

Anticipated acquisition by Atlas Copco AB of Ingersoll-Rand Drilling Solutions

The OFT's decision on reference under section 33(1) given on 16 June 2004

Please note that square brackets indicate figures replaced at the request of the parties

PARTIES

Atlas Copco AB (Atlas) is an international construction and mining group based in Sweden. It develops, manufactures and markets a variety of products for sale and rent in the mining and construction industry. The **Drilling Solutions Business (DSB)** of Ingersoll-Rand Company Ltd (I-R) is a manufacturer and distributor of drilling equipment and consumables to the surface mining, exploration, oil and gas and quarry industries around the world. In the UK it only operates through an independent distributor, Skelair Ltd. For the financial year ended 31 December 2003, the DSB's UK turnover was [less than £2] million.

TRANSACTION

Atlas has proposed to buy the DSB through the purchase of its assets – the only assets being acquired in the UK are [less than £100,000] of stock held by a UK subsidiary of I-R. Post-merger, DSB's UK distributor Skelair will remain independent and be given the opportunity to continue its current distribution agreement with DSB. The extended statutory deadline is 17 June 2004. The transaction has been cleared in the USA.

JURISDICTION

As a result of this transaction, Atlas Copco and DSB will cease to be distinct. The parties overlap in the supply of surface crawlers, spare parts and repair and maintenance of surface crawlers in the UK and the supply of consumables for use with surface crawlers in the UK. The share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. A relevant merger situation is likely to be created.

RELEVANT MARKET

Product market

Surface crawlers

A surface crawler is a relatively small, manned, tracked vehicle equipped with a drilling tool. It is used in the mining, quarrying and construction industries to produce a small diameter hole in rock using a percussive drilling technique. This hole is then used as a blast hole for explosives.

There are two types of drilling methods used by surface crawlers: 'top hammer' (or drifter) drilling and 'down the hole' (DTH) drilling. Machines using DTH drilling account for 90-95 per cent of UK sales.

UK customers tend to prefer DTH drilling rigs because they require less servicing. In the UK drilling is primarily undertaken by contractors, who depend heavily on the rig manufacturer for servicing as they do not tend to have sufficient expertise in-house. Third parties have unanimously indicated that there is no economic alternative to the use of a surface crawler.

Service

Atlas sells optional service contracts with the majority of its new surface crawlers. These are not bundled in the surface crawler price. The parties submitted that they have never been asked to provide a service contract for another manufacturer's surface crawlers, and believe equally that other manufacturers do not provide service contracts for the parties' surface crawlers. Although nothing prevents manufacturers from providing service contracts for competing manufacturers, there was no evidence that that this is currently taking place. It therefore appears that the sale of service contracts is not distinct from the sale of surface crawlers.

Spare parts

Spare parts for surface crawlers are the components which form part of the fundamental machinery, such as parts for the engine. Atlas is not under contract to provide spare parts for its surface crawlers, except in the case of replacement of a part in a machine still under the 1-year-warranty. Most customers buy their spare parts through the manufacturer of their surface crawler in order to ensure compatibility, though some third party sales do take place.

Replacement Drilling Tools and Consumables

Both parties offer replacement drilling tools and consumables such as drill bits and steel rods. These components wear down with use and are replaced by customers relatively frequently. Customers are not obliged to purchase their consumables from the surface crawler manufacturer, even if they take out a service contract. There are a number of third party providers of consumables that are not also active in the manufacture of surface crawlers.

Geographic market

The parties submitted that the market for surface crawlers, parts and consumables is worldwide in scope, with biggest demand in countries with large surface mining industries, notably the US and China. There are several globally organised producers which sell the relevant products in numerous countries throughout the world. The surface crawlers sold in the UK by Atlas and the DSB are produced in Sweden and the USA respectively.

It appears necessary to have a local presence to provide the maintenance services which are expected by customers. Atlas maintains its own sales force in the UK while the DSB sells through its UK distributor, Skelair Ltd, which also provides spare parts, consumables and service contracts for the DSB surface crawlers. There are some manufacturers of surface crawlers that are not currently selling in the UK.

Given that even on the narrowest possible geographic frame of reference (the UK) the OFT does not believe that it is or may be the case that this merger may be expected to result in a substantial lessening of competition, it is not necessary to conclude on the geographic market.

HORIZONTAL ISSUES

Shares of supply

Table one: Shares of supply of Surface Crawlers 2003

	UK - share	UK – number of crawlers	Worldwide
Atlas	[30-40 per cent]		[20-30 per cent]
Ingersoll-Rand (DSB)	[20-30 per cent]		[20-30 per cent]
<i>Combined</i>	<i>[60-70 per cent]</i>		<i>[50-60 per cent]</i>
Sandvik/ Tamrock	[10-20 per cent]		
Furukawa	-		[0-10 per cent]
Reeddrill	-		[< 5 per cent]
Dainong	-		[< 5 per cent]
Hausherr	[20-30 per cent]		-
Others	-		[< 5 per cent]

Source: Atlas and Hausherr

Notes: Atlas estimated Atlas' post-merger share of supply to be [70-80 per cent].

The merger results in a considerable consolidation in the surface crawler sector at both the UK and worldwide level. There is some uncertainty surrounding the share of supply figures provided by the parties, though it appears that the merged entity's combined share of supply in the UK is between [60-80 per cent] (increment [20-30 per cent]) in surface crawlers and [30-40 per cent] (increment: [0-10 per cent]) in replacement drilling tools and consumables. On a worldwide basis, Atlas Copco's share of supply in surface crawlers will amount to [50-60 per cent] (increment: [20-30 per cent]).

