OFFICE OF FAIR TRADING

Anticipated acquisition by Silverline Tanks Limited, a subsidiary of Killarney Manufacturing Group Limited, of Balmoral Tanks, the GRP water tank business of Balmoral Group Limited

No. ME/3191/07

The OFT's decision on reference under section 33(1) given on 25 October 2007. Full text of decision published 6 November 2007.

Please note that square brackets indicate text or figures which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Silverline Tanks Limited** (Silverline) is a wholly owned subsidiary of **Killarney Manufacturing Group Limited** (Killarney), a holding company for a group of companies which undertake a range of activities including the supply of glass fibre reinforced plastic tanks (GRP tanks). Killarney has three separate companies trading in GRP tanks: Dewey Waters Limited; Nicholson Plastics Limited; and AC Plastic Industries Limited. Killarney is based in Ireland but has GRP tank operations at various locations in the UK.

2. Balmoral Tanks (Balmoral), a part of **Balmoral Group Limited,** is the GRP water tank business being acquired. Balmoral Group Limited is a part of Balmoral Group Holdings Limited which manufactures and supplies GRP water tanks in the UK.

TRANSACTION

3. On 25 July 2007 Silverline agreed to purchase the GRP tank business, related fixed assets and goodwill of Balmoral. Balmoral staff will also be transferred as a part of the acquisition.

JURISDICTION

4. As a result of this transaction Silverline, an enterprise carried on by or under the control of Killarney, will cease to be distinct from Balmoral Tanks, the GRP water tanks business carried on by or under the control of Balmoral Group Limited. The parties overlap in the supply of GRP water tanks and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met.

5. The Office of Fair Trading (OFT) therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

Product market

6. The parties overlap in the supply of GRP tanks, used mainly for storing potable water. They contract to supply, deliver and install the tanks although both parties tend to sub-contract the actual delivery and installation which the parties told the OFT is normal within the industry (although some other suppliers do not sub-contract the installation). The parties submitted that the relevant frame of reference is liquid storage tanks and that these can be constructed from a number of materials including plastic, steel, concrete or GRP. Third parties have generally told the OFT that the relevant frame of reference is narrower with some suggesting GRP tanks only, while others have suggested that it is appropriate to segment GRP tanks into one piece and sectional GRP tanks.

One piece and sectional GRP tanks

7. One piece tanks are made as a single, integral unit whereas sectional tanks are constructed on site from individual GRP panels which are bolted

together and sealed to form a tank which is reinforced with stainless steel cross-bracing rods.

8. The parties and some third parties have told the OFT that in some circumstances customers are able to substitute between one piece and sectional GRP tanks. However there is a size limit on one piece tanks of between 5,000 and 9,000 litres whereas sectional tanks can be produced in capacities of over a million litres. While a number of one piece tanks could be linked together and so used in place of a larger capacity single sectional tank, this would increase the cost of fittings such as flow regulating valves, filters and overflows needed for each tank.

9. Where there is restricted access to the area where the tank will be located it is often not possible to install a one piece tank due to its size. In these circumstances a sectional tank would have to be used. In some cases of restricted access a semi sectional two piece tank could be used, but the view from both the parties and third parties is that two piece tanks are rarely used.

10. Further, a number of third parties have suggested that for an equivalent size of tank, a one piece tank will always be significantly cheaper as it would not require the same labour cost in terms of installation and fitting. The parties have disputed this, arguing that depending on the tank's dimensions, one piece tanks can be either cheaper or more expensive than sectional tanks. However, based on the evidence supplied by the parties, the price difference between a one piece and an equivalent sized sectional tank is more than 10 per cent. The available evidence indicates that there is little demand side substitution between one piece and sectional GRP tanks.

11. On the supply side, a number of one piece GRP tank suppliers also supply sectional GRP tanks although not all of them manufacture their own GRP panels (some of them import the panels). The production process and equipment is different between the two types of GRP tank. Therefore, in manufacturing, there is little scope for supply side substitution.

12. Overall, the evidence is mixed. However, on a cautious approach the balance of evidence indicates that one piece and sectional GRP tanks should be split into separate frames of reference.

GRP tanks and tanks made from other materials

13. The parties submitted that size is a key determinant of a customer's choice as to which material their tank will be made from. They also submitted that there is no size of water tank for which GRP tanks are the only option since the range of capacities for which GRP tanks can be used is very broad. The parties told the OFT that GRP tanks are usually used for tanks holding anywhere between 45,000 and one million litres. However, around [20-40] per cent of Balmoral's sales were of tanks of 5,000 litres or below and around [40-60] per cent were 10,000 litres or below, while the average size of Killarney's tanks was [ ] litres.

