

## 2 Conclusions

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### The reference

2.1. Under the reference (see Appendix 1.1) dated 1 June 2000, made under sections 64 and 69(2) of the Fair Trading Act 1973 (the Act), we are required to investigate and report on whether a merger situation qualifying for investigation has been created, in that enterprises carried on by or under the control of Sylvan International Ltd, a body corporate incorporated in the UK, have within the four months preceding this reference ceased to be distinct from enterprises carried on by or under the control of Locker Group plc. The enterprises in question are Askern Group Ltd and its subsidiaries, subsidiaries of Sylvan, and Pentre (Holdings) Limited and its subsidiaries, and subsidiaries of Locker. If we find that a merger situation has

been created, we are required to report on whether the creation of that situation operates or may be expected to operate against the public interest.

## **The companies concerned**

### ***Locker/Pentre***

2.2. Locker is a public company quoted on the London Stock Exchange, engaged in a number of general engineering businesses with a turnover of £60.4 million in the year to 31 March 2000. In January 1996 it merged with Pentre. Immediately prior to the creation of the joint venture between Pentre and Askern (see paragraph 2.8), Pentre consisted of seven companies (excluding dormant companies) in the UK and abroad, grouped into three operating divisions.

2.3. Pentre was created in 1988. Pentre manufactures and supplies a range of timber, steel, plywood, cardboard and plastic drums and reels, which in this report we refer to as ‘drums’, and the purpose of which is to facilitate transportation of cable, wire, rope and other linear wound products from their point of manufacture to their point of end use. Pentre also produces process reels, which are highly engineered products, designed to run at high speeds and/or to critical tolerances for use in a variety of manufacturing situations. Pentre also supplies drum management services, plastic trade mouldings and plywood boxes. ‘Drum management services’ and other terms are defined in the glossary.

2.4. In the year to 31 March 2000, Pentre’s total turnover was £29.2 million on which it made a pre-tax profit of £2.5 million. Its net assets were £4.5 million. Due to Pentre’s corporate structure and accounting systems, Pentre was unable to provide us with separate information on profitability for its total UK drums operation. Over the past four years, turnover of Pentre’s UK Packaging Division, which includes among other products the manufacture of timber, plywood and cardboard drums, has remained relatively stable while profitability has increased. Turnover was £10.6 million in the year to 31 March 1997 and £10.9 million in both the years to 31 March 1999 and 2000. Operating profit increased from £0.4 million in the year to 31 March 1997 to £1.1 million in the year to 31 March 2000. Return on sales increased from 3.8 per cent in the year to 31 March 1997 to 10.1 per cent in 2000. In relation to Pentre’s UK Process/Industrial Reels and Drums operations, which includes steel drums, process reels and plastic drums, turnover was £12.8 million in the year to 31 March 1997 and £12.2 million in the year to 31 March 2000 while operating profit increased over the four years from £0.3 million in the year to 31 March 1997 to £1.1 million in the year to 31 March 2000. Return on sales increased over the period from 2.3 per cent in the year to 31 March 1997 to 9 per cent in the year to 31 March 2000. More details are given in paragraphs 3.3 to 3.46.

### ***Sylvan/Askern***

2.5. Sylvan owns and operates a number of companies whose business is the importation, manufacture and distribution of timber products. Its turnover in the year to 31 March 2000 was £196 million. It acquired Askern in July 1998. Immediately prior to the creation of the joint venture between Pentre and Askern, Askern consisted of 19 companies in the UK and overseas (excluding dormant companies).

2.6. Askern commenced trading in 1948. Like Pentre, Askern manufactured and supplied a range of timber, steel, plywood and cardboard drums for the packaging and distribution of energy and communications cable, wire and rope. Askern also offered drum management services. Askern did not manufacture plastic drums, process reels, plastic trade mouldings or plywood boxes.

2.7. In the year to 31 March 2000 Askern's turnover was £31.2 million on which it made a pre-tax profit of £1.1 million. Net assets were £14.1 million. After excluding overseas activities and Russian Timber Limited (RTL), a timber sourcing company, the past five years show turnover and profitability of Askern's UK drums operation declining. Turnover was £20.2 million in the year to 31 July 1996 and £19.6 million in the year to 31 March 2000. Operating profit was £3.1 million in the year to 31 July 1996 and £1 million in the year to 31 March 2000. Return on sales reduced from 15.3 per cent in the year to 31 July 1996 to 5.1 per cent in the year to 31 March 2000. More detail is given in paragraphs 3.47 to 3.79.

## **The merger situation**

### ***The joint venture***

2.8. Since late 1998, Sylvan and Locker had discussed a merger of their respective drums businesses and some other businesses owned by Pentre (described in paragraph 2.3). On 14 March 2000, they announced the formation of a joint venture, to be called Pentre Askern Group Limited, to be owned 51 per cent by a subsidiary of Locker and 49 per cent by a subsidiary of Sylvan. Pentre Askern is now the holding company for both Pentre and Askern. The transaction was completed on 3 April 2000 and became unconditional on 4 April 2000. The parties told us that the stronger results of Pentre were the basis for the percentage shareholdings and for management control passing to Locker.

2.9. On 15 June 2000, Locker and Sylvan gave undertakings to the Secretary of State that they would maintain Pentre and Askern as separate operating units pending the outcome of this inquiry. Further details of the joint venture are given in paragraphs 3.80 to 3.91.

### ***Jurisdiction***

2.10. In order to determine whether a merger situation qualifying for investigation exists we have to address the following questions:

- (a) whether enterprises carried on by or under the control of Sylvan have ceased to be distinct from enterprises carried on by or under the control of Locker (of which at least one was carried on in the UK or by or under the control of a body incorporated in the UK); and
- (b) if so, whether that event referred to in (a) happened not earlier than four months before the date of the reference to the CC; and
- (c) whether the value of worldwide assets taken over exceeds £70 million (the assets test); or
- (d) whether, as a result of enterprises ceasing to be distinct, at least one-quarter of goods or services of a particular description supplied in the UK is supplied by or to one and the same person or, if this was already the case, the share of supply of these goods or services by or to that person is increased (the share of supply test). 'Person', in the context of the relevant sections of the Act, includes a company.

2.11. If we find that either the assets test or the share of supply test is satisfied, we are required to exclude the other from our consideration.

2.12. 'Enterprise' is defined in section 63 of the Act as the activities, or part of the activities, of a business. The circumstances in which enterprises are to be regarded as ceasing to be distinct are set out in section 65: one of the circumstances is where they come under

common control. The time at which enterprises are to be regarded as ceasing to be distinct is governed by section 66.

2.13. As described in paragraph 2.8, on 4 April 2000 the company now known as Pentre Askern, formerly a wholly-owned subsidiary of Sylvan, became a subsidiary of Locker. As of that date, Pentre Askern and Locker became enterprises under common control pursuant to section 65(2)(a) of the Act. We are satisfied that, as a result of that transaction, enterprises controlled by Sylvan have ceased to be distinct from enterprises controlled by Locker, and that at least one of the enterprises which has ceased to be distinct was carried on in the UK.

2.14. The date of 4 April 2000 was not earlier than four months before the date of the reference, which was made to us by the Secretary of State on 1 June 2000.

2.15. Section 68(3) of the Act provides that in determining whether the share of supply test is fulfilled, with respect to services of any description, the CC shall apply such criteria or such combination of criteria as appear to it to be most suitable in all the circumstances.

2.16. Both Pentre and Askern supply packaging drums of a number of types, the main ones being those made principally out of steel, timber, plywood and cardboard (see paragraphs 2.3 and 2.6). Table 2.1 sets out our estimates of sales of drums of those types.

TABLE 2.1 Sales of new steel, timber, plywood and cardboard drums in 1999

	£'000	%
Askern	14,800	48.2
Pentre	9,700	31.6
<b>Combined</b>	<b>24,500</b>	<b>79.8</b>
Total*	30,720	100.0

Source: Information from suppliers.

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\*The total figure includes £2.1 million of imports of large steel drums in addition to the figures for drum sales set out in Table 2.2 (identical to Table 4.5).

2.17. In addition to these sales a very small number of drums are made by cable manufacturers for in-house use. We see them as a different form of supply as they are not made for sale. As shown in Table 2.1, before the merger in 1999 Pentre and Askern had a combined share of around 80 per cent of steel, timber, plywood and cardboard drums for sale. As we indicate above, we have arrived at this conclusion by reference to the drum markets. It is on these markets which we focus in this chapter, and accordingly we do not consider further the plastic trade mouldings and plywood boxes to which we refer in paragraph 2.3. We do consider the process reels at paragraph 2.34, however.

2.18. We therefore conclude that the share of supply test is satisfied and that a merger situation qualifying for investigation has been created.