The high share in surface crawler sales might be expected to account for a high share in service contracts, which are typically bought with the surface crawler and maintained for a few years. It might also result in a high share in spare parts, because buyers tend to prefer the OEM's spare parts. In consumables, shares of supply are significantly lower due to the presence of independent suppliers.

Table two: Shares of supply by value of Replacement Drilling Tools and Consumables 2003

	UK	Worldwide
Atlas	[20-30 per cent]	[30-40 per cent]
Ingersoll-Rand (DSB)	[0-10 per cent]	[0-10 per cent]
<i>Combined</i>	<i>[30-40 per cent]</i>	<i>[30-40 per cent]</i>
Sandvik/ Tamrock	-	[20-30 per cent]
Boart	-	[10-20 per cent]
Mitsubishi	-	[0-10 per cent]
Others	-	

Source: Atlas

Notes: Atlas has been unable to estimate shares of supply for its competitors in the UK. However, each of the firms listed above is active in the UK.

As a result of the merger there will be a reduction in the number of suppliers of surface crawlers currently active in the UK from four to three, with the two biggest suppliers merging. The remaining suppliers are Tamrock, part of the international Sandvik group, and Hausherr UK. However, customers generally expressed a lack of concern about the merger and supported the possibility of switching to both Tamrock and Hausherr. Some customers also indicated the possibility of switching to suppliers not currently active in the UK.

There is conflicting evidence from third parties regarding the strength of competition between the parties. There is some indication that DSB had a declining market position outside the USA which is consistent with Atlas' rationale for the merger to acquire a stronger position in the substantial US market. On the other hand, the parties were clearly bidding against each other in tendering for a number of contracts.

Third party comments suggest that brand loyalty is high and many sales are simply repeat sales: customers who had previous experience with DSB and/or Atlas rigs respectively often prefer to continue buying these rigs as they only need to carry one set of spare parts and engineers have knowledge of the equipment. However, there are alternative sources of surface crawlers and there is no obligation on customers to purchase consumables with the surface crawler. The customers will therefore post-merger retain choice between the parties' and third parties' consumables.

Barriers to entry and expansion

The most likely source of new entry into the provision of surface crawlers to the UK appears to be from manufacturers of surface crawlers not currently active in the UK, either through the establishment of a local sales operation, the use of a distributor or through a direct sales operation from its foreign base.

For a supplier already active in the sale of surface crawlers outside the UK the costs of commencing operations in the UK would be minimal. If servicing is subcontracted it is possible to manage the entire operation from a non-UK base. Alternatively, sales can be made through the use of a locally based distributor, the method used by DSB. Some customers indicated that they have already looked at the use of foreign suppliers, even though these suppliers do not currently have any UK sales presence. Customers also indicated that sourcing from suppliers not currently active in the UK would be possible in response to a post-merger price rise and named potential suppliers.

However, two potential competitors that do not currently have DTH crawlers in their portfolios indicated that such products are currently undergoing development, and one anticipates that its product will be available within six months. These products are being developed with a view to generating UK sales, indicating that firms intend to begin supplying in the UK. In addition, several customers cited foreign suppliers as potential alternatives to the parties.

De novo entry could be achieved by an existing manufacturer of mining and quarrying machinery not currently active in the production of surface crawlers at a cost of £2-3m. These firms have the fundamental engineering capacity, brand reputation and customer relationships and could enter on a worldwide basis if they felt this to be profitable.

Buyer power

Many customers are big international groups buying these products on an international scale, with some customers having single contracts for the provision of surface crawlers in more than one country. This facilitates price comparisons between surface crawlers purchased in the UK and other, more important, markets. Atlas submits that suppliers have been unable to increase their prices for several years and customers do

indicate that they are often able to negotiate prices downwards. The use of contract drilling as opposed to each individual quarry owning its own surface crawler equipment affects the average size of surface crawler purchasers. Overall, therefore, customers appear to benefit from a degree of countervailing buyer power.

VERTICAL ISSUES

Some third party producers of consumables that do not manufacture surface crawlers have argued that this merger makes their competitive situation more difficult as the parties encourage customers to buy their own consumables.

Atlas does not oblige customers to buy its consumables and if such an obligation were to be introduced customers would have the option of buying surface crawlers from alternative manufacturers if the bundled offer was not financially preferable.

Atlas provides spare parts to customers under its warranty and for surface crawlers purchased on lease hire, but no other customers have an obligation to make use of Atlas parts (even in the case where the customer has a service contract). The DSB does not tie warranty or service contract validities to the use of its own consumables, and did not oblige customers to purchase spare parts through its own business.

THIRD PARTY VIEWS

Customers were mainly unconcerned about the merger, arguing that they would still have options for alternative suppliers post-merger. It was also argued that the DSB's technology had fallen behind the market and therefore was not a credible competitor. A competitor expressed concern that it would be more difficult to compete with the merged firm on price. Consumables manufacturers raised concerns regarding the bundling of consumables with surface crawler sales.

ASSESSMENT

The merger results in one firm having a high share of supply of surface crawlers in the UK. Customers were generally unconcerned about the merger, arguing that post-merger they still retain options when sourcing their surface crawlers. These options include the two remaining UK suppliers as well as the possibility of sourcing from suppliers not currently active in the UK. In addition customers appear to possess a degree of countervailing buyer power, which should tend to increase as the trend towards contract drilling and therefore larger purchasers of surface crawlers continues.

It appears that pre-merger, Atlas has a more effective means of encouraging its surface crawler customers to buy its consumables than that pursued by the DSB. The merger might therefore make competition for consumables sales more intense. There are no obligations on customers to purchase consumables with the surface crawler, and

alternative sources of surface crawlers exist, if customers do not feel that they are being offered a good deal.

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

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