

6 Views of Pentre Askern

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Introduction

6.1. This chapter summarizes the views of Pentre Askern provided to us in written submissions and at an oral hearing. We use the term ‘drums’ to cover both drums and reels.

Summary

6.2. Pentre Askern provided background and a summary of its position. The background to the joint venture is set out in Chapter 3.

6.3. Pentre Askern summarized its position by saying that the market was highly competitive and the implementation of the joint venture would not give it any opportunity to raise prices, reduce quality of products or service, or prejudice the interests of customers or suppliers. Pentre Askern said that it would remain subject to a range of competitive constraints and that these were:

- (a) A high proportion of drums were now recycled and reused and there was scope for further reuse.

- (b) Barriers to entry were minimal; and UK-based competitors were increasing their capacity and range of products.
- (c) Overseas producers of drums were actively competing for UK orders, and there was significant import and export activity.
- (d) Alternative methods of packaging cable and wire were proving increasingly popular.
- (e) Customers for drums had enormous countervailing purchasing power.
- (f) UK cable and wire manufacturers could also manufacture their drum requirements in-house.
- (g) UK and overseas competitors had entered the UK market and were providing increasing price competition.

6.4. Pentre Askern said that the demand for drums was influenced by overcapacity in the European cable industry. Prices for cabling had been falling, leading to demands for reduced packaging costs. Rationalizations and acquisitions within the cable industry had resulted in a small number of major international cable groups. Purchasers of cable and wire within the UK (many of which were new privatized utilities with no particular commitment to sourcing from the UK) were under pressure to reduce costs and looking to source on as competitive a basis as possible, including importing cable from overseas. The growth in cable imports had led to more overseas drums entering the UK market and, as a result, drum manufacturers in the UK had lost business and been pressed by customers for price reductions. The formation of the joint venture had therefore been necessary to cope with the increasing demands of cable producers seeking better value from their packaging suppliers, and to enhance the competitiveness and safeguard the future of the businesses in the face of increasing competitive pressure from UK and overseas suppliers.

6.5. Pentre and Askern had had combined turnover in the year ending 31 March 2000 of around £60 million. In contrast, most of their customers were very large multinational wire and cable manufacturers with the ability to require supply to a price. Drums were cheap commodity items whose manufacture required no particular technology or know-how. Pentre Askern said that customers had sought to find ever cheaper forms of packaging for cable and wire, and prices of drums had declined in real terms.

6.6. The historical market share enjoyed by Pentre and Askern particularly for timber drums had been substantially eroded. The size of the market for new drums had decreased and Pentre and Askern had faced increasing competition and pressure from other UK suppliers, overseas suppliers, the second-user market, customers' in-house production facilities and alternative packaging solutions. The creation of the joint venture had, therefore, to be seen as predominantly defensive. There would be no opportunities to exploit Pentre Askern's market share; but it was hoped that cost savings, expected to amount to around £[\$] annually, and rationalization would turn declining fortunes into opportunities to respond to European-wide market trends, reduce overcapacity and increase investment in product development and value-added services which in the longer term would be to the benefit of customers.

6.7. Over the last two years, there had been a significant erosion of the parties' profitability. Askern's profits had halved. Pentre's profits had been supported by the selling of process drums, which were supplied on a wider geographic base, to 50 countries. It would be desirable for the joint venture to widen the geographic base within which packaging drums were supplied; for example, there was demand in Indonesia, Scandinavia, Spain and Eastern Europe.

6.8. Pentre Askern no longer had customers committed to manufacturing their products in the UK. The customers were sourcing on a European and worldwide basis; for example, Pirelli was setting up a central purchasing division within Europe. Reuse of drums within the UK was in its infancy and was increasingly displacing sales of new drums. The proportion of reused product would continue to grow. Customers wanted more services and were ready to encourage and support competitors to Pentre Askern.

Jurisdiction

6.9. We asked Pentre Askern if the conditions to which the joint venture was subject had been fulfilled, and when. Pentre Askern stated that there had been two conditions:

- (a) a requirement that Locker's shareholders approve the transaction at a general meeting: this had been fulfilled at an EGM on 31 March 2000; and
- (b) satisfaction of conditions precedent contained in a credit agreement and an invoice discounting agreement. This had been satisfied on 4 April 2000.

The details of the joint venture agreement are described in paragraphs 3.80 to 3.113. Pentre Askern stated that, in its view, it had a share of 72.5 per cent of supplies of new cable drums and therefore the share of supply test in the Fair Trading Act 1973 was satisfied.