### ***Reasons for the merger***

2.19. The parties told us that a merger of the two businesses was essential in the light of prevailing market conditions, and that Askern's profits had virtually halved in the last 12 months. Cable producers had consolidated their operations and were increasingly seeking better value from their packaging suppliers. The parties said that the size of the market for new drums had decreased as increases in cable imports had led to more overseas drums entering the UK market and the formation of the joint venture had been necessary to enhance competitiveness and safeguard the future of the cable drums businesses in the face of pressure from

other UK suppliers, overseas suppliers, the reuse of drums, customers' in-house production facilities and alternative packaging solutions.

2.20. The parties said that the creation of Pentre Askern had to be seen as predominantly defensive. Their views are set out in greater detail in paragraphs 3.92 to 3.96 and 6.3 to 6.21.

2.21. The parties told us that, if the joint venture had not gone ahead, severe rationalization of resources would have been necessary. They said that Pentre might have had to abandon UK timber drum-making where significant losses were being incurred; and Askern might have had to withdraw from the manufacture of steel drums (see paragraph 6.20). We give our views on the situation without the merger in paragraphs 2.53 to 2.55.

## **The manufacture of drums**

2.22. The customers for drums are cable and wire manufacturers who supply cable to end users such as utilities, and cable distributors. Customers retain ownership of the drums. Drums are manufactured from various raw materials, namely steel (from which both solid and skeletal steel drums are made), timber, plywood, cardboard and plastic (see paragraphs 2.3 and 2.6). We refer to drums made of a particular material (for example, timber) as drums of a 'product type'. The drums consist of cylinders (barrels) with flanges at each end and are used for the packaging and transportation of all types of cable, wire and rope. Drums vary in flange diameter and can carry different weights of cable and wire. We draw a particular distinction between large and small steel drums (see paragraph 2.36). Prices vary from £0.45 for a cardboard drum to £2,000 for a small solid steel drum. The parties said that there were few economies of scale in the manufacture of drums (see paragraph 4.72). A fuller description of the products and their manufacturing process is given in paragraphs 4.2 to 4.8.

## ***Supply of drums***

2.23. Pentre and Askern were the only UK manufacturers supplying a product range including steel, timber, plywood and cardboard drums, and, as stated in paragraph 2.17, Pentre Askern now has an 80 per cent share of the total market covering these four product types (see Table 2.1). A number of other suppliers produce one or more of these products on a smaller scale. Pentre and Askern also offered drum management services (see paragraphs 2.3 and 2.6), with a 39 per cent share of this market (see Table 4.7). The small UK suppliers of each product type are described in paragraph 4.12 and summarized in Table 2.2 (also Table 4.5). In brief:

- (a) Yorkshire Cable Drums Ltd (YCD) is the principal competitor to Pentre Askern in the manufacture of timber drums, with 12 per cent of the timber drum market. YCD was set up in 1998 by a former Askern employee, encouraged by Draka UK Industrial Cables Ltd (Draka) which was one of Askern's customers.
- (b) CDR Ltd (CDR) which is owned by Marlin Industries has recently entered the new timber drums market with a share of 1 per cent of that market, which may reach 2 or 3 per cent this year. Its main business is in drum management services with a 59 per cent market share; it told us that it was expanding its manufacture of new timber drums. CDR was set up in 1992 by two ex-employees of BICC General UK Cables Ltd (BICC), [ *Details omitted. See note on page iv.* ]. It began the manufacturing of new timber drums in 1999.
- (c) Cable Reels Ltd (Cable Reels), which, like CDR, is owned by Marlin Industries, is the principal competitor to Pentre Askern for plywood drums and has 12.7 per cent of that market.

- (d) Other competitors include: J J Mountain in timber drums; Great Western in cardboard drums; J E Jervis Ltd (Jervis) in plywood and cardboard drums; and a recent new entrant, PKR Ltd (PKR), in cardboard (see paragraph 4.91).
- (e) Some steel drums are manufactured by general steel fabrication companies which the parties said competed with Pentre Askern for orders (see paragraph 6.46).
- (f) Drums are produced in-house by one UK cable manufacturer, AEI Ltd (AEI), for its own use.

2.24. Table 2.2 excludes large steel drums (for reasons explained in paragraph 2.36), and the total market share for Askern and Pentre combined (85.6 per cent) is therefore different from that in Table 2.1 (80 per cent) where large steel drums are included.

TABLE 2.2\* Sales of new drums† and suppliers' market shares of these sales in the UK in 1999

Supplier	Material									
	Small steel		Timber		Plywood		Cardboard		Total	
	£'000	%	£'000	%	£'000	%	£'000	%	£'000	%
<i>UK</i>										
Askern	1,200	34.8	6,200	61.9	4,900	48.0	2,500	50.5	14,800	51.7
Pentre	2,000	58.0	2,200	22.0	3,800	37.3	1,700	34.3	9,700	33.9
<b>Combined</b>	<b>3,200</b>	<b>92.8</b>	<b>8,400</b>	<b>83.8</b>	<b>8,700</b>	<b>85.3</b>	<b>4,200</b>	<b>84.8</b>	<b>24,500</b>	<b>85.6</b>
YCD	-	-	1,200	12.0	-	-	-	-	1,200	4.2
CDR (Marlin)	-	-	70	0.7	-	-	-	-	70	0.2
J J Mountain	-	-	100	1.0	-	-	-	-	100	0.3
Cable Reels (Marlin)	-	-	-	-	1,300	12.7	-	-	1,300	4.5
Great Western	-	-	-	-	-	-	550	11.1	550	1.9
Jervis	-	-	-	-	100	1.0	200	4.0	300	1.0
Other UK	250	7.2	-	-	100	1.0	-	-	350	1.2
<b>Total</b>	<b>3,450</b>	<b>100.0</b>	<b>9,770</b>	<b>97.5</b>	<b>10,200</b>	<b>100.0</b>	<b>4,950</b>	<b>100.0</b>	<b>28,370</b>	<b>99.1</b>
Imports	-	-	250	2.5	-	-	-	-	250	0.9
<b>Total</b>	<b>3,450</b>	<b>100.0</b>	<b>10,020</b>	<b>100.0</b>	<b>10,200</b>	<b>100.0</b>	<b>4,950</b>	<b>100.0</b>	<b>28,620</b>	<b>100.0</b>

Source: CC based on information provided by suppliers.

\*Identical to Table 4.5.

†Excluding plastic drums, process reels and large steel drums.

2.25. The level of imports is low, and in the past has been concentrated primarily in large steel drums. The parties gave us information about a number of suppliers in Europe (see paragraph 6.66). There are some alternatives to drums for winding cable, but the evidence that we received suggested that these were not close substitutes for drums (see paragraphs 4.37 and 4.38).

### ***Demand for drums***

2.26. The parties provided background on trends in the cable and wire industry and on rationalization among cable manufacturers. Details of past and current acquisitions are given in paragraph 4.25. We note that, according to information on the cable industry received from CRU International, an economic consultancy (see Appendix 4.2), UK cable production in 1999 was 10 per cent off its 1997 peak and is not expected to regain that peak until 2003. The parties also said that the market for new drums had been affected by increased reuse of drums in recent years and we have evidence of growing reuse of timber drums in particular (see paragraph 4.68).

2.27. Customers are split between a few which individually account for a relatively large proportion of purchases, and the majority which have smaller purchasing requirements. Purchasing requirements vary by product type. We have defined ‘small customers’ as those accounting for less than 5 per cent of Pentre Askern’s sales of a particular product type and less than 2 per cent of its sales overall (see Table 4.2). Those who have given evidence may use the expression differently. Small customers by our definition account for nearly half of cardboard, but only 8 per cent of steel drum sales. By ‘large customers’ we mean customers other than small customers. Some large and some small customers are part of large multinational businesses.

2.28. We obtained information about 14 customers whose views are set out in Chapter 5, all of whom had in the past used more than one supplier:

*(a) Small customers*

Five of them bought from both Pentre and Askern:

- Anixter International Ltd (see paragraph 5.16);
- Auto Marine Cables Ltd (see paragraphs 5.17 to 5.19);
- A medium-sized UK cable manufacturer (see paragraphs 5.3 to 5.5);
- South East Cables Ltd (see paragraph 5.57); and
- Permanoid Ltd (see paragraphs 5.41 to 5.43).

Three others had also in the past used more than one supplier:

- Aluminium Wire and Conductor plc (AWC) (see paragraphs 5.7 to 5.10);
- Concordia Electric Wire Co Ltd (Concordia)(see paragraphs 5.31 to 5.32); and
- Thomas Bolton Flexible Cables Ltd (Thomas Bolton) (see paragraphs 5.61 to 5.71).

As to sourcing from other suppliers, AWC purchased from Pentre and CDR; Concordia purchased from Cable Reels and PKR, having switched from Askern; Permanoid Ltd and the medium-sized manufacturer both bought from Cable Reels as well as from both Pentre and Askern; Thomas Bolton had been supplied by Pentre before the merger and had expected to invite tenders from Pentre, Askern and Cable Reels.

