mm to 270mm); consequently it may not be possible to use this space for storage due to the insulation lying above the joists which should not be compressed by weight being placed directly on top. One way to avoid this problem is to install a warm roof; and
- a shortage of living space in parts of Britain is increasing the conversion of lofts to living space, requiring warm roof insulation.

A key issue in terms of the identification of possible competitive constraints is whether an increase in the price of glass fibre by a hypothetical monopolist would lead to switching to insulating the inside of the roof rather than the loft floor (thus encouraging a switch from glass fibre to other materials). The factors outlined above suggest that matters other than the relative cost effectiveness of the materials may determine whether the roof or loft floor is insulated. The OFT has little real information on which to gauge the effect of these changes to the building regulations on demand for mineral fibre and the extent of marginal users of glass fibre for whom a

³ The Market for Building Insulation Great Britain 2002 to 2004.

significant price rise would prompt switching.

Contractors have almost all dismissed substitutes to glass fibre for loft floor insulation. In particular, they have pointed to:

- stone fibre being substantially more expensive;
- stone fibre being an irritant making its handling more difficult;
- stone fibre being substantially more bulky than glass fibre, which prevents material sufficient for a day's work being stored in a van;
- cellulose fibre preventing circulation of air; and
- plastic boards being very expensive.

The parties have countered that:

- the installed cost of stone fibre is comparable to glass fibre;
- both glass and stone fibre are classified identically as an irritant and some contractors prefer to handle glass and some stone fibre;
- a contractor requires 22 rolls of glass fibre or 39 rolls of stone fibre to complete 3 jobs per day. A typical van holds 80 rolls and thus stone fibre's space requirements do not represent an issue, and the price of stone fibre reflects the extra bulk and its superior fire and sound insulation qualities; and
- Wickes DIY stores stock only stone fibre and this would not be viable if stone fibre were not considered suitable for loft insulation by jobbing builders.

The parties' views are thus opposed to those of their customers. In support of their views the parties have provided evidence of switching: there are only (see note 1) instances of switching between glass fibre and stone fibre products, and (see note 1) between mineral fibre and other products⁴. This would indicate that the competitive constraint offered by products other than mineral fibre is weak and there is doubt as to the strength of the constraint to glass fibre products offered by stone fibre products.

Despite the views on substitutability expressed by contractors, the OFT has taken the supply of mineral fibre loft insulation material as the starting point for its competition analysis of this transaction. Nevertheless, in carrying out its analysis, the OFT has taken account of customer scepticism in relation to the substitutability of stone fibre for glass fibre and has also considered the potential constraint offered by warm roof insulation.

⁴ That were evidenced by the parties (footnote added at the request of the parties).

Geographic market for loft insulation

As with retro-fit cavity wall insulation, imports for loft insulation material appear limited by the importance of continuity of supply, the higher price levels currently existing on the continent and the fact that, in those countries close to the UK, over 70 per cent of production of mineral fibre insulation material is represented by companies already present in the UK. Imports that do occur tend to be internal transfers by manufacturers rather than direct purchases by customers. (Superglass has imported some mineral fibre loft insulation material, (see note1), in order to meet customer demand during the current shortage.) Furthermore the OFT has been sent copies of a recent letter issued by Knauf (at the end of April 2004) to its customers notifying them of a 20 per cent price increase for June. The letter notes that such a price increase would bring prices in line with the continent. In itself this would suggest that imports have not, in the past, acted as a significant constraint. In the light of this evidence, the OFT, contrary to the parties' submissions, has taken as the appropriate frame of reference the supply of mineral fibre loft insulation material in the United Kingdom.

Industrial cladding

Cladding is used in industrial buildings to insulate walls and roofs. At a late stage of its investigation the OFT received a third party complaint concerning industrial cladding. In the time available the OFT has not received sufficient information to be able fully to assess the effects of the merger upon this sector. However, given the OFT's findings in relation to retro-fit cavity wall and loft insulation, it has not been found necessary to extend the investigation to assess more fully the competitive effect of the merger in relation to industrial cladding.