14. The parties told the OFT that **plastic tanks** are used for tanks up to 45,000–50,000 litres. Injection moulded plastic tanks are generally cheaper than GRP tanks but are only available in smaller sizes. Therefore, it seems logical to the OFT that where plastic tanks can be used they will be, with more expensive GRP tanks only being used in situations where plastic tanks cannot be used.

15. According to the parties, rotationally moulded plastic tanks are available in sizes up to 30,000 litres. However, one third party who makes such tanks, including some larger than 30,000 litres, stated that larger tanks would be in the form of very tall silos which may not be suitable in many situations.

16. In regard to **steel tanks**, the parties said that these are used for tank jobs of around 45,000 to one million litres. They supplied information which showed that Balmoral lost a number of tenders to a company called Franklin Hodge which makes galvanised steel and aluminium tanks. The parties suggested that this showed sectional GRP and sectional steel tanks are in the same product frame of reference.[1]

17. Further, one third party told us that the regulations affecting one particular type of tank – sprinkler tanks for fire prevention systems – favour steel tanks but do not exclude GRP tanks. Some of the lost tenders indicate that if steel tanks do compete with sectional tanks then it is only in this one specific area.

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[1] Balmoral Group Limited also manufactures sectional steel tanks but that part of the business is not being sold to Killarney.

18. Killarney also supplied evidence to show that it had lost work to competitors offering steel tanks. However, the unique nature of many of the projects, and the small number of examples submitted (around two per cent of Killarney's tenders) indicate that Killarney does not routinely lose business to competitors offering steel tanks.

19. Overall the evidence indicates that in some cases steel tanks, despite being up to 50 per cent more expensive, may be a substitute for GRP tanks but that this will generally be in the specific and clearly identifiable area of sprinkler tanks. However, that customers are prepared to accept such a price differential indicates that there might be other reasons why a steel tank is preferred to a GRP tank.

20. **Concrete** is also used in water storage tanks although it is generally not suitable for tanks situated higher than ground level due to the weight. Concrete tanks can be used for sizes above 50,000 litres. The parties have provided information to show that for very large tanks (generally over 500,000 litres) they have lost a number of tenders to competitors supplying concrete tanks. As with losses to steel tanks, the number of tenders lost to concrete tanks is very small compared to the number of tenders bid for and lost against GRP tank suppliers.

21. On the supply side, some GRP tank suppliers supply more than one type of tank. For example, Drayton Tanks (GRP and thermoplastic) and Braithwaite (GRP and steel). However, the OFT was not made aware of suppliers of other types of tank who could quickly and easily move into the supply of GRP tanks in the event of a price increase. The OFT did contact manufacturers of other GRP products (discussed below).

22. Overall the OFT considers that concrete tanks only provide a substitute for GRP tanks in very limited and clearly identifiable circumstances.

GRP water tanks and GRP tanks to hold other liquids

23. The OFT is aware of at least one other company that makes **one piece GRP tanks** for chemical storage. Consequently it may be possible for customers of GRP water tanks to switch to using tanks intended for other liquids.

24. There is some third party evidence to suggest that different resins are needed to make tanks to hold chemicals and that these tanks are made on a

bespoke basis depending on the chemical stored and the needs of the individual customer. The OFT considers that there are likely to be significant cost differences between water tanks and tanks designed to hold other liquids which would encourage only limited customer switching.

25. In terms of **sectional GRP tanks** the parties submitted that these cannot be used to store oil-based chemicals as the liquid tends to seep through seals between the sections. The OFT has not been made aware, either from the parties or from third parties, of any sectional GRP tank manufacturers who make tanks for storing liquids other than water.

26. In terms of supply side substitution, the OFT contacted a number of manufacturers of other GRP products (including baths and yachts). None had produced sectional GRP tanks in the past nor did any have any plans to do so in the foreseeable future.

Conclusion

27. Overall, the OFT considers on the available evidence that there are two distinct product frames of reference in this case: one piece GRP water tanks and sectional GRP water tanks.

Geographic market

28. The parties submitted that the appropriate geographic frame of reference is the UK. The tanks supplied to the UK are mostly produced in the UK and that there is no regional price or product differences.

One piece GRP water tanks

29. The view of the parties was largely supported by third parties, who told us that they are able to serve the whole of the UK. There was no evidence of regional or local geographic markets. Third parties also confirmed that imports and exports of one piece GRP water tanks are limited because of their bulky shape and the fact that they would be transporting mostly air.

