

## Anticipated acquisition by GKN Plc of the aerospace division of Pilkington plc

The OFT's decision on reference under section 33 of the Enterprise Act given on 25 September 2003

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### **PARTIES**

**GKN Plc (GKN)** is UK listed company. It operates a global engineering business, principally in the automotive and aerospace sectors. Through its UK subsidiary, ACT, GKN develops and manufactures a range of cockpit transparencies and associated products for aircraft and produces coatings for aircraft transparencies. In the year to 31 December 2002, ACT's worldwide sales in aircraft transparencies were approximately (see note 1).

**Pilkington plc (Pilkington)** operates an aerospace division comprising of four subsidiaries based in Brazil, England, Thailand and the USA. Its UK subsidiary, Pilkington Aerospace Limited (PA), manufactures aircraft transparencies for military and commercial aircraft and produces coatings for aircraft transparencies. In the year to 31 March 2002, PA's UK turnover was around (see note 1).

### **TRANSACTION**

GKN proposes to acquire the entire issued share capital of PA and all outstanding shares of the common stock of Pilkington Aerospace Inc. The transaction is conditional upon merger clearance in the UK and Brazil.

The transaction was notified by GKN on 22 July 2003. The 40 working day administrative deadline expires on 1 October 2003.

### **JURISDICTION**

As a result of this transaction, GKN and PA will cease to be distinct. The parties overlap in the supply of aircraft transparencies and associated coatings in the UK and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. It is therefore probable that a relevant merger situation will be created.

### **RELEVANT MARKET**

#### **Product market**

Aircraft transparencies consist of the front windshield and cockpit windows in both commercial and military aircraft; passenger windows in commercial aircraft; and canopies in military aircraft. They can be manufactured from either glass or plastic and can also be coated to improve performance. The coatings are formulated from

chemicals sourced on the open market and are applied by transparency manufacturers using proprietary formulae. Therefore, it seems reasonable to consider coatings as part of the same product market as transparencies.

Transparencies are supplied both as original equipment (OE) for installation in aircraft during their manufacturing process and as aftermarket products for repair and maintenance purposes. GKN supplies only plastic transparencies; whereas, PA supplies both glass and plastic transparencies.

On the demand side, customers have indicated that only plastic transparencies are suitable for use in military aircraft. This is because, in comparison to plastic, glass is heavier and cannot be as easily moulded into different shapes. The parties have stated that plastic transparencies for military aircraft (See note 2) are required by defence procurement agencies to be of a higher optical standard than those installed in commercial aircraft. Otherwise, the same plastic transparencies can be used in both military and commercial aircraft.

As for commercial aircraft, the parties have argued that glass and plastic transparencies are broadly substitutable at the design stage. However, some customers have indicated that they would only use plastic transparencies; whereas others agreed that either plastic or glass could be used for certain window requirements. At the aftermarket stage, it would appear that glass and plastic are generally not substitutable as switching from one to the other would necessitate a more lengthy procedure and the added expense of recertification of the aircraft with aviation authorities.

Third parties have suggested that replacement transparencies required at the aftermarket stage would generally be supplied by the original transparency supplier. In the USA, however, the Parts Manufacturer Approval System (PMA) allows suppliers to produce a transparency that competes with the one supplied by the original transparency supplier.

On the supply side, the technology and manufacturing processes used to make glass and plastic transparencies are different and it is unlikely that a supplier of one type could quickly and with minimal cost switch to producing the other.

In this case, therefore, the appropriate frames of reference would appear to be the supply of plastic transparencies for use in both military and commercial aircraft; for completeness, we have also analysed the supply of plastic transparencies for use in military aircraft; and the supply of plastic and glass transparencies for use in commercial aircraft.

### **Geographic market**

The parties have provided examples of aircraft manufacturers purchasing transparencies on a worldwide basis. Third parties have generally confirmed this view, although some indicated that military customers may prefer suppliers from NATO countries. Overall, in this case, the most suitable frame of reference would appear to be worldwide.