Acoustic insulation

Acoustic insulation is a means of reducing the impact of sound. The majority of this type of insulation is stone fibre. Superglass is not active within stone fibre and Knauf represents only a small proportion of stone fibre sales (at [0 per cent-5 per cent]). The parties estimate that their shares in the acoustic insulation sector are less than [10 per cent-20 per cent] (Knauf [5 per cent-10 per cent], Superglass [0 per cent-10 per cent]). The OFT's investigation has not uncovered any contrary evidence. Accordingly, given the parties' low combined share of supply, this sector is not considered further.

HORIZONTAL ISSUES

General considerations

The parties have pointed to a lack of spare capacity within mineral fibre production and that most firms are operating at full capacity. Evidence presented to the OFT shows

that while substantial capacity expansion is planned in this sector, substantial growth in demand is also expected due to the government's drive to reduce fuel poverty and carbon dioxide emissions. In our view, incentives for capacity expansion to meet demand growth are likely to be positively related to the extent of competition in the market.

Knauf's stated rationale for the merger is to increase capacity, the expansion of which is cheaper at the Superglass factory. Given the current capacity shortages, in the short-run, prices might be expected to rise with or without the merger. One third party expressed the concern that, since competition drives capacity expansion, the merger will lead to less capacity as product shortages will be in the best interest of the merged entity. (see note 1).

Retro-fit cavity wall insulation

The merger will represent significant consolidation in what was already a concentrated industry. The parties' estimate of their combined share of supply of all insulating materials for use in retro-fit cavity wall insulation is approximately [60 per cent-70 per cent] (Knauf [35 per cent-45 per cent], Superglass [20 per cent-30 per cent] even if polystyrene beads are taken into account. (BGI's glass wool product having [10 per cent-20 per cent], Rockwool's stone wool product having [5 per cent-15 per cent] and Polystyrene beads having [5 per cent-15 per cent].) If polystyrene beads are excluded the parties would represent over [65 per cent-75 per cent] of UK supply of mineral fibre retro-fit cavity wall insulation material.⁵

Substantial third party representations have been received expressing concerns about the proposed acquisition and subsequent concentration in mineral fibre blowing wool. The merged entity will represent a large proportion of the supply of blowing wool and will be a significant supplier to the only two independent system designers (Insta and 1st Insulation), with which Knauf will also compete through its downstream cavity wall system designer business. (see note 2).

The parties state that, in the retro-fit cavity wall insulation sector, system designers play a crucial role in negotiating prices and that Insta will remain independent (with security of supply under the (see note 1) year supply agreement mentioned above). They go on to say that there is vigorous competition in insulation contracts leading to price-sensitive customers who will switch designers in response to small price changes. Knauf contended that it would wish to maintain the route to market offered by Insta and that it has no incentive to foreclose Insta from the supply of mineral fibre retro-fit cavity wall insulation material.

⁵ We do not have separate GB figures, although the limited impact of polystyrene beads within GB, unlike Northern Ireland, is likely to make the share of mineral wool on a GB basis slightly higher than on a UK basis.

(see note 1). In addition, pre-merger, when Knauf's system designer business lost business to Insta, this entailed a loss of both wholesale and retail margin. Post-merger such a switch will only entail a loss of retail margin. Given that Knauf is the largest system designer and Insta is the second largest, the merger might lead to a muting of competition between system designers.

In the light of the above, the merger would appear to give rise to a realistic prospect of competition being lessened through non-coordinated effects.

Potential for co-ordinated effects

Some of the comments of third parties give rise to the question of whether the industry could be susceptible to co-ordinated effects and whether this susceptibility would be increased following the merger. In particular it has been suggested that manufacturers tend to announce price rises by similar amounts at similar times. Consequently the OFT has examined the three criteria referred to in its substantive assessment guidance⁶ for assessing whether a credible case for co-ordinated effects exists within this industry. The various points raised in this connection are set out below.