Sectional GRP water tanks

30. The OFT is not aware of any evidence supporting local or regional geographic markets for sectional GRP water tanks. As with one piece

tanks, third parties told the OFT that they are able to serve the whole of the UK and in some cases overseas (see below). The OFT therefore considers that the appropriate scope is at least as wide as the UK.

31. There is substantial evidence of GRP panels being imported into the UK. The OFT is aware that one supplier acquires all of its sectional panels from a firm located in Japan. Another sources its panels from Spain, while another again gets its panels from Malaysia.

32. The parties have told the OFT that the cost of panels only accounts for around one third of the cost of supplying and installing a tank. Therefore, if the cost of imported panels is around 10–15 per cent more expensive than the cost of a domestically sourced panel (which are the figures which have been quoted to the OFT), the extra cost to the final customer is only around three to five per cent. However, some third parties have suggested that panels make up a higher proportion of total costs (50–80 per cent), which means that the cost to the final customer using imported panels could be around 5–12 per cent more expensive than using domestically produced panels.

33. Overall the evidence indicates that the appropriate frame of reference for one piece GRP water tanks is the UK, and the supply of GRP panels may be wider than the UK. Although imports of sectional panels come from a variety of countries, the OFT does not consider that it is appropriate to have a worldwide geographic frame of reference. There is no evidence of end customers using overseas suppliers directly, which indicates that a UK presence is necessary at the sales, distribution and installation level of activity. Therefore, the OFT's competitive analysis below focuses on the supply of sectional GRP water tanks from UK-base supply sources but taking into account current domestic rivals that source imported GRP panels. Entry and expansion are considered further below.

THE COUNTERFACTUAL

34. In order to assess the effect of the proposed merger on competition the OFT needs to consider what the situation would be without the merger. Ordinarily, this would simply be the pre merger situation. However, in some situations the OFT will take into account imminent changes to the competitive landscape in order to assess as best it can the likely competitive

conditions that would exist without the merger. Examples include imminent entry to, or exit from, a market, and imminent regulatory changes.[2]

35. [*Paragraph excised*]

36. [*Paragraph excised*]

HORIZONTAL ISSUES

One piece GRP water tanks

37. The parties' combined market share in one piece GRP water tanks is around [15–35] per cent (with the increment from Balmoral being around [ ] per cent). There is also evidence of a number of sizeable competitors, the largest of which has a share of supply of over three times that of Balmoral.[3] There is some evidence of recent entry over the past five years, although the entrants have only managed to capture a very small share of supply. One competitor did describe the parties as close competitors in one piece tanks but in general third party responses strongly suggested that neither company had its main business in one piece tanks, but rather that they were the main players and closest competitors in sectional tanks.

38. The OFT does not consider that competition concerns arise in regard to one piece GRP water tanks and therefore these are not discussed any further.

Sectional GRP water tanks

39. The merger combines the two largest competitors by some margin and creates a market leader with over [40-60] per cent of sectional GRP water tanks installed in the UK (increment around [15-35] per cent). According to the parties' data, eight competitors have a share of supply of [ ] per cent or less while only three competitors have a share of supply of between [ ] and [ ] per cent.

40. Bidding win-loss records validate that the share data does not appear to overstate the likely competitive impact of the merger. A number of third parties told the OFT that the parties are each other's closest competitor.

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[2] See 'Mergers: substantive assessment guidance', OFT516, May 2003, paragraphs 3.23–3.24.
[3] In all, the evidence before the OFT shows that there were [-] suppliers larger than Balmoral.

Bidding data provided by the parties show that Killarney lost out to Balmoral in around one third of tenders (over the course of one month) while Balmoral lost out to Killarney in around a half of tenders (over the course of a year).[4] Bidding information received by the OFT from customers supported this pattern. It showed that the parties bid closely to each other with other bidders quoting higher prices. Therefore, the parties are most likely to lose tenders to each other.

41. The above analysis raises substantial concerns subject to constraints provided by expansion, entry or buyer power, considered below.

Barriers to entry and expansion in sectional GRP water tanks

Views of market participants

42. The parties submitted that barriers to entry are low. They submitted that an entrant could import panels, source the panels domestically, sub-contract the panel moulding (as some suppliers currently do), or establish its own manufacturing capability. The parties submitted that an entrant could be a new entrant, an existing installer (a number of existing suppliers started this way) or a manufacturer of a related product.

43. The parties submitted that a new entrant manufacturing GRP water tanks could recoup its costs of entry in around two-and-a-half years assuming an overall share of supply of two per cent. The parties subsequently submitted that this may be overly cautious and that they believe a 10 per cent share of supply could be achieved by a new entrant within two years, although the evidence before the OFT shows that no competing supplier has yet achieved this.