### **HORIZONTAL ISSUES**

Suppliers of transparencies usually bid for long term contracts to supply specifically designed products over the life-cycle of an aircraft. Once a contract is awarded,

customers are usually locked into purchasing their transparency requirements for that aircraft from the chosen supplier. However, third parties have indicated that, despite this, it is not profitable for suppliers to increase prices in the long term as this would impact on their ability to win future contracts in a sector that is based on repeated interactions, albeit fairly infrequent given the length of contracts, between a relatively small number of customers and suppliers.

### **Market shares**

Post merger, the parties will be one of only two remaining aircraft transparency suppliers in the UK.

In the worldwide supply of plastic transparencies for use in both military and commercial aircraft, the merger will reduce the number of major suppliers from seven to six. The parties will be the joint largest supplier. Their combined worldwide market share will be [10-20] per cent (see note 3) with an increment of [5-15] per cent (see note 3). However, there is one remaining large player as well as a number of smaller firms that currently account for over a third of sales of plastic transparencies. Although some of the smaller companies only supply nationally, the parties have argued that they nevertheless operate as a competitive constraint because of their ability to start supplying globally. Overall, therefore, it would seem that post merger the sector is likely to remain unconcentrated.

In the worldwide supply of transparencies for use in military aircraft, the parties will have a combined share of sales of [20-30] per cent (see note 3) with an increment of [5-15] per cent (see note 3). They will be the second largest supplier. However, there are a number of additional suppliers that can be expected to constrain the parties' behaviour post merger.

In the worldwide supply of transparencies for use in commercial aircraft, the parties' combined market share will be [10-20] per cent (see note 3) with an increment of [less than 5] per cent (see note 3) and the merger will reduce the number of suppliers from five to four. Again, there appear to be a number of other suppliers that can be expected to operate as a constraint on the parties post merger.

Bid data provided by the parties for major aircraft projects over the last five years indicate that for military aircraft, the parties competed against each other in approximately [30-40] per cent (see note 3) of bids and in (see note 2) they the only bidders. For commercial aircraft, the parties bid against each other in less than [30-40] per cent (see note 3) of cases and in no instance were they the only bidders. This data suggests that the parties are unlikely to be each others' closest competitor.

### **Barriers to entry and expansion**

There has been no significant market entry in the manufacture of either glass or plastic transparencies since the 1970s and no new entry is expected in the short to medium term. The parties estimate that set up costs would be in excess of £10m. A new entrant would also need access to significant technology and know-how in order to compete effectively. Therefore, it would seem unlikely that the threat of new entry would act as a constraint on the parties post merger.

## **Buyer power**

Customers, who are mostly large multi-national firms and governments, believe that they can successfully negotiate lower prices because of the threat of switching when new contracts are awarded. The parties have provided one example of a customer imposing a non-negotiable requirement to freeze prices.

## **VERTICAL ISSUES**

GKN has a joint venture with Finmeccanica S.p.A. in Agusta Westland, a helicopter manufacturer and a customer of the parties. However, GKN has provided evidence that Agusta currently uses a range of suppliers for its transparencies to show that it does not influence Agusta's purchasing decisions. Given that the increment to the share of supply of transparencies is relatively small, whichever frame of reference is adopted, it appears unlikely that the transaction will increase the parties' ability to leverage downstream any market power that it may possess.

## **THIRD PARTY VIEWS**

Most third parties were unconcerned. However, a few competitors raised concerns that the merger would strengthen the parties' power in the supply of transparencies for use in military aircraft and helicopters as well as enhancing their ability to invest in research and development and to exert upstream buyer power.

## **ASSESSMENT**

The transaction qualifies in respect of the share of supply test of the Act and the parties overlap in the supply of transparencies for use in military and commercial aircraft.

It has not been possible to determine with certainty whether glass and plastic transparencies are substitutable. However, in this case, it has not been necessary to reach a firm view of the relevant product market. As a result of the merger, the parties will be one of only two remaining suppliers of transparencies in the UK. However, it appears that transparencies are supplied on a worldwide basis and the parties will continue to face significant competition from six other major suppliers. As contracts are awarded subject to a competitive bid process, it would appear that customers are likely to possess significant negotiating strength and are able to secure lower prices through the threat of switching. Most third parties were also unconcerned.

For the above reasons, the merger is not expected to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services.

## **DECISION**

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

## **NOTES**

1. Figure excised at parties' request
2. Details excised for confidentiality reasons
3. Actual figures replaced by a range at the parties' request