Ability to align behaviour in the market

- The Knauf 'Contracting monthly report January 2003' included a price increase of 8 per cent on 6th January. This report noted that: (see note 1). This close matching of price rise announcements and dates of price rises could evidence or facilitate co-ordinated action on prices.⁷
- Mineral fibre cavity wall insulation material is a fairly homogenous product (despite some branding and technical differences between glass fibre and stone fibre), and therefore it would seem there is a clear 'focal' point which may give the firms the ability to align their behaviour.

Incentives to maintain coordinated behaviour

- BGI appears to have been actively competing on price for specific customers and the statements in the letter to Herr Knauf (see note 1) also suggest that BGI actively competes.

⁶ See paragraphs 4.11–4.16 of *Mergers – Substantive assessment guidance* (May 2003, OFT 516).

⁷ In this respect a unilateral price increase could be expected to lead to diversion of product to competitors with the expectation that they then increase price as demand for their product increases. A co-ordinated price increase seeks to minimise this effect and thus allows a greater

- Price competition also occurs in terms of rebates given which can be very substantial but may not be immediately visible (until switching occurs).
- There appear to be capacity constraints which would suggest that there is currently little ability to punish those that stray from the coordination. The situation post capacity expansion is less clear. There are also some (albeit limited) examples of manufacturers importing product into the UK.
- Notwithstanding the points above, vertical integration into system design may increase visibility of pricing to contractors. The quote under the 'Ability to align behaviour' heading above came from Knauf's downstream operations in supplying direct to contractors. This evidence appears to show quite detailed knowledge of competitors' price increases.

Sustainability of coordinated behaviour

- As discussed below, barriers to entry appear high.
- Some contractors are very large customers and may in the past have been able to undermine price rises through the threat of switching large amounts of demand. This is supported by the Knauf sales reports (see note 1). (see note 2).

In sum, the sector has some of the characteristics which favour coordinated behaviour although other factors such as the existence of current spare capacity are absent. As to whether the merger may increase the likelihood or stability of such co-ordination, there is some evidence that the merger may have a significant impact, namely:

- the merger reduces the number of producers in the industry and thus simplifies co-ordination;
- such an effect will be amplified by the fact that, post-merger, Knauf will be supplying three of the five system designers including the only two independent ones; and
- as noted above, while customers have suggested that typically manufacturers tend to try to increase price by about the same amount at the same time, (see note 2).

These factors suggest that the removal of Superglass as an independent supplier of glass fibre (and the subsequent dependence of Insta on Knauf for supply of mineral fibre retro-fit cavity wall insulation material) may adversely affect the dynamics of competition and increase the likelihood of co-ordination occurring in the sector.

Loft insulation

Information available to the OFT suggests that the parties represent up to 70 per cent of all material used in loft insulation as outlined in the table below.

Shares of insulation material for use in loft insulation, 2002

Manufacturer	Est. Sales in 2002	Shares (inc. warm roofs)	Shares (exc. warm roofs)*
Superglass	[£5m-£15m]	[10 per cent-20 per cent]	[15 per cent-25 per cent]
Knauf	[£25m-£35m]	[40 per cent-50 per cent]	[45 per cent-55 per cent]
Combined	[£35m-£45m]	[55 per cent-65 per cent]	[65 per cent-75 per cent]
BGI	[£5m-£15m]	[10 per cent-20 per cent]	[15 per cent-25 per cent]
Rockwool	[£0m-£10m]	[5 per cent-15 per cent]	[5 per cent-15 per cent]
Sub-Total	[£50m-£60m]	[80 per cent-90 per cent]	100 per cent
Other (inc. warm roofs)	[£5m-£15m]	[10 per cent-20 per cent]	N/A
Total	[£60m-£70m]	100 per cent	N/A

Source: the parties

** This is a guide only. Some sales of Superglass, Knauf, BGI and Rockwool will be mineral wool used to a limited extent in warm roofs. The shares assume that the firms have the same proportion of such sales.*

As in the case of retro-fit cavity wall insulation, substantial third party concern has been received and there is evidence that (see note 2).