Industry background

6.10. Pentre Askern gave us details on the background to the drums industry. It told us that the production and supply of drums was heavily dependent on the cable and wire producers and distributors and was directly affected by trends in the cable and wire industry.

6.11. In response to problems of overcapacity in recent years across Europe as a whole, there had been rapid consolidation within the cable industry, not only in Europe but globally. In the last 12 to 18 months especially, there had been several major closures, rationalizations and acquisitions which had substantially reduced the number of cable plants and consequently reduced demand for drums (see paragraph 4.25).

6.12. Pirelli had recently announced its acquisition of the UK cable operations of BICC, which had been investigated by the European Commission on the grounds of concerns about its impact on the market for cable and wire. Pirelli had been the largest customer of both Askern and Pentre, and BICC had also been a major Pentre customer.

6.13. Concentration and restructuring in the cable industry was likely to continue, not only among the larger cable groups, but also among second-tier and third-tier cable suppliers. The cable industry's requirements for wooden drums in the UK had declined. A relatively small number of major international cable producers now accounted for the bulk of purchases of drums in the UK, with the ability to exert considerable purchasing power.

6.14. Overcapacity in the cable industry had led to strong pressures on cable prices. In certain sectors, particularly low-commodity cabling, prices had been falling in real terms. The cable producers, in turn, were exerting strong pressures on their raw material suppliers, including suppliers of drums, to reduce prices and improve efficiencies.

6.15. Major UK users of cable, such as the electricity and telecommunications utilities, were sourcing an increasing volume of cable from overseas. According to CRU International, a consultancy specializing in analysis of the cable and wire markets, cable imports had grown from 98 million euros in 1991, representing 26 per cent of UK consumption, to 381 million euros in 1999, representing 44 per cent of UK consumption. The sustained strength of sterling made imports particularly attractive to UK cable users. Imported cable and wire would be packaged on locally produced drums, thus reducing demand for UK drums. Furthermore those imported drums would then be frequently reused within the UK supply chain, thus even further reducing requirements for new drums from local UK suppliers.

6.16. In view of these developments, the UK cable producers were constantly looking for ways to reduce their cost base when procuring products and services. They expected their suppliers to reduce prices and invest further in innovation and product development. Pentre Askern gave examples of how its customers indicated that they expected prices of drums to be reduced; details are given in paragraph 4.77.

6.17. More generally, most cable producers were insisting on significant, year-on-year price reductions from their suppliers. The cable drum suppliers had no choice but to reduce prices if they were to retain the business of their customers.

6.18. Apart from developments in the cable industry, other long-term trends had affected the UK drums operations of Askern and Pentre. These were as follows:

- (a) There was increasing interest on the part of overseas drum manufacturers in securing orders in the UK market (see paragraphs 6.46 to 6.48).
- (b) New suppliers of drums had considerable ease of entry. Before the merger, Askern and Pentre had been facing increasing competition from recent entrants into the market such as YCD, CDR and PKR.
- (c) Some European cable manufacturers produced their own drums on the Continent and AEI did this in the UK; any cable manufacturer could establish or re-establish in-house drum production operations.
- (d) The reuse of drums was growing. Currently over half of steel and two-thirds of wooden drums were being reused, at a cost much less than the price of a new drum.
- (e) Import substitution of cable was significantly reducing demand for new UK produced drums, and the reuse of drums imported with the cable was further depressing sales of UK drums.
- (f) Alternative methods of packaging cable and wire competed with drums.

6.19. Pentre Askern said that in view of the pressure on the businesses, there had been a substantial decline in drum prices in recent years. We asked how prices were determined; Pentre Askern said that it agreed prices with individual customers but there was not great variation for similar products, although prices were negotiated in the light of trading conditions. Pentre Askern said, further, that the decline in demand for drums had led to significant overcapacity, particularly in the supply of wooden drums. Each of the former Pentre and Askern had significant levels of excess capacity at the UK plants.

The joint venture

6.20. Pentre Askern told us that developments in the market place had prompted the parties some time ago to discuss a merger of their respective businesses in order to allow them to reduce costs, invest in product and service development and improvement, and maintain and improve price competitiveness. The parties had concluded that a merger of the two businesses was essential in the light of prevailing market conditions. On 14 March 2000, the parties announced the formation of a joint venture which would combine the Askern and Pentre businesses in the manufacture and supply of drums. Pentre Askern told us that the commercial sense of proceeding to a joint venture had become ever more apparent since initial discussions. Askern's trading profits had virtually halved in the last 12 months. Had the joint venture not gone ahead, severe rationalization of resources would have been necessary. Pentre might have had to exit from UK timber drum-making where significant losses were being incurred and Askern might have had to withdraw from the manufacture of steel drums. Pentre had also acquired a steel drum manufacturing facility in the Czech republic because Pentre's steel drum-making capacity in the UK was under pressure from the price of steel and the strength of sterling.