44. Third parties told the OFT that barriers to entry are more significant. These include having a dedicated network of sales representatives which would develop relationships with contractors, building companies and construction consultants. Some third parties mentioned to the OFT that the WRAS approval scheme forms a barrier to entry.[5]

[4] The data supplied by Killarney was for only one of its three companies active in the supply of GRP tanks.

[5] The WRAS approval process takes around 8–12 weeks. The parties told the OFT that approval fees amount to around £1,200. A supplier needs to be re-approved every five years and every time it launches a new product.

OFT's assessment

45. Two of the four main (but nevertheless much smaller) competitors are supplied wholly by imported GRP panels. This indicates that competitors that source sectional panels from abroad are currently able to win some contracts for which it is assumed that the parties might have bid. The OFT received some evidence which showed that there are some overseas manufacturers who have obtained WRAS approval.

46. On the basis of the evidence before it the OFT considers that domestic suppliers reliant on imports could increase their output but may not be sufficiently price competitive (as reflected in the small number of contracts won) to be able to expand sufficiently in response to a price rise in the UK in order to offset the loss of Balmoral.

47. In terms of expansion by existing suppliers, some third parties have also told the OFT that the barriers to expansion are not in obtaining more panels, but in winning contracts, hiring more tank fitters and the personnel to deal with design, planning and after-sales services. While these do not seem to be insurmountable structural barriers, the rationale for the transaction, in which customer goodwill and acquisition of Balmoral's sales staff features heavily, suggests that the distribution and customer relationship aspects of suppliers' business models may be a key ingredient to the parties' relative size and success compared to the fringe. This raises questions as to the ability and speed of rivals to replicate the constraint provided by Balmoral, even assuming the absence of domestic manufacturing does not render them uncompetitive on price.

48. The OFT is aware of two new entrants over the past five years. Pure Water Storage entered in 2002 and Forbes entered in 2005. Neither makes its own panels – one sources panels from abroad while the other sources domestically. Neither has a share of supply above five per cent. Indeed, apart from the parties, no supplier has been able to establish a share of supply above 10 per cent with most competing suppliers accounting for a less than five per cent share. This past record of entry and expansion does not resolve the questions raised above regarding the ability and speed of rivals to constrain Killarney post-merger.

49. On the basis of the evidence before it, the OFT believes that expansion or entry are plausible countervailing constraints to the exercise of market power by Killarney post-merger. However, critical doubts remains that such responses by rivals would be timely, likely or sufficient enough to offset the absorption of Balmoral into Killarney in sectional GRP water tanks.

Countervailing buyer power

50. The parties, together with some third parties (including some customers), submitted that some of their customers possess significant countervailing buyer power which would enable them to prevent any price rises after the proposed merger.

51. Major customers use competitive tenders and the parties told the OFT that is easy for them to include another supplier if they are not happy with a particular one.

52. However, evidence submitted to the OFT shows that each of the parties' top [ ] customers account for a relatively small proportion of the parties' overall revenue.

53. Moreover, countervailing buyer power is only effective to the extent that customers have viable choices of suppliers capable of supplying at similar prices, volumes and terms. The proposed merger brings together the two leading suppliers of sectional GRP water tanks in an environment in which no other supplier has managed a share of supply of over 10 per cent and most have a share of less than five per cent. Bidding information (discussed above) show that the parties are more likely to lose contracts to each other than to any other competitor.

54. The OFT did not find any evidence of customer de-listing suppliers to get a better price or terms. Nor has the OFT found any examples of sponsored entry into the industry.

55. Overall, the OFT considers that to the extent a minority of customers were to possess countervailing buyer power, they would not be in a position to protect the rest of the customers from any price increases arising as a result of the proposed merger.

VERTICAL ISSUES

56. Killarney supplies sectional GRP water tank panels to downstream competitors while Balmoral currently does not (there is some evidence that Balmoral did so in the past). The proposed merger will significantly strengthen the merged entity's position in the manufacture of sectional GRP panels, thereby raising the possibility that it would have a significantly increased ability and incentive to embark upon a strategy of raising the input costs of some of its downstream rivals, or simply refusing to supply them.

57. Increasing the costs of certain downstream rivals (or refusing to supply them altogether) could lose the merged entity some sales of sectional GRP panels. However, given that the merged entity will control over half of supply of sectional GRP water tanks, it might expect the majority of such losses to be re-captured through an increased ability to win the underlying installation contract.

58. Some downstream rivals who previously had been supplied with sectional GRP panels by Killarney in the past are now supplied by manufacturers abroad. This indicates that there may be some alternatives to the parties for suppliers who do not manufacture their own sectional GRP panels, although the evidence shows that imports are more expensive than domestically produced panels.

