

Summary

1. On 1 August 2005, the Office of Fair Trading (OFT) referred the completed acquisition of Redfearn Glass Limited (formerly Rexam Glass Barnsley Limited) (Redfearn) by Ardagh International Holdings Limited, a wholly-owned subsidiary of Ardagh Glass Group plc (Ardagh), to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). We are required to publish our final report by 13 January 2006.
2. Ardagh and Redfearn overlap in the manufacture of glass containers used as packaging in the food and beverage industries.
3. On 20 May 2005, Ardagh International Holdings Limited bought the entire share capital of Rexam Glass Barnsley Limited from Rexam Beverage Packaging Holdings Limited, which was wholly owned by Rexam PLC (Rexam). Redfearn's turnover exceeds £70 million, which satisfies the turnover test in the Act. We therefore concluded that a relevant merger situation was created.
4. We concluded that the market primarily affected by the acquisition is that for the supply of glass containers, excluding containers for use for pharmaceutical and cosmetic products. Our analysis of the patterns of imports and exports, and of the costs of supplying United Kingdom (UK) customers from outside Great Britain and Ireland, led us to conclude that the market extends to the UK and the Republic of Ireland, but no further.
5. The manufacture of glass containers involves high fixed and sunk costs. This drives the nature of competition, which we found to be in large part determined by the interaction of demand and capacity. We expect that UK demand will remain broadly stable or at best show modest growth of 1-2% per cent per annum. Quinn Glass Limited (Quinn) built a new plant in Northern Ireland in 1998 and is currently building a further plant at Ince in Cheshire. These have substantially increased the available capacity in the market.
6. We would expect the price of glass containers to be lower during periods of excess capacity than during periods when demand and capacity are broadly in balance. When there is excess capacity manufacturers have an incentive to cut prices in order to increase sales, because the high fixed costs of production can be spread over a larger sales volume. By contrast, when capacity is tight customers find it relatively more difficult to switch their contracts between different manufacturers, manufacturers have less incentive to reduce prices to win business, and we would expect less downward pressure on prices.
7. We considered what might have happened to Redfearn if the merger had not gone ahead. We were told by Ardagh, and our analysis confirmed, that the Redfearn business had been in decline. We considered that it was unlikely that Rexam would have been willing or able to sell Redfearn to anyone other than Ardagh. It is clear that closure would have been a major decision which is unlikely to have been made without a serious option appraisal. We saw no evidence of such an appraisal, nor of any kind of closure plan. We do not believe in the light of this that closure was either imminent or inevitable. We

also saw nothing to suggest that, in the absence of the merger, this subsidiary would have been allowed to fail without any support from Rexam.

8. We believe that in the absence of the merger the minimum that we can expect is that in the short to medium term (which we take to be one to two years) Redfearn would have remained in the market as a competitive force, though possibly as a less strong competitor than it has been to date. We think that in the longer term it may have undergone a process of decline and possibly closure, but only after a significant period.
9. The principal effect of the merger has been to remove an independent competitor (Redfearn – in 2004 the third largest producer in the UK) from the market, and thus to reduce the number of substantial UK manufacturers from four to three (the other two are Quinn and United Glass (UG), a division of Owens Illinois Inc.). It has also led to an increase in the share of productive capacity held by the market leader (Ardagh). We think that Ardagh, following the merger, will have 40-45 per cent of UK productive capacity once Quinn's new plant is fully operational.
10. In assessing the effect of the merger on the glass container market, we considered first a "period of overcapacity" in which the additional capacity built by Quinn means that available capacity exceeds market demand. In these circumstances, manufacturers have an incentive to pursue additional sales to ensure that capacity is fully utilised, and may be expected to discount prices in order to do so. However, manufacturers may also have an incentive to cut capacity to bring a period of falling prices to an end. This incentive increases with share of capacity and might thus be increased by the merger. We considered whether, following the merger, Ardagh would be likely to reduce capacity to the detriment of customers.
11. In practice, three factors led us to doubt that competitive harm might arise from unilateral action by Ardagh to withdraw capacity in order to bring a period of overcapacity to an end:
 - the existence of a viable alternative strategy for Ardagh (and the lack of any compelling reason why the strategy of closing capacity is the best);
 - the lack of any evidence that Ardagh intended or intends to close capacity; and
 - the degree of uncertainty about the current levels of overcapacity in the market and the period for which such an imbalance may be expected to persist.We conclude that there is insufficient evidence to form an expectation that competitive harm would result from the merger in a period of overcapacity.
12. We also considered the position once capacity and demand have returned to approximate balance. We think that in practice this may shortly be the position in the UK (and the Republic of Ireland) market. We would normally expect that, where capacity and demand are broadly in balance (and capacity is more or less fully utilised), prices would stabilise and market shares would come broadly to reflect shares of capacity. The incentive for manufacturers to compete for business by lowering prices would be lessened, since they would be unable to service the additional business they won.
13. During a period of balance, the constraints inhibiting a large player from raising prices derive from the threat (or the reality) of expansion of capacity by

UK manufacturers or from increases in imports (or new entry). The points at which those constraints might be likely to have an effect could be expected to be the point at which the price rise exceeded the cost implications of capacity expansion, the cost disadvantage of imports or the cost of entry. Manufacturers have only limited ability to increase capacity quickly without significant investment.

14. We considered whether the merger would give Ardagh increased market power which it could exercise to customer detriment in this environment. We might not expect the *ability* of manufacturers to raise prices in a period of balance to depend on market share. In the absence of customers' ability to switch, we might expect all manufacturers to raise prices to a level just below that at which the constraints identified above might bite. However, the market leader has the greatest *incentive* to exercise market power in these circumstances, and we might expect this incentive to be increased by the merger.
15. The most likely exercise of market power would be for Ardagh to raise prices, tolerating reduced capacity utilisation if it lost some business in consequence. Ardagh told us that it was unrealistic to expect that it could raise prices; specifically that it would be prevented from doing so by two constraints:
 - the intensity of competition from existing market participants; and
 - the risk of attracting imports.
16. In the circumstances which we expect to prevail during certain periods in the foreseeable future, we expect the threat or reality of competitive response by Quinn or UG to constrain a price rise by Ardagh. We think that uncertainty on Ardagh's part about the nature and extent of a potential competitive response by its rivals reduces Ardagh's incentive to seek to exercise market power conferred by the merger.
17. We find it very difficult to judge how immediate the threat of imports might be and thus the extent to which it might constrain a price rise in the UK. Undoubtedly price rises beyond a certain point would attract imports, but that point can be expected to move over time, influenced by factors external to the UK market. We note that it must be equally difficult for Ardagh to judge, and that this uncertainty might itself act as a disincentive to raising prices.
18. We do not think the case is clear cut. The loss of an independent competitor, albeit a relatively weak one, and the share of productive capacity which Ardagh will acquire through the merger would normally lead us to expect that Ardagh will acquire market power which it could exercise, in the period of balance, to the detriment of customers. Potentially, this is of considerable concern.
19. But we identified potential constraints on Ardagh's behaviour in the period of balance. We were not persuaded that the constraint from imports is in itself sufficient to prevent the exercise of market power in the period of balance. However, we think that the competitive strength of the two main competitors (Quinn and UG), and their ability and incentive to act to defeat a price rise, may serve as a powerful constraint on Ardagh. In the light of this, we are unable to form an expectation that Ardagh could be expected to raise prices in the period of balance.

20. In the light of our findings, the evidence does not, in our view, support a conclusion that it is more likely than not that the merger will give rise to an SLC. We provisionally conclude that the merger does not result, and may not be expected to result in an SLC.