6.21. We asked how the joint venture agreement was intended to work in practice. Pentre Askern said that the shareholding split of 51 per cent to Locker and 49 per cent to Sylvan had been negotiated in the light of the balance sheets and profitability of the parties. Also, Pentre was more highly developed with regard to drum management services, which were in demand in the industry, and therefore would be able to lead on the development strategy. The shareholders' agreement stated that Locker had the right to choose four of the six directors; three of their appointees were Locker directors or employees; the fourth, although currently a Sylvan director, would be the Finance Director of Pentre Askern and would not act for Sylvan when on the board of the joint venture. In effect, although the agreement gave management control to Locker, there was reasonably equal representation from both sides. Ultimately, Locker would have the final say except on matters which required the agreement of both Locker and Sylvan.

The definition of the market

The products

6.22. Both Askern and Pentre had been involved in the production and sale of packaging drums. Pentre, but not Askern, had also manufactured process drums. In the view of Pentre Askern, process drums were not part of the same market as packaging drums, since their application and technical requirements were quite different.

6.23. Before the merger, both Pentre and Askern had produced in the UK drums made of steel, wood, plywood and cardboard. The choice of material for a drum or reel depended upon: the length and weight of the cable to be transported; the customer's preferences, including environmental considerations; and the possibility of reuse. Pentre, but not Askern in the UK, also produced plastic moulded drums. Drums could also be produced using composite materials, such as chipboard and fibreboard.

Competition analysis

6.24. Pentre Askern stated that, for the purpose of competition analysis, the relevant market was the narrowest description of products within which a hypothetical profit-maximizing sole supplier of goods or services would impose a small yet significant and non-transitory increase in price, assuming all other terms of sale remained constant without buyers switching to another product. Typically, this increase was considered to be between 5 and 10 per cent. In the event that buyers reacted to such a hypothetical price increase by switching their custom to the suppliers of other goods or services, those goods or services should be included in the same product market as the goods or services in question.

6.25. Pentre Askern went on to state that the key determinant of the goods or services dimension of a market was substitutability in demand or supply. The greater the extent to which one good or service was substitutable for another, the greater the likelihood that they were bought and sold in the same market. The technical viability of one good or service as a replacement for another must also be assessed, as must relative prices, quality and performance.

Demand-side substitutability

6.26. Pentre Askern stated that an assessment of demand-side substitutability required consideration of the alternatives available to purchasers of a particular good or service. Consideration therefore needed to be focused on each of the different types of drums, on alternative, reel-less, technologies, and on the reuse or recycling of drums.

● *Different types of drums*

6.27. Pentre Askern provided information about the relative prices and sizes of different types of drums; this is discussed in paragraphs 4.3 and 4.35.

6.28. Prices of comparable drums of different materials differed from each other; however, customers chose products on the basis not just of price but also of reusability. More expensive drums made of steel or wood might be cheaper in the long term because of their potential to be reused. The cable producer was frequently faced with the choice of investing in a new drum or reusing an old one, and furthermore the presence of substantial stocks of used drums constrained the price of new drums. Consequently, new and reused drums were competing alternatives and should be regarded as part of the same product market.

6.29. There was often a degree of overlap in the sizes and load capacities of each type of drum, which provided manufacturers of cable with a choice between wooden and steel drums or wooden and plywood, or plywood or cardboard, or plastic drums. Recently the manufacture of skeletal steel drums had provided customers with the option of switching from timber drums, subject to appropriate modification of their equipment. It was also likely that some customers would switch to using wooden drums with steel rims which required minimal repairs.

- *Reel-less technologies*

6.30. Alternative, reel-less, technologies were increasingly replacing the drums, particularly smaller drums, and the cost could be well under half that of an equivalent drum. However, the cost of the initial investment in reel-less machinery could be between £100,000 and £1 million. This large variation in price reflected the range of technologies available and whether the appropriate machinery functioned as part of a cable production line.

6.31. Once a customer had switched to reel-less technology, that customer was unlikely to return to using conventional drums. Typically, manufacturers who had high drum use were investing in new technology, influenced by customer demand for presentation of the final product, particularly in a retail context, and also environmental considerations.