*(b) Large customers*

All six large customers bought from both Pentre and Askern:

- Andrew Ltd (Andrew) (see paragraphs 5.11 to 5.15);
- Belden UK Ltd (Belden) (see paragraphs 5.20 to 5.28);
- Corning Cable Systems (Corning) (see paragraphs 5.33 to 5.37);
- Draka (see paragraphs 5.38 to 5.40);
- Pirelli Cables Ltd (Pirelli) (see paragraphs 5.44 to 5.56); and
- Supertension & Subsea Systems (a unit of BICC) (see paragraphs 5.58 to 5.69).

Andrew had also requested a bid from one small supplier; Corning also purchased from CDR; Draka also purchased from YCD and PKR. We note in paragraph 4.29 that 46 per cent of the parties' combined sales in 1999 were to customers using both Pentre and Askern. As to intentions for the future, Pirelli, Andrew, Corning and Draka said that their intention was not to single source with Pentre Askern in the future (for more detail see paragraphs 4.30 and 5.15, 5.34, 5.39 and 5.50) but other customers did not indicate their intentions. Buyer power is analysed in the section on issues (paragraph 2.67).

2.29. Exports of drums are significant (Pentre exported 26 per cent of its drums and Askern 18 per cent—see paragraphs 3.113 and 4.57 to 4.60).

### ***Pricing of drums***

2.30. Prices of drums are usually negotiated on an order-by-order basis directly between customer and manufacturer. There are no independent wholesalers of drums in the UK. Neither of the main parties has a price list, and prices charged depend on a range of factors including: the customer's demand for drums; its negotiating skills; the specifications of the drums including size, requirement for painting or stencilling and other features; transport costs; and the requirement for just-in-time delivery. As a result, prices charged to different customers are not easily comparable, and in practice there is little price transparency in the market. When YCD entered the market for timber drums with Draka as its principal customer, Askern was able to respond by reducing its prices to Draka without having to offer the same price reduction to other customers (see paragraph 4.72).

2.31. Large customers, besides being potentially in a stronger negotiating position, are likely to have better information about prices than small customers, as they have greater incentive to track prices of raw materials used in drums. Multinational customers—large and small—can more easily compare their UK prices with those paid overseas. Belden told us that it used prices from mainland Europe to benchmark prices offered by Pentre. Pirelli, the largest buyer of drums in the UK, told us that it was currently planning to coordinate its drum purchasing across Europe.

2.32. Pricing data provided to us by Pentre Askern shows that prices charged to large customers have fallen considerably in recent years, and for some customers this fall has been greater than the decline in raw material prices over the period (see paragraph 4.78 and Table 4.10). As regards small customers, it appears from limited evidence that prices have fallen for some small customers but have risen for others, particularly for those buying cardboard drums (see paragraph 4.78 and Appendix 4.4).

### **Market definition**

2.33. Consideration of the effects of the merger on competition requires us to identify the relevant markets. The parties submitted that the relevant market was that of new and reused products for packaging cable. This definition would include both drums and alternative technologies, of which the main ones are Reelex and Skaltek (see paragraphs 4.37 and 4.38). However, the UK representative of Reelex told us that the Reelex system was used only for a type of cable which was too valuable and delicate to be packed on drums, while the Skaltek systems, although found in the UK, have not been sold recently. Moreover, the Skaltek machines in the UK use drum components which are supplied by Pentre Askern and others. We therefore concluded that these systems do not constitute substitutes for drums.

2.34. Within the broad category of drums, steel and plastic process reels appear to have a use, as part of the cable manufacturing process, which is distinct from that of drums for packaging. While there is some similarity in the manufacturing technology used to make steel

drums for packaging and steel process reels, the latter are more highly engineered products and hence we view them as being in a market separate from that of drums for packaging. As process reels are manufactured by Pentre but not by Askern, we do not consider this market relevant in considering the effects of the merger, and no further mention will be made of it.

2.35. As regards the different types of drum for packaging, some limited substitution does take place between steel, timber, plywood, cardboard and plastic drums. However, for the majority of customers there is little scope or incentive to switch from the use of one drum type to another in response to a moderate price increase. We therefore consider these five broad product types as distinct markets. Plastic drums are manufactured by Pentre but not by Askern, and therefore we do not see them as relevant for considering the effects of the merger, and no further mention will be made of them.

2.36. A distinction could be made between solid and skeletal steel drums. The latter are used to package ducting products and are unsuitable for carrying heavy cable; in terms of possible uses they are closer to timber drums. However, the parties submitted that both skeletal and solid steel drums were in the same market because the two are supply-side substitutes, and we accept this. We do, however, distinguish small steel drums from large steel drums (more than 4 metres in flange diameter), for which orders are less frequent. These large steel drums appear to be distinct from other steel drums in that their high order value of up to £80,000 per drum and the one-off nature of orders attract competition from general UK steel manufacturers and from abroad.

2.37. Steel drums are reused as a matter of routine, timber drums are increasingly reused, and plywood drums are occasionally reused. The reuse of timber drums is growing annually at around 4 to 6 per cent (see paragraph 4.68). Pentre Askern argued that drums which are reused by cable manufacturers should be included in the market, as a customer has a choice between buying a new drum and reusing an old one. It estimated the value of new drums by treating each reuse of a drum as having the same value as the price of a new drum. If this approach were to be adopted, Pentre Askern's market share in small steel drums would be 34 per cent (rather than 93 per cent); in timber, 28 per cent (rather than 84 per cent); and in plywood, 76 per cent (rather than 85 per cent).

2.38. The parties said that one large customer had reduced its annual purchase of timber drums from £[ \$ ] to £[ \$ ] by increased reuse and that there was considerable scope for other customers to do likewise (see paragraph 6.41). When a customer chose this course, the number of new timber drums it needed to purchase fell sharply.

2.39. However, we consider that the ability to reuse drums is reflected in the initial purchase price. There is only a small trade in second-hand drums, as the original purchaser generally retains title over a drum, even if it is retrieved and repaired by another business. The cost of reusing a timber drum, for example, is on average around 30 per cent of the cost of buying a new drum. It may therefore be expected that a customer which is able to reuse its drums, and which has a system in place to retrieve them, would use each drum the maximum number of times before purchasing a new one. Several large customers told us that they tried to reuse as many steel drums as possible, and those which had already introduced drum management made the same point about timber drums. We considered a considerable body of material from the parties (see Appendix 4.1) on this issue and return to it in paragraph 2.100.

2.40. The parties submitted that any in-house production of drums by cable manufacturers should be included in the market. In practice, only one cable manufacturer in the UK, AEI, makes any drums, and only for its own use, while there appears to be considerable reluctance among cable manufacturers to engage in this activity. We consider that while in-house production may be expected to constrain prices paid by a customer which is both producing drums for its own use and buying some in the market, this is unlikely to be of benefit to other customers. Thus in our view this production should not be included in the market. We were told

that, in the past, in-house production had been common but over the last few years drum manufacture had generally been outsourced and that this trend was unlikely to be reversed.

2.41. Turning to drum management services, which facilitate the reuse of timber drums, we see the provision of these services to customers as a distinct market. It is open to cable companies to operate such a service in-house, and the investment required to do so is likely to be substantially less than for in-house manufacture. It is not clear, however, how many are doing so at present, nor how effectively. In any case, we do not regard the in-house provision of the service as part of the drum management services market, since purchasers of those services are not affected by those companies which use the in-house approach.

2.42. As to the geographic markets of relevance to the inquiry, it appears that proximity to customers can be an advantage in providing prompt, reliable delivery and lower transport costs. Within the UK, we do not consider that this advantage is sufficiently pronounced to justify the identification of regional markets.

2.43. In considering whether the market is broader than the UK, we note that imports of small steel, timber, plywood and cardboard drums have been low or zero in recent years. The need for delivery at short notice, and greater transport costs, appear to have placed significant constraints on suppliers from abroad, who might need to make suitable arrangements for stocking in the UK. Imports have been largely confined to large steel drums.

2.44. We note that Pentre and Askern between them export significant volumes of each of these drum types (see paragraph 2.29), largely to mainland Europe. The parties told us that this was because they had each concentrated on developing external markets, while foreign manufacturers had not made a serious attempt to enter the UK. Another possible reason is that drum specifications appear to be more standardized in some mainland European countries than in the UK, increasing the ease with which demand can be anticipated, and therefore making it easier to deliver at short notice.

2.45. [ *Details omitted. See note on page iv.* ] Pentre Askern intends to import skeletal steel drums from its Czech factory (see paragraph 4.83). [

*Details omitted. See note on page iv.*

] The most recent attempts by drum-makers from Italy and Germany to enter the UK markets for small steel, plywood and timber drums appear to have met with little success to date (see paragraph 2.68). Several of these foreign manufacturers told us that they had been unable to compete on price with Pentre and Askern, due to high transport costs.

2.46. Drum management services tend to be offered on a factory-by-factory basis. We note that KTG, the main German drum management company, has recently expressed an interest in developing a presence in the UK market. Drum rental occurs in Ireland and KTG provides a drum rental service in mainland Europe, and the choice between purchase and rental might encourage more drum users to reuse their drums. Although there has been some discussion about managing drums on a pan-European basis, the nature of the service requires a presence in the UK.

2.47. In the light of the above discussion, we consider the relevant markets to be:

- (a) the global market for steel drums with a flange diameter above four metres (large steel drums);
- (b) the UK market for steel drums below four metres (small steel drums);
- (c) the UK market for timber drums;

- (d) the UK market for plywood drums;
- (e) the UK market for cardboard drums; and
- (f) the UK market for timber drum management services.

### **The extent of competition before the merger**

2.48. Prior to the merger, Pentre and Askern were the largest competitors in each of the four UK markets for new products (paragraph 2.47 (b) to (e)): their combined market shares ranged from 84 to 93 per cent (see Table 2.2). Customers on the whole appear to have been active in comparing prices between the two and in some cases using both suppliers or switching from one to the other. At least some large customers were able to exercise a degree of buyer power in their negotiations with suppliers. Some customers also tracked changes in the raw material prices faced by drum manufacturers in order to negotiate for decreases in these prices to be reflected in the price of finished goods. While there was little competition from other suppliers in the market for small steel drums, smaller suppliers were active in the other three markets: YCD in timber; Cable Reels in plywood; and Great Western and Jervis in cardboard drums. A new company, PKR, has recently entered the market for cardboard drums, having made a significant capital investment for the size of the market. Because of the competitive environment created by interaction between the two large suppliers, smaller suppliers in each of the markets were also forced to price competitively, and to compete for business from both large and small customers.

2.49. Technical and commercial barriers to entry to, or expansion in, each of the markets appears to be low: only limited technical skills are required, and the necessary capital investment is small (although not insignificant relative to the size of the market). Other possible barriers may be the need to establish a reputation among customers, and the possibility of an aggressive price response by large incumbent firms. In practice, several companies, such as CDR, YCD and PKR, have entered one or other of the markets in recent years, although the entry is small and appears to be fragile in some markets.

2.50. The entry of some smaller suppliers has been encouraged by customers themselves. Draka has encouraged YCD with supply agreements. CDR was established by ex-employees of BICC to provide repair services to BICC, [ *Details omitted. See note on page iv.* ].

2.51. Prior to the merger, although imports were limited or none in each of the four product markets other than large steel, some larger customers used international prices as a negotiating tool, whether by comparing their UK prices with those received by associate companies abroad, or occasionally requesting quotes from foreign suppliers. Several mainland European suppliers have, for their part, attempted to enter the UK market. They have had little, if any, success to date. However, as mentioned in paragraph 2.45, [ *Details omitted. See note on page iv.* ]. Quotes from abroad have, in some cases, enabled some customers to obtain lower prices from UK suppliers; and indeed we obtained evidence that on one occasion, for example, Pentre lowered its prices by 10 per cent in response to a threat of imports from a German supplier. It appears that Pentre and Askern were able to respond to attempts by foreign manufacturers to enter the market. We note that sterling rose substantially against other European currencies from 1996 to 1998, and against the euro in 1999 and 2000, while UK prices of drums fell. Hence imports should have become cheaper, relative to domestic products, in the past few years. It is notable that this change in the level of sterling was not sufficient to bring imports into the market, perhaps because of the price response of UK suppliers.

2.52. As to the market for drum management services, CDR appears to have a substantial share, although it is not clear that information has been received from Pentre Askern and CDR on a comparable basis (see paragraph 4.68). Again, Pentre and Askern have competed directly in this market. As a service, it is not subject to a threat from imports as such, but a large German supplier, KTG (see paragraph 2.46), has expressed an interest in developing a presence in the UK market based on drum rental and these are services which can be organized in-house.

## **Absent the merger**

2.53. If the merger were not allowed to stand, the parties told us that Pentre might have to exit from timber manufacturing, possibly by closing its Knowsley operation, and Askern might have to exit from the steel market (see paragraph 2.21). As noted earlier (see paragraphs 2.4 and 2.7) both Pentre and Askern are profitable operations, although Askern's operating profits have fallen significantly over the last few years and it was only marginally profitable in the year to 31 March 2000. Pentre at present provides a full range of services, has a substantial customer base for timber drums, and plans to develop further its timber drum management service, for which a continued involvement in the closely-related area of new timber drum production appears to be an advantage. Furthermore, although the timber drum market has become smaller in recent years, it has attracted two new entrants: YCD and, more recently on a smaller scale, CDR. We do not therefore expect that, absent the merger, Pentre would leave the market for new timber drums although it might choose to move to assembly rather than manufacture.

2.54. Askern told us that if the merger did not go ahead it would not expect to continue producing steel drums (see paragraph 6.20) and said that it had lost money in this market recently (see paragraphs 3.74 and 3.75). It was not able to produce a fuller rationale to support this statement, however, and no final decision appeared to have been taken prior to the merger. To the extent that sale of Askern's business proved possible, Pentre might gain only a small proportion of Askern's customers, whereas if sale of the business did not prove possible, Pentre might well gain most of the Askern customers. In our view there is considerable uncertainty about the prospects for Askern's small steel drum business absent the merger and the extent to which it would retain its customers. In reaching conclusions on competition in this market and on the effect of the merger we do not rely on the assumption that absent the merger Askern would exit the market (see paragraph 2.78).

2.55. Thus we conclude that if the merger were not to be allowed to stand, Pentre and Askern would once more be the principal competitors in the markets for timber, plywood and cardboard drums; Pentre would be the second largest supplier of timber drum management services, with Askern a much smaller supplier; and Pentre would be the largest supplier of small steel drums, although it is unclear whether Askern would remain in this market.

## **Issues**

### ***General considerations***

2.56. The merger creates an entity with market shares which range between 84 and 93 per cent in the four UK products markets we have identified: small steel, timber, plywood and cardboard drums. This inevitably raises considerable concern about reduction in competition. In the other two markets our competition concern is reduced because neither Pentre nor Askern has won an order for large steel drums in recent years; and for drum management services Pentre Askern is not the largest supplier, although it does have 39 per cent of this market.

2.57. Before the merger, Pentre and Askern were the main suppliers in each of the four UK product markets and competed with each other. The loss of this competition, and Pentre

Askern's very high market share, inevitably raise major concerns. In the absence of factors which would ensure the continuation of competitive pressure, Pentre Askern would be well placed to exploit its position by squeezing out smaller suppliers and raising prices. What we need to consider in this case is whether there are characteristics of these markets which will nevertheless secure the continuation of effective competition in them if the merger is allowed to stand.

2.58. The critical question is whether either the existing smaller UK suppliers or new entrants from within the UK or abroad can be expected to build up their position to the extent necessary to put real and continuing pressure on Pentre Askern. The role of the customers and how they will react to the merger is an important factor in considering this question. We therefore need to look at whether customers are likely to insist on dual sourcing, the extent to which customers have buyer power in dealing with Pentre Askern, the prospects for imports, and the likelihood of new entrants in the UK or the expansion of existing UK suppliers.

### *Dual sourcing*

2.59. Some large and small customers told us that it was important to them to have more than one supplier (see paragraph 2.28). Many took most of their requirements from one supplier (usually Pentre or Askern), but said that they had been able to use the threat of switching to the other as a tool to keep prices down. Concerns about security of supply in a business in which just-in-time delivery is important was another reason for wanting more than one source of supply.

2.60. Of the 14 customers who discussed their drum usage with us (see paragraph 4.29), seven used only Pentre and Askern for the supply of drums, a further two used only Pentre, two used either Pentre or Askern and another supplier, while three used only other suppliers. More details are given in paragraph 2.28. Some customers claimed that they had been able to use the threat of switching between suppliers as a tool to keep prices down. Some written price agreements contain clauses which enable customers to force down prices if competitors offer lower prices during the lifetime of the contract. We were told of two customers (Pirelli and [ \$ ]) which had recently refused suggestions from Pentre Askern that they enter into fixed-price contracts as they were seeking price reductions. Some customers consider that just-in-time delivery requires the supplier to be located nearby, but others seem less concerned.

2.61. Some large customers (Pirelli, Andrew, Corning and Draka) went further and said they did not intend to single source from Pentre Askern in the future. They would, if necessary, take steps to encourage or support the development of a competitive source. Three of them said they were actively seeking second suppliers, some from abroad. Some small customers said that in general they were reluctant to use only one supplier. Pentre Askern told us that it expected as a result of the merger to lose [ \$ ] per cent of the market for new timber drums and [ \$ ] per cent of the market for plywood drums.

2.62. The extent of the commitment to dual sourcing by customers is critical for the impact of imports and for the success and growth of other UK suppliers.

### *Buyer power*

2.63. The parties told us that they faced a concentrated customer base of large multinational companies, who would be in a position to exercise considerable purchasing power over the merged group. The evidence we received indicated that cable manufacturers are under pressure from their own customers to cut costs and they seek to pass this pressure on to drum suppliers even though drums account for only 2 per cent of cable manufacturers' costs.

2.64. We consider that whether or not a customer has buyer power depends on a number of factors. The most important is its share of drum sales. Other factors are the availability of offers from other suppliers, the market knowledge of the customer (particularly in respect to possible alternative sources of supply), and the customer's preparedness in the last resort to manufacture drums itself. The volume of a customer's purchases of all drums is important as well as the volumes purchased of a particular product type.

2.65. Pirelli, the largest customer in the UK by value of purchases, has recently merged with BICC. The two together accounted for 24 per cent of the combined revenue of Pentre and Askern in 1999. Pirelli told us that it considered itself to be in a strong negotiating position with Pentre Askern, and would be able to source from mainland Europe if the merged group increased prices.

2.66. Belden, the next largest customer, accounted for only 6 per cent of Pentre and Askern's combined revenues. The main parties have shown us letters from [ \$ ] and from management at [*Details omitted. See note on page iv.*] which requested retrospective rebates from suppliers (see paragraph 4.77). The purchasing manager of [*Details omitted. See note on page iv.*] had never accepted a price increase from Pentre relating to raw materials.

2.67. Andrew, with a 5 per cent share of the combined revenues of Pentre and Askern, told us that it would seek a second source of supply if the merger went ahead. Only one other customer, Bridon, had a share of 5 per cent or more of purchases across all product types, although some other customers had more than 5 per cent of purchases of a particular product type.

### *Imports*

2.68. There have so far been very few imports and these have been mainly of steel drums (see paragraphs 2.25 and 4.57 to 4.60). The parties argued that exports are significant and demonstrate that, in principle, problems such as transport costs and the need for just-in-time delivery can be overcome. They submitted that, since they themselves exported flat-packed kits for assembly overseas, there was no reason in principle why such kits should not be imported. They stated that mainland European suppliers were keen to supply in the UK and pointed to imports from the Pacific Rim and to interest from Brazil. However, Hildebrandt (based in Germany) told us that it had found UK competitive conditions difficult (see paragraph 5.73) and Boffi (based in Italy) had similar views (paragraph 5.75). Nevertheless Boffi did not appear to have given up hope of doing business in the UK in due course.

2.69. Whether imports occur in the future will depend on a number of factors, including the determination of customers seeking dual sourcing, the pricing strategy of Pentre Askern, the level of sterling, the availability of drums from other UK suppliers, and whether overseas suppliers will lose interest in the UK market if they are unable to establish a foothold here. We noted that Pirelli, for example, is considering its purchasing strategy for drums on a pan-European basis.

### *New entrants or expansion by existing UK suppliers*

2.70. Technical and financial barriers to entry on expansion are low although an entrant may have to establish a reputation with customers and might face an aggressive price response by large incumbent firms (see paragraph 4.94). There has been market entry in recent years. We consider whether this is likely to continue, or whether existing small suppliers are in a position to expand their share of the markets. The attitude of large customers towards encouraging competition to Pentre Askern is relevant. We consider whether it could cut prices selectively as part of a strategy to discourage new entry or expansion by existing suppliers. We received

evidence that Askern has in the past reduced its prices for a customer in response to a competitive threat, without apparently making similar reductions for other customers (see paragraph 2.30); and, as there are no published price lists, the joint venture can be expected to be in a position to do this in future.

## Separate product markets

2.71. Of the four factors we have discussed above, dual sourcing applies across all four of the markets for small steel, timber, plywood and cardboard drums. The other three factors—imports, buyer power and new entry—apply differently in those four UK product markets and therefore we analyse them separately below for those four markets.

### *Large steel*

2.72. Very large steel drums, over 4 metres in flange diameter (see paragraph 2.36), constitute a global market and Pentre Askern had no significant sales in recent years. Non-specialist suppliers enter the market from time to time; we were told of imports worth £2.1 million in 1999, and of a recent order worth £1.4 million placed with a general steel firm (see paragraph 4.44). We are satisfied that Pentre Askern does not have sufficient market share or market power to produce any competitive concerns and, accordingly, the merger may not be expected to have adverse effects on competition in this market.

### *Small steel*

2.73. Before the merger, market shares for small steel drums in 1999 were as shown in Table 2.3.

TABLE 2.3 **Market shares: small steel drums**

<i>Suppliers</i>	<i>Small steel</i>	
	<i>£'000</i>	<i>%</i>
<i>UK</i>		
Askern	1,200	34.8
Pentre	2,000	58.0
<b>Combined</b>	<b>3,200</b>	<b>92.8</b>
Other UK	250	7.2
Total UK	3,450	100.0
Imports	-	-
Total	3,450	100.0

*Source:* CC based on information provided by suppliers.

### *Buyer power*

2.74. Three customers (BICC, Pirelli and Bridon) accounted for 82 per cent of the combined sales of small solid steel drums by Pentre and Askern. We consider that Pirelli/BICC has considerable buyer power with regard to the merged group. Bridon, which accounts for 24 per cent of these sales and also accounts for around 7 per cent of Pentre and Askern's timber sales,

may also be expected to have some buyer power. A further three UK customers purchased skeletal steel drums from Pentre or Askern in 1999.

### *Imports*

2.75. Pentre told us that it had acquired a subsidiary in the Czech republic to produce cheap steel drums as it was finding it difficult to produce drums at a reasonable price in the UK. As set out in paragraph 2.45, skeletal steel drums have recently been imported for one customer [ \$ ]. We are aware that the UK supplier which assembled the component parts of these drums, [ \$ ], is looking to expand this area of its business in both solid and skeletal drums.

### *New entry and expansion*

2.76. The parties submitted that there were no technical barriers to entering the market for small steel drums. They said that any steel fabricator could supply such drums, and steel manufacturers had supplied them from time to time.

2.77. We were not able to obtain specific evidence about the likelihood of new entry and expansion of general steel manufacturers into this market.

### *Assessment*

2.78. We do not rely on the assumption that absent the merger Askern would exit from this market. We note that customers have not expressed any concern about the impact of the merger in this market.

2.79. Three customers are the main purchasers of small solid steel drums, while another three account for all skeletal steel purchases. There is interest in dual sourcing. The activities of [ \$ ] may suggest that importing steel drums is economically viable. [ \$ ] has imported skeletal drums and also plans to import or manufacture solid drums, but has not agreed a price for imports and its plans may depend on the continued success of its timber drum management business. Despite the high concentration of buyers for solid steel drums, there is no obvious alternative supplier at present. Switching could require some expenditure of resources on the part of these buyers (to whom drums are a very small part of costs) and may not result in a competitive price. We note that the market for solid steel drums is small (£2 million in 1999). Given the evidence about the interest in dual sourcing and the possible economic viability of imports, two of us conclude that the merger may not be expected to have an adverse effect in the market for small steel drums. Denise Kingsmill, however, is of the view that this evidence is very slight and considers instead that the merger may be expected to have adverse effects on competition in this market.

### *Timber*

2.80. Prior to the merger market shares were as shown in Table 2.4.

TABLE 2.4 **Market shares: timber drums**

<i>Supplier</i>	<i>Timber</i>	
	<i>£'000</i>	<i>%</i>
<i>UK</i>		
Askern	6,200	61.9
Pentre	2,200	22.0
<b>Combined</b>	<b>8,400</b>	<b>83.8</b>
YCD	1,200	12.0
CDR (Marlin)	600	0.7
J J Mountain	100	1.0
Total UK	9,770	97.5
Imports	250	2.5
Total	10,020	100.0

*Source:* CC based on information provided by suppliers.

2.81. Before the merger there was competition between Pentre, Askern and the other UK suppliers, including YCD (see paragraphs 2.23 and 2.48).

### *Buyer power*

2.82. Among Pentre and Askern’s customers in 1999, seven accounted for at least 5 per cent each of the parties’ sales of timber drums: Pirelli, Bridon, BICC, Andrew, Belden, AEI and Draka. We consider that each of the first five may have at least some buyer power, although there is a considerable difference between the power of Pirelli/BICC and that of the others (see paragraphs 2.63 to 2.67). AEI may also be expected to have some negotiating power due to its in-house production of drums (see paragraph 4.12), which provides it with an alternative source of supply (subject to capacity constraints). Draka’s negotiating position against the merged group may be strengthened by the fact that it (Draka) is YCD’s most important customer for timber drums. Together these companies account for 55 per cent of the parties’ combined sales (of which 25 per cent is to Pirelli/BICC). We have seen no evidence of buyer power among small customers who purchase the remaining 45 per cent.