59. The parties submitted that the merged entity would not have the incentive to raise costs or refuse supply to downstream rivals. This is because its profit margins on sectional GRP water tank panels are higher than those on final tank sales.

60. The parties also submitted that the merged entity would not have the ability to foreclose rivals since other options exist for the downstream rivals, such as imported panels or sourcing panels from contract moulders.

THIRD PARTY VIEWS

61. Three large customers were concerned. One told the OFT that the parties are the only manufacturers of hot-pressed GRP tank panels in the UK, and claimed switching to foreign suppliers would increase costs and switching

to producers of hand-lay up panels would mean poorer quality and higher prices. Another large customer said that it was confident of finding alternatives but it was not confident that these would be competitively priced.

62. A third concerned large customer told the OFT that if one of the two merging parties does not win a particular tender, it is usually the other one. It also named its next most competitive option as approximately 10 per cent more expensive.

63. Three small and medium sized customers were concerned by the reduction in competition caused by the proposed merger and by the lack of alternatives to the merging parties.

64. Further, a number of companies which distribute the parties' panels or have done so in the past were concerned about higher prices or the risk of foreclosure of supply.

65. In contrast, the majority of third party customers were unconcerned and felt that they would always have outside options. In some cases customers were able to name other options such as Braithwaite, PFG, Decca and Brimar, that they felt could provide a competitive alternative to the parties. In other cases customers could not name alternative suppliers but were confident that there were other suppliers available.

ASSESSMENT

66. The parties predominately overlap in the supply of glass fibre reinforced plastic (GRP) tanks. The OFT has assessed this proposed merger on the basis of one piece GRP water tanks and sectional GRP water tanks separately. For one piece tanks the appropriate geographic scope was found to be the UK, while for sectional tanks it was found to be the supply to the UK taking into account domestic suppliers using imported sectional GRP panels.

67. The OFT does not consider that the proposed merger raises competition concerns in regard to one piece GRP water tanks. The increment is small, a number of sizeable competitors will remain after the proposed merger and, in the main, third parties were not concerned about the proposed merger in regard to one piece GRP water tanks.

68. In regard to sectional GRP water tanks, the parties are by far the two largest suppliers in the UK. After the proposed merger, they will account for [40-60] per cent of the supply of sectional GRP water tanks in the UK (with an increment arising from the proposed merger of around [15-35] per cent) while all of their competitors account for less than [5-20] per cent each (most account for less than [ ] per cent). All of the evidence indicates that the parties are each other's closest competitor.

69. It may be the case that a number of existing competitors or entrants could collectively expand output in order to offset the loss of Balmoral which would occur as a result of this proposed merger. However, the OFT is not convinced that the threat of expansion by existing rivals supplied through imports or producing domestically would prevent the parties increasing prices to customers given the price differentials of imported materials and the ability and speed of existing competitors or new entrants to replicate Balmoral's network of sales representatives and relationships with key clients.

70. The OFT also indicates that if some customers do possess countervailing buyer power it is only a minority of customers who would not be able to protect other customers from price increases as a result of the merger.

71. Given its conclusion on the horizontal aspect of the proposed merger the OFT has not found it necessary to reach a view as to whether the proposed merger would enable the merged entity to foreclose downstream rivals by either refusing supply of sectional GRP water panels or increasing the cost of them.

72. Consequently, on the basis of the evidence before it, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

UNDERTAKINGS IN LIEU OF A REFERENCE

73. Where the duty to make a reference under section 33(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the

substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.

74. The OFT has therefore considered whether there might be undertakings in lieu of reference which would address the competition concerns outlined above. The OFT's guidance states that 'undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation'.[6]

75. By way of undertakings, Killarney offered to [ ]. The OFT does not believe that such a remedy is clear-cut as it does not suitably address the OFT's horizontal concerns which form the basis for the reference decision. In particular, while it seeks to address rivals' foreclosure concerns, it does not restore a player comparable to Balmoral to the market and does not therefore address the direct loss of competition between the merging parties. Even if the merged firm is obliged to supply rivals in a fair and reasonable manner, this does not provide clear-cut assurance that such as remedy will defeat a price increase: Killarney has the ability an incentive to inflate the input costs of rivals to ensure they cannot realistically undercut the merged firm's higher prices. This concern alone renders the remedy unsuitable for undertakings in lieu, before considering the enforcement and monitoring costs of a regulatory remedy of this nature.

DECISION

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

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[6] Mergers: substantive assessment guidance, OFT516, May 2003, paragraph 8.3