6.32. As the onus increased on cable manufacturers and buyers of cable to reduce packaging waste so did the demand for novel packaging methods. Reel-less technology for packaging cable and wire typically resulted in 20 per cent less waste packaging than the use of drums.

6.33. Pentre Askern gave examples of a number of customers using reel-less technology and also gave examples of 20 machines at the premises of its customers using reel-less technology. We asked if either Pentre or Askern had been involved in manufacturing reel-less products; Pentre told us that its company Meltech, which was not part of the joint venture, produced despatch-winding equipment that included some winding and coiling operations.

6.34. Pentre Askern gave us information about two manufacturers of reel-less systems, Reelex and Skaltek. Pentre Askern estimated that the number of Reelex packages sold to the UK market had grown from 546,000 units in 1995 to 1,900,000 in 1999. At recent exhibitions of suppliers to the cable and wire industry, Skaltek had exhibited a coiling system using shrink-wrapped plastic to replace a reel. This method was now standard in mainland Europe and other countries for manufacturers producing small lengths of cable. Pentre Askern provided us with copies of a number of advertisements relating to reel-less systems which indicated that coiling products were being marketed as an alternative to drums.

- *Reuse of drums*

6.35. Concerning the reuse of drums, there was a strong and growing trend towards reuse, in part reinforced by the European Directive on packaging and packaging waste, which required businesses handling packaging to recycle specified amounts of packaging waste. The relevant EC Directive was Council Directive 94/62/EC of 20 December 1994, implemented in the UK by Regulations in 1997 (SI 648) and 1998 (SI 1165). Pentre Askern stated that Askern and Pentre were manufacturers of packaging materials and their customers were packers, as defined in the Regulations. The Regulations did not take full effect in the UK until 31 December 1999 and, accordingly, had not yet made a significant impact on the drums and reel industry. However, it was anticipated that Pentre Askern's customers were likely to much increase their reuse of drums in the future.

6.36. The degree of reuse of the various types of drums varied considerably, depending partly on the different lifetimes for different types of drums, which varied from 20 years for steel to a single trip for cardboard.

6.37. A number of factors influenced the degree of reuse:

- (a) the return rate from the end-user, which could be improved by drum management systems;
- (b) the cost of recovering drums relative to the cost of new drums;
- (c) the extent of damage to drums and the consequent repair work that had to be done: most repair work was straightforward carpentry and the typical repair (where repair was required) of a timber drum cost £[\$] in comparison with the new cost of a 2-metre drum being £[\$];

- (d) environmental concerns and costs: legal restrictions on burning or dumping drums were now more extensive; and
- (e) the construction of the drums: different construction types had significantly varying lifetimes (see paragraph 6.36).

6.38. A key factor in a cable manufacturer's decision as to which type of drum to specify was the return and damage rate and, accordingly, the manufacturer's ability to reuse the drum. If there were a high degree of loss, manufacturers would use the cheapest drum available. If return rates were high, then investment in better-quality drums made more sense.

6.39. Both Pentre and Askern had provided a drum management service for certain customers, arranging for: collection of used drums; repair and refurbishment; management of stock; and delivery to the cable producer. Those operations could be run from the customer's own premises or from a yard and workshop; the repairs were typically simple carpentry.

6.40. The provision of drum management services was not tied in any way into the provision of new drums or reels. Typically, drum management services were agreed separately from the tendering for the supply of new drums. Formal agreements or contracts were not common. Customers often used one supplier for drum management services and another for new drums.

6.41. One of Pentre's large customers had reduced its purchases of new wooden drums from £[\$] to £[\$] annually, simply through the greater reuse and management of its existing drum stock over a two-year period when new timber drum prices had been declining in real terms and when the cable business of the customer had been increasing. There was considerable scope for other customers improving their drum return rate and use of recycled drums. Steel drums were reused, but not managed by outside contractors; plywood drums had scope for being reused.

6.42. In broad terms, Pentre Askern estimated that there were sales of 100,000 new wooden drums a year in the UK and that the total number of wooden drums in the drum pool was between 500,000 and 1 million. The size of this pool relative to the amount of sales of new drums indicated that even a slight increase in the reuse of drums could lead to a considerable resulting drop in new drum sales. Recycled drums exercised a formidable competitive constraint on the pricing of new drums.

6.43. There was some limited buying and selling of second-hand drums. However, there was little history in the UK of drums being hired, unlike in Germany where KTG, owned by Alcatel Cablenet Ltd and Siemens, had a very extensive drum rental business.