### *Imports*

2.83. At present there are no imports of new timber drums. But the level of exports may suggest that imports are feasible in principle. There are many manufacturers of timber drums on mainland Europe.

2.84. Drums could be imported ready-made or assembled in the UK from parts imported in kit form; an approach which Pirelli and Andrew said was quite feasible and one which is used successfully for some UK exports. Either approach would be able to meet customers’ requirements for just-in-time delivery.

2.85. Direct imports of assembled drums by cable manufacturers might be a possibility, but we consider this less likely than UK suppliers importing in kit form because transport costs would be higher. Once imported into the UK in kit form the drums would need to be assembled, stocked and supplied at short notice. This could be organized by the customers in-house, but equally it could be done by relatively small competitors to Pentre Askern.

2.86. Pirelli is engaged in a study of drum purchasing across Europe and told us that timber drum prices varied widely between European countries, sufficiently to offset transport costs.

However, we received other evidence to the effect that prices did not vary greatly as between different European countries. We were unable to reach a definite view on relative international prices.

2.87. Importing in kit form for assembly by UK suppliers is a hypothetical scenario, but we did not find that any of the parties giving evidence disagreed with our assessment that it is feasible. Most UK export of timber drums is in kit form. This type of importing has not yet occurred on any significant scale; but the threat of imports has been sufficient to provoke a reduction in prices by Pentre or Askern for some customers. As set out in paragraph 2.51, we received evidence that a proposal by a German firm to undertake this activity with a local assembler resulted in a 10 per cent drop in the prices quoted by Pentre.

### *New entry and expansion*

2.88. Technical and financial barriers to entry are low and economies of scale are not significant, but new entrants also need access to customers. There has been successful new entry in recent years with YCD gaining 12 per cent market share in two years. CDR began manufacturing timber drums in 1999 and achieved 1 per cent of the market in that year, which is expected to grow to 2 or 3 per cent this year.

2.89. The capacity of existing small manufacturers of timber drums such as YCD is limited in the short term, but they could expand production if customers were to encourage them with long-term contracts or capital, as has been done in the past. Firm orders would help them to raise finance provided prices were sufficient for profitability.

2.90. The gradual trend towards greater reuse of timber drums by some customers means that new drums may be ordered in smaller batch sizes than in the past, which should make it easier to source from smaller suppliers. This provides an opportunity for them, although their current position in this market is not strong.

2.91. Small suppliers could either manufacture drums themselves, or import in kit form and undertake storage, assembly and just-in-time delivery.

2.92. Askern's sister company Montague L Meyer (MLM) will be supplying timber to Pentre Askern (see paragraph 4.85) but we do not think this is likely to make much difference to suppliers' ability to sustain competition in the timber drum market. Pentre Askern told us that Pentre had been more successful than Askern in obtaining low-cost timber prior to the merger, despite Askern's link with MLM.

### *Assessment*

2.93. The main questions in this market are:

- Are the large customers sufficiently committed to dual sourcing and do they have sufficient buyer power to give us confidence that they will be able to continue to obtain supplies at a competitive market price?
- What will happen to small customers?
- Will the large pool of used drums constrain the power of Pentre Askern to raise prices of new ones?

2.94. Two of the members consider that the large customers, especially Pirelli, Andrew and Draka, have by their actions already demonstrated their commitment to dual sourcing. They believe that dual sourcing is necessary in the longer-term interests of these companies both to

secure continuity of supplies if their main supplier cannot deliver and to maintain downward pressure on prices. Cable manufacturers face financial penalties if they do not deliver on time and cannot pass on any price rises to their customers. Dual sourcing is a valuable safeguard even if there are some additional costs involved.

2.95. There are several forms which dual sourcing could take. One possibility is to support existing smaller UK suppliers with long term orders (as we note has been done in the past). The desire of customers to dual source may be expected to encourage either new entry or expansion by existing UK suppliers. In the short term, YCD and CDR would not be able to meet more than a small percentage of the requirements of the large customers, but they should be able to obtain the finance needed to expand their capacity if they were to receive firm orders at prices which enabled them to make a profit. The lead time for setting up a production line is short. In the meantime, in a decreasing market, the threat of switching even a small part of the purchases of a large customer with buyer power away from Pentre Askern would have a constraining effect on prices.

2.96. Importing is another possible route to dual sourcing, although there have been no significant imports in the past. There are a number of overseas suppliers interested in exporting to the UK market. We note that it would not be in Pentre Askern's long-term interest to put prices up so high as to attract a large overseas supplier into the UK market. Even the threat of imports will have some impact on prices (as has already happened) although potential exporters may lose interest if in practice no orders are received. But we would expect that situation to change quickly if Pentre Askern attempted to raise its prices. In principle, imports could be either of fully assembled drums or in kit form with local assembly and stocking to meet just-in-time requirements more easily. In practice, import in kit form is more probable as it would reduce transport costs. The existing smaller UK suppliers would be a natural choice for the local assembly, and CDR has previously attempted to do this.

2.97. The small UK suppliers have an important role in either of these two scenarios. All three members of the Group considering this merger have a concern that Pentre Askern might target these suppliers' customers for price cuts. That would force suppliers either to lose customers or to reduce their prices to a loss-making level, eventually driving them out of the market and allowing Pentre Askern to increase the prices concerned. The lack of price transparency increases this risk. Two of the members believe that, given the commitment of large customers to dual sourcing, and provided that the small suppliers were allowed the time to develop their facilities and build up their customer base, the latter could reasonably be expected to survive and grow to a size at which they would offer effective competition. Denise Kingsmill considers this to be an unrealistic expectation given the size of market share which Pentre Askern will enjoy as a result of the merger.

2.98. We do not expect that many small customers will dual source. Two members, however, expect that, provided the small suppliers have time to develop their businesses, this will benefit the small customer who is more likely than before to use these suppliers. But Denise Kingsmill considers that small suppliers will be unable to expand in a market in which Pentre Askern has such a significant market share and may even risk being driven out of the market.

2.99. All three of us agree that, at present, many potential customers do not appear to be aware of the existence of alternative UK suppliers (see paragraph 4.100). This inquiry may help to increase such awareness, but the lack of price transparency may still make it difficult for small customers to make the best use of the opportunities which would be available if competition from Pentre Askern were for a time restrained.

2.100. The issue of the competitive role of used drums is relevant primarily to the timber drum market. In the context of the merger the question is how far the merged company will be constrained in increasing prices by the possibility that this would also increase the incentive of

customers to make greater use of used drums. We agree with Pentre Askern that timber drum management services are still relatively underdeveloped and that there is scope for greater reuse of drums. However, the existence of a stock of 500,000 to 1 million used drums already provides the incentive to customers to find ways of using the stock more efficiently and reducing the cost to them of new drums. We note that drum reuse has been increasing even though the price of new drums has been falling. It is true that the greater the price differential between new and used drums, the greater the incentive will be, but we doubt that an increase in the price of new drums of (say) 10 per cent would make much difference to the incentives that already exist to use the stock of drums more efficiently. We would, however, accept that there may be cable manufacturers that have not yet gone far down the path of more efficient drum use and might be prompted to do so by an increase in the new drum price. We therefore believe that the threat of a shift in the balance of use between new and used drums will help to constrain Pentre Askern's ability to increase prices to a minority of customers.

2.101. In conclusion, and in the light of our thinking, particularly set out in paragraphs 2.97 and 2.99, we unanimously conclude that the merger may be expected to have adverse effects on competition in the market for new timber drums which, if not remedied, would lead to higher prices.

## ***Plywood***

2.102. Prior to the merger, market shares were as shown in Table 2.5.

TABLE 2.5 **Market shares: plywood drums**

<i>Supplier</i>	<i>Plywood</i>	
	<i>£'000</i>	<i>%</i>
<i>UK</i>		
Askern	4,900	48.0
Pentre	3,800	37.3
<b>Combined</b>	<b>8,700</b>	<b>85.3</b>
Cable Reels (Marlin)	1,300	12.7
Jervis	100	1.0
Other UK	100	1.0
Total UK	10,200	100.0
Imports		-
Total	10,200	100.0

*Source:* CC based on information provided by suppliers.

2.103. Before the merger, there was competition between Pentre, Askern and Cable Reels.

## ***Buyer power***

2.104. Five customers accounted individually for over 5 per cent of the parties' sales of plywood drums in 1999: BICC, Belden, Andrew, Pirelli and AEI. Draka had 4.5 per cent. These customers account for 44 per cent of the parties' sales. The extent of buyer power of some of these customers is discussed in paragraphs 2.63 to 2.67. We note that our remarks in paragraph 2.82 about AEI and Draka's alternative sources of timber are not applicable to plywood.

2.105. The merger will increase concentration in the market for the sale of new plywood drums. But, as with timber, the large customers can be expected to take steps to encourage alternative sources of supply.

### *Imports*

2.106. There have not been imports of plywood drums in the past. There is a significant level of UK exports, and some overseas interest in entering the UK market. We would not expect significant imports of assembled drums; a more likely scenario might be existing suppliers assembling drums from imported kits. A report by Jaakko Poyry for Pentre Askern gave examples of transport cost savings in France and Spain causing a trend towards a trade in plywood components to be assembled by the buyer. Nevertheless there has been less interest in entering the plywood drum market than in the timber drum market. We received evidence from one customer, Thomas Bolton (see paragraph 5.65), to the effect that European suppliers had not shown great interest in soliciting orders.

### *New entry and expansion*

2.107. There have been no new entrants since 1992. One company has indicated that it might enter the market to supply plywood drums, and has embarked on discussions with customers, but has not taken a decision. Cable Reels' market share has remained static for some years and we do not expect that it will put much pressure on Pentre Askern.

### *Assessment*

2.108. The desire for dual sourcing may encourage large customers to seek imports or place more of their business with existing UK suppliers, but, compared with the timber market, there is less buyer power, less interest from overseas and less competition from existing UK suppliers. Market entry is possible in the longer term. But we do not believe that in the short term an adequate level of competition will be maintained while alternative sources of supply become better established. There is a likelihood of higher prices for small customers and of selective pricing by Pentre Askern to discourage new entry. We therefore expect that the merger will have adverse effects on competition in the market for plywood drums which, if not remedied, would lead to higher prices.

## **Cardboard**

2.109. Market shares before the merger were as shown in Table 2.6.

TABLE 2.6 **Market shares: cardboard drums**

<i>Suppliers</i>	<i>Cardboard</i>	
	<i>£'000</i>	<i>%</i>
<i>UK</i>		
Askern	2,500	50.5
Pentre	1,700	34.3
<b>Combined</b>	<b>4,200</b>	<b>84.8</b>
Great Western	550	11.1
Jervis	200	4.0
Total UK	4,950	100.0
Imports		-
Total	4,950	100.0

*Source:* CC based on information provided by suppliers.

2.110. Before the merger, Pentre and Askern were competing. Great Western and Jervis were also supplying but their market shares have not risen in recent years.

### *Buyer power*

2.111. Only three customers of Pentre and Askern had had individual purchases of over 5 per cent in 1999: Pirelli (16 per cent), Doncaster Cables (14 per cent) and Draka (9 per cent). As discussed in paragraph 2.65, we consider Pirelli to have significant buyer power with regard to Pentre Askern, while Draka may also have some buyer power. Doncaster Cables also purchases timber and plywood drums from the main parties, and accounted for 3 per cent of all sales by Pentre and Askern in 1999. We do not consider that customers accounting for the remaining 61 per cent of sales have buyer power (with the possible exceptions of AEI, BICC and Belden, which each accounts for 1 to 2 per cent of sales).

### *Imports*

2.112. There have been no imports in the past. There have been UK exports, but we have no reason to believe that significant imports will occur in the future, given the low value of the cardboard drums and the relatively few significant sources of supply in mainland Europe.

### *New entry and expansion*

2.113. More capital is required for entry or expansion in cardboard drums than for steel or timber because of greater automation (see paragraph 4.88).

2.114. PKR was set up earlier this year and has supply commitments from [ \$ ] customers (including one large customer) to produce cardboard drums. It expects sales of £[ \$ ] in the next [ \$ ]. It is too early to judge whether PKR will succeed.

### *Assessment*

2.115. Some customers are interested in dual sourcing and large customers have buyer power which would enable them to pursue it by placing business with smaller UK suppliers. There are many small customers in this market, but we believe that they would also be able to purchase from small UK suppliers.

2.116. We would expect small suppliers to be keen to reduce their dependence on large customers and to be keen to meet part of the needs of the small customers.

2.117. There is some existing competition to Pentre Askern and the entry of PKR, if successful in achieving its targets, would augment this. But we cannot be confident of this in the short to medium term. There is a likelihood of higher prices for small customers and of selective pricing by Pentre Askern to discourage new entry. We therefore expect that the merger will have adverse effects on competition in the market for cardboard drums which, if not remedied, would lead to higher prices.

## ***Timber drum management services***

2.118. Timber drum management services are currently operated to support drum reuse within the UK (see paragraphs 4.16 to 4.18). In-house operation by the cable manufacturers may be an alternative, although we received little evidence about this.

2.119. CDR is currently the leading supplier in this market. We found it difficult to establish CDR's market share but believe it has some 59 per cent of the UK drum management services market (see Table 4.7). [ *Details omitted. See note on page iv.* ], but we note that since barriers to entry are very low we do not believe CDR's exit would necessarily damage competition.

2.120. It would seem that the barriers to entry for management services are even lower than for timber drum manufacture. YCD and CDR told us that it was necessary to be able to supply new timber drums as part of offering drum management services, but it is noteworthy that CDR was able to offer drum management for eight years without manufacture.

2.121. KTG has recently expressed an interest in running a drum rental business in the UK. Pentre Askern believed it was likely that in due course KTG would enter the UK market (see paragraph 6.47).

2.122. We conclude that the merger may not be expected to have adverse effects on competition in the drum management services market.

## **Conclusions on competition and price rises**

2.123. Our conclusions on the expected level of competition after the merger are set out in paragraphs 2.72, 2.79, 2.101, 2.108, 2.117 and 2.122, discussing the effects of the merger on each market.

2.124. In summary, we do not expect the merger to have adverse effects on competition in the markets for large steel drums or for drum management services. Two members of the Group do not have an expectation of an adverse effect on competition in the market for small steel drums. However, Denise Kingsmill believes that there would be an adverse effect. We therefore by a majority make no adverse finding in respect of the market for small steel drums. But we expect the merger to have adverse effects on competition in the markets for timber, plywood and cardboard drums.

2.125. In those three markets, imports have scarcely occurred in the past and, although this may change, two members believe that the main potential source of competition is the expansion of existing UK suppliers and some new entry by other UK suppliers. The two members consider that most customers would in principle like to dual source and that some large customers will continue to do this, thereby encouraging small UK suppliers; if time were allowed, say three years, for these suppliers to expand their customer base, there would be an adequate level of competition, given the low barriers to entry and the buyer power which large customers can exercise. Denise Kingsmill believes, however, that most customers for whose business Pentre and Askern have competed in the past will not dual source following the merger, if an alternative, local source is not readily available to them.

## **Benefits of the merger**

2.126. Pentre Askern told us that it expected to rationalize manufacturing activities both in the UK and overseas to reduce over capacity, and reduce costs in the purchase of raw materials.

These savings would enable them to develop further value added services for their customers—for example, in drum management—and to provide an international capability for their increasingly international customers. Pirelli also told us that the consolidation of Pentre and Askern complemented each other and had offered Pirelli the benefit of both their areas of expertise. It was more positive than neutral about the merger. But some other customers did not expect to benefit.

2.127. Such developments might benefit some customers and also strengthen Pentre Askern's export performance. Nevertheless Pentre Askern's business plan suggested that it hoped to retain many of the benefits for itself and not to pass them on to customers in the form of price cuts. Whether it succeeded in this would depend on the strength of competition, and we have already concluded that the merger is expected to damage competition in some of the markets.

2.128. The claimed benefits appear fairly small (see paragraph 3.102). We were told that rationalizations would depend on circumstances (for example, on what Pirelli does now that it has acquired BICC). In our view, although the merger might cause the elimination of excess capacity to be accelerated, it is not clear why these benefits could not be obtained from Pentre and Askern separately, given that there do not appear to be significant economies of scale in drum manufacture. We therefore conclude that the public interest benefits arising from the merger may be expected to be small at best.

## **Conclusions on the public interest**

2.129. All three members conclude that the merger situation may be expected to operate against the public interest in that it may be expected to have adverse effects in the markets for new timber, plywood and cardboard drums, for the reasons given in paragraphs 2.101, 2.108 and 2.117.

2.130. Denise Kingsmill also believes that the merger situation may be expected to have adverse effects in the market for small steel drums (see paragraph 2.79). By a majority, however, we conclude that the merger situation may not be expected to have adverse effects in this market.

## **Remedies**

2.131. We are required by section 72(2) of the Act to consider what action (if any) should be taken for the purpose of remedying or preventing the adverse effects we have identified and we may, if we think fit, include in our report recommendations as to such action.

2.132. We consider that there are two main public interest concerns arising out of the merger. The first is the inability of the smaller UK suppliers to survive if Pentre Askern makes selective offers of very low prices to the main customers of those suppliers—in the expectation that it will be able to increase prices later. The second concern is the adverse effects on small customers who may not have the information to make informed choices between Pentre Askern and alternative suppliers and may as a result pay the higher prices that Pentre Askern would be likely to seek. The lack of price transparency is a contributory factor in both these concerns. Two members conclude that remedies should be directed at remedying these weaknesses in the market in the expectation that this will enable the alternative suppliers to compete effectively in the longer term, and their views are set out in paragraphs 2.133 to 2.145. Denise Kingsmill believes that these remedies would not be sufficient and her views are set out in paragraphs 2.146 and 2.147.

## ***Remedies proposed by two members***

2.133. Remedies are required to deal with the adverse effects identified in the markets for timber, plywood and cardboard drums. We considered the possible remedy of selling one or more factories in the markets about which there are concerns. Two members took the view that such a remedy would not prevent Pentre Askern from retaining its customers or from making better use of or increasing capacity elsewhere. The two members noted that in at least one of the markets, Pentre Askern was in any case planning to close a factory to reduce costs. The two members therefore concluded that such a remedy was not effective.

2.134. We considered a number of remedies relating to prices. Our deliberations on the price remedies proposed by two members are set out in paragraphs 2.135 to 2.142 and the views of main and third parties are set out in paragraph 2.143.

2.135. Two members believe that measures to improve price transparency in these markets would go some way to reducing the ability of Pentre Askern to exploit small customers or eliminate small competitors by discriminating on price between customers. The *first proposed remedy* is that Pentre Askern should be required to give an undertaking that it would post on a web site information which would help UK customers assess prices or trends in prices for timber, plywood or cardboard drums. In deciding what information should be provided, the DGFT would need to have regard to the desirability of protecting the anonymity of the customer, as well as to whether the information would provide practical assistance. A simple approach might be to give information about Pentre Askern's raw material costs. A more complex approach would give details of all Pentre Askern's sales to UK customers of new timber, plywood or cardboard drums. Details could include the unit price paid, the material type, and some indication of the size of the orders and the size and specification of drum, but even though the identity of the customer would not be included, too much detail might enable the customer to be identified and might make it difficult for others to sift through the information.

2.136. The *second proposed remedy* addresses the concern that Pentre Askern might lower prices to selected customers in order to discourage those customers from placing business with Pentre Askern's competitors. It would be more expensive for Pentre Askern to engage in this behaviour if it were prevented from subsequently raising prices once the damage to the competitor had been done.

2.137. The proposed remedy concerns the prices charged by Pentre Askern to an individual UK customer for drums of a particular product type: timber, plywood or cardboard. The DGFT would need to consider whether the categories should be further refined in relation to size ranges, or broad specifications of drum, or size of order. Within each category, the average price paid during a defined period, perhaps three months, would be compared with the average price paid by that customer for the same category during a reference period occurring before the merger (to be chosen by the DGFT). Pentre Askern would give an undertaking that, if the average price had fallen by more than 5 per cent, it would not be increased for that customer for that category until the expiry of the undertaking. It would be desirable to allow Pentre Askern some flexibility in making price cuts. The DGFT could consider whether that flexibility should be provided by an allowance for raw material costs or general inflation, or by exempting any price cut which extended to more than 50 per cent of the sales of that category.

2.138. The *third proposed remedy* is ancillary to these: namely that Pentre Askern would undertake to provide independently audited, summary information to the DGFT to enable him to assess compliance with the pricing undertakings.

2.139. In the markets for timber, plywood and cardboard drums the assessment of the risks to competition depends on the continued existence of independent suppliers. The *fourth*

*proposed remedy* is that the DGFT obtains an undertaking from Pentre Askern to notify him of any proposal to acquire control of another UK supplier of timber, plywood or cardboard drums.

2.140. The *fifth proposed remedy* is also ancillary and would require Pentre Askern to notify all its customers and potential customers in the UK of the undertakings it had given.

2.141. In all these proposed remedies, references to price are to prices actually paid, net of any discount or rebate, and there would need to be a further undertaking that, during the lifetime of the principal undertakings, no agreement would be made to give a retrospective rebate (whether during or after that lifetime).

2.142. The remedies on price would not need to apply to exports of drums (without cable wound around them), second-hand drums, reused drums, or drum rental.

2.143. A full list of the hypothetical remedies on which main and third parties were consulted is in Appendix 2.1. It includes some which we decided not to recommend, namely a possible freeze on prices or a cap on prices, as we considered that these were less likely to counter the adverse effects identified. The comments received from Pentre Askern and some third parties are summarized in paragraphs 6.79 to 6.92 and 5.10, 5.15, 5.19, 5.28, 5.30, 5.56, 5.60, 5.71, 5.74, 5.80 to 5.83 and 5.95. On the possible remedy that prices of drums be published, Pentre Askern, CDR and BICC commented that anonymity might be difficult to guarantee in an industry where particular drum specifications were known and where the number of large customers was small. On the possible remedy that Pentre Askern be not permitted to lower prices and then raise them again, Pentre Askern suggested that this should apply only if 40 per cent of customers, by value, benefited from a price cut. On possible divestment, Pentre Askern considered that regard would need to be paid to practicabilities. Divestment of facilities which the joint venture intended to close would be theoretically feasible but there was no basis for concluding that this would lead to transfer of market share. Pentre Askern submitted that in any case this hypothetical remedy would be disproportionate. On publicizing undertakings, Pentre Askern said that this would be acceptable in principle, as would be the suggestion that it pay the costs of independent audit for complying with any monitoring required by the DGFT. We invited Pentre Askern to comment on the relative costs of various remedies, but no systematic comment was offered.

2.144. Two members consider that the remedies described in paragraphs 2.135 to 2.142, taken together, would be adequate to deal with the adverse effects identified, and do not consider that it is necessary to dismantle the merger provided that undertakings to give effect to these remedies can be negotiated within three months of the date of publication of this report. These remedies would need to last for three years. The two members note that Pentre Askern indicated that it would be prepared to pay the costs of independent audit for complying with any monitoring required by the DGFT. They do not believe that this would be an unreasonable imposition on Pentre Askern for the three-year period.

2.145. The two members therefore recommend that the DGFT obtains undertakings from Pentre Askern on the proposals described in paragraphs 2.135 to 2.142. The two members believe that, having regard to the size of the three markets and such detriments as have been identified in each, demerger is not justified. Moreover, the two members believe that, given satisfactory undertakings such detriments as have been identified are unlikely to persist for longer than three years. The two members attach importance to the clear indications from Pirelli, Andrew, Corning and Draka that these customers will not be content to single source and will seek to broaden their supplier base. The two members see no reason why imports

cannot effectively compete, particularly with the encouragement of these customers who are willing to look to European-wide sourcing policies. The two members note also that, despite the fierce competition in recent years between Pentre and Askern, new entrants have arrived and stayed in the markets and no significant economies of scale have been identified which would give the joint venture a cost or efficiency advantage in the market against their smaller competitors. For these reasons, if the suggested undertakings are given, the two members believe that a structural solution is not necessary and that the proposed behavioural remedies will suffice.

### ***Remedies proposed by Denise Kingsmill***

2.146. Denise Kingsmill is of the view that the proposals in paragraphs 2.135 to 2.142 to remedy the adverse effects identified in paragraphs 2.101, 2.108 and 2.117 in relation to the new timber, plywood and cardboard drum markets are not sufficient for the following reasons:

- (a) the lack of competition in each of the markets due to the small number of competitors and their small market shares (see paragraph 2.48) which make it unlikely that in the short to medium term (within 12 months) they will be able to develop their businesses to such an extent as to offer effective competition to Pentre Askern and may even risk being driven out of the market;
- (b) the absence of imports in each of those markets (see paragraphs 2.83, 2.106 and 2.112) and the ability of Pentre to respond effectively to the threat of imports (see paragraph 2.87) does not give rise to an expectation of imports in the near future;
- (c) the very limited evidence of customers providing support to smaller suppliers; the only evidence of such support is Draka's continuing use of YCD despite Askern offering lower prices;
- (d) the view that most customers for whose business Pentre and Askern have competed in the past will not dual source following the merger, if an alternative, local source is not readily available to them; and
- (e) the expectation that the small suppliers will recognize the difficulty of competing with Pentre Askern—even if the latter is subject to price undertakings—and will choose instead to follow the higher prices set by Pentre Askern.

2.147. Given all these factors, Denise Kingsmill concludes that undertakings of the sort recommended by the other members of the Group would not be effective. Having regard to the size of the drums industry, her view is that the undertakings would impose too high a regulatory burden, which would not be compensated by benefits to customers or the ultimate consumer and that a structural remedy is more appropriate to a structural problem, which this merger presents. The merger situation has produced a significant market share in four of the product markets and gives rise to an expectation of adverse effects in the minds of all members of the Group in respect of three of the markets in question (timber, plywood and cardboard drums). She therefore concludes that the only appropriate remedy is to proceed to a division of Pentre Askern so that the businesses of the joint venture company return to the separate ownership of Sylvan and Locker. This should not present insurmountable difficulties since the companies had undertaken to maintain Pentre and Askern as separate operating units pending the outcome of this inquiry (see paragraph 2.9).