The parties consider that glass fibre quilt faces considerable competitive constraints from both stone fibre quilt (Rockwool), stone fibre blowing wool (Rockwool) and that plastic board is taking a substantial and increasing share of the loft market, which will increase with the effects of new legislation increasing the required level of insulation. The parties state that 70 per cent of BGI's core product goes to this sector and therefore that BGI will always remain a competitive discipline. In addition, the parties point to the fact that stone wool is already produced to the CE standard while glass wool is not (see note 3). With the impending imposition of the CE standard across the loft insulation sector, it is estimated that this will add between 8 per cent and 10 per cent to the cost of glass fibre quilt, thereby minimising any price advantage currently enjoyed by glass fibre loft insulation materials.

As noted elsewhere, however, evidence of switching from glass wool to alternative means of loft insulation is mixed. The third party customer views received by the OFT often directly contradict the views expressed by the parties. Many third parties do not, for the reasons outlined at paragraph 22 above, regard the alternative products as substitutes in this sector. Again, the merger would appear to give rise to a realistic prospect of competition being lessened through non-coordinated effects.

Potential for co-ordinated effects

The factors identified above in relation to retro-fit cavity wall insulation are relevant to the feasibility of tacit collusion in the mineral fibre loft insulation material sector, and the evidence cited that this merger may contribute to increasing or stabilising any such co-ordination is equally applicable here (save that vertical integration is not present to the same extent). In particular, the OFT has received evidence that recently there have been almost simultaneous announcements by Superglass, Knauf and BGI of a 20 per cent price rise with effect from 1 June 2004.

Barriers to entry

The parties have estimated that to build a new mineral fibre production plant on a green field site would cost £1 million per 1000 tonnes of capacity and note that it would not be worth building a production line to produce less than 15,000 tonnes. This would appear to be a largely sunk cost and substantial in the context of total annual UK sales retro-fit cavity wall insulation materials ([£10m-£20m]) or loft insulation materials ([£60m-£70m]). In addition, it is notable that the threat of potential entry appears not to have constrained the parties from issuing a 20 per cent price increase notification to their customers for glass fibre loft insulation material. Consequently, on the evidence before us, it appears unlikely the threat of new entry acts as a strong competitive constraint.

Third party views

The OFT's investigation into this merger prompted widespread concerns from third parties and many unsolicited letters and phone calls from contractors. Some contractors also expressed support for the merger as it was felt that the acquisition would lead to greater security of supply. Most of the concerns expressed related to recent price rises and difficulty in obtaining product. Although these concerns relate to current circumstances, they may also be relevant to the assessment of the merger. (see note 2).

Customer benefits

Knauf has told the OFT that the following customer benefits will occur as a result of the merger:

- increased investment in capacity at the Superglass Stirling plant;
- improved capability to service customers across GB due to the location of the two companies' facilities;
- a 15 per cent reduction in vehicle miles travelled by redrawing its customer service boundaries and so leading to reduced transportation costs, which would result in customer savings and environmental benefits;
- the provision to Superglass of self off-load vehicles enabling a swifter turnaround of vehicles in customer premises;
- the transfer of Knauf technology to the Superglass Stirling plant leading to a superior quality product (see note 4) and significant manufacturing cost reductions through internal benchmarking, new packaging equipment and Knauf fiberising technology;
- extending Superglass to a full product range; and
- improved research and development expenditure.

It is not clear that the merger would result in all these claimed benefits to consumers, or that such benefits would not arise anyway either as part of the process of competition, or as a result of another purchaser or new investment by the current owners. (see note 1).

ASSESSMENT

The merger brings together two major manufacturers and suppliers of mineral fibre retro-fit cavity wall insulation material and mineral fibre loft insulation material. Within retro-fit cavity wall insulation, the parties would represent a very significant proportion of supply of insulating materials (at around [60 per cent-75 per cent]) and this may affect both upstream competition between mineral fibre insulation material

manufacturers and downstream competition between system designers. In the absence of strong potential competition this gives ground for concern that the merger will lead to a substantial lessening of competition. A lessening of competition could lead to higher prices and slower capacity expansion to meet growing demand.

Within loft insulation, the parties would also represent a large proportion of mineral fibre insulation material supply, again raising concerns about a substantial lessening of competition. This is notwithstanding that alterations in building regulations are changing the quantities of materials that need to be used and over time this may change which materials act as a competitive constraint on glass fibre products.

In both of these areas the OFT has received a large number of expressions of concern by third parties at the loss of Superglass as a competitive constraint on the ability of Knauf to increase prices.

In view of the factors set out above, the OFT is concerned that the merger may result in a substantial lessening of competition in respect of both mineral fibre retro-fit cavity wall insulation material and mineral fibre loft insulation material even before taking into account the possibility that the merger might enhance prospects of co-ordinated behaviour between the remaining firms.

The sector has some of the characteristics which favour co-ordination and there is evidence of announcements by Knauf and its competitors of similar price rises on similar dates. The evidence also shows that Superglass has been used in the past as a bargaining tool by some customers to resist the price increases. Accordingly, the OFT believes on the evidence before it that the merger may also substantially lessen competition by increasing the likelihood and effectiveness of coordination among competitors, tacit or otherwise.

Knauf has claimed that a wide range of potential cost savings and customer benefits would arise from the merger. Some of these may occur without the merger and there is a question as to what extent any cost savings will be passed on to customers. It is far from clear that any such benefits would outweigh the potential substantial lessening of competition.

Consequently, the OFT believes 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. The criteria for the customer benefits exception to the duty to refer the merger to the CC are not met.

Undertakings in lieu

Notwithstanding their view that a substantial lessening of competition is unlikely to result from the merger, the parties have made an offer of undertakings in lieu. They have offered to commit to honouring the supply contract between Superglass and Insta as a condition of clearance of this merger. (see note 1). Given the substantial proportion of the post-merger supply of mineral fibre materials for retro-fit cavity wall insulation that Knauf would represent, the agreement may not, in itself, be sufficient to enable Insta to continue to provide a competitive constraint on the merged group in the retro-fit cavity wall insulation material sector.

Moreover, the parties' proposed undertaking does not address fully the competition concerns identified above in relation to the supply of mineral fibre loft insulation material. The existing contract between Superglass and Insta does cover the supply of some loft insulation material but there are other distributors (currently supplied by Superglass) that would not be protected by the contract.

The OFT's published guidance⁸ indicates that undertakings in lieu will be accepted only if they represent a clear-cut remedy to a clearly identified competition concern. The remedy offered does not meet these criteria and therefore cannot be accepted in lieu of reference.

DECISION

This merger will therefore **be referred** to the Competition Commission under section 33(1) of the Act.

NOTES

Note 1 - Text removed at request of the parties for reasons of commercial confidentiality.

Note 2 - Specific text outlining third party concerns at the loss of Superglass as a competitive constraint on the ability of Knauf to increase prices has been removed for reasons of commercial confidentiality.

Note 3 - while agreeing that they made this statement to the OFT, the parties wish to state the following 'Manufacturers of glass mineral wool are producing CE marked products which require a loft wool thickness of 270mm in new build houses: however, some house builders are continuing to install loft wool in new houses to a thickness of only 250mm, which means that thermal performance standards are not met'.

⁸ Chapter 8 of *Mergers – substantive assessment guidance* (May 2003, OFT 516)

Note 4 - Encon wishes to state that it does not believe that the introduction of Knauf technology will necessarily lead to a superior quality product.