Supply-side substitutability

6.44. Pentre Askern submitted that supply-side substitutability involved an assessment of those parties which did not currently supply the good or service in question, but which could readily switch their production to do so. That switching could be between products and between countries. It was necessary to focus on the availability of imports, costs of entry, and barriers to entry. All these factors constituted significant price constraints for any party competing in the drums sector.

6.45. Although Pentre Askern submitted that there was one market for cable, wire and rope packaging, it considered that it was appropriate to consider supply-side substitutability with particular reference to each of the four different drum and reel types supplied by Pentre and Askern before the merger.

6.46. Concerning steel drums, many steel fabrication companies had, over the years, produced drums; little specialized equipment or knowledge was required and there were virtually no barriers to entry. Pentre Askern gave us a number of examples of such steel fabrication companies which, it said, had previously taken business from Pentre or Askern or forced reduction of prices. As to overseas suppliers, they would have no difficulty in manufacturing to UK specifications, and transport costs from European countries would be approximately [\$] per cent of the cost of the drum, and less if drums were flat-packed. A recent example of competition from imports had occurred with Pentre's largest timber drum customer which had switched to imported steel drums for the supply of a large export order to

Asia. In recent times, there had been significant imports of specialist steel drums from countries such as the USA and Brazil for the offshore oil industry, with a total value of as much as £2.1 million. Pentre Askern estimated that as much as 38 per cent of UK new sales of steel drums, by value, were from imports.

6.47. As to timber drums, Pentre Askern gave us information about other manufacturers (see paragraph 4.12). Overseas suppliers faced no impediments; costs could be kept to a minimum by importing flat-packed drums. Pentre Askern said that incremental transport costs were approximately [%] per cent of the ex-factory price of the drums. Many overseas suppliers had a lower cost base than UK suppliers, due to the ready availability of raw materials, particularly timber, in countries such as Russia, Estonia, Finland, the USA, France and Germany. The comparative strength of the pound also contributed to lower costs. Several overseas companies had recently been tendering for UK business in wooden drums; one of Pentre's customers had recently obtained prices for timber drums from a German manufacturer and, with plans for local assembly, had put pressure on Pentre to achieve a price reduction. The German company had used a representative who had previously worked for Askern. The German industry's drum pooling organization, KTG, which was owned by the major European cable manufacturers (see paragraph 6.43), was known to have substantial stocks of wooden drums in Germany, and had approached Askern with a view to establishing a wooden drum rental system in the UK. KTG had also previously approached one of the major cable companies to offer to supply it. It was likely, therefore, that in due course KTG would enter the UK market, providing a drum hire system. As to barriers to entry, start-up costs could be as low as £100,000, and the equipment required was standard woodworking equipment and a nailing machine. Suppliers could also import components from overseas manufacturers for assembly into drums in the UK.

6.48. Concerning plywood drums, Pentre Askern gave us information about several competitors. Plywood drums were often shipped in flat-pack form and were easy to transport. Although current levels of imported plywood drums appeared low, those levels did not include the imports of plywood circles which were assembled locally into drums. A number of overseas suppliers of plywood drums had recently shown interest in quoting for UK contracts. Barriers to entry were very low as the manufacture of plywood drums required only general purpose woodworking equipment.

6.49. As to cardboard drums, Pentre Askern gave examples of other suppliers and stated that companies manufacturing corrugated packaging had seen an opportunity to diversify and could easily grow. Although total UK sales of cardboard drums had increased over the last five years as a result of cable being supplied in shorter lengths, it was likely that demand for cardboard drums would decline and that reel-less technology would be used instead. Nonetheless, a recent new entrant, PKR, had already made a competitive impact; there were other competitors also which made cardboard products generally and Pentre Askern said that Askern had recently acquired a small cardboard drum-maker in order to maintain volume in a declining market. As to imports of cardboard drums, these had been limited, although a Polish manufacturer had recently approached UK customers. Barriers to entry were low, as the equipment required was in general use in industries such as printing and box manufacturing, and thus there were no sunk costs.

Geographic market

6.50. Pentre Askern submitted that, in addition to the product scope of a market, its geographic scope required definition. Information on transport and costs had to be assessed; also consideration was needed as to whether products were uniform across geographic areas. We asked why it was that exports were considerable (22 per cent of Askern's drums and 25 per cent of Pentre's) but imports had not been substantial except in the case of steel drums. Pentre Askern said that ten years ago exports had been negligible. Askern and Pentre had decided to pursue exports because they had needed to look for new markets to grow their business in the face of overcapacity in the UK. The profitability of exports was lower than it had been two years ago, prior to the introduction of the euro. Products were exported both in assembled and flat-packed form. The German market had been an attractive market into which to export a couple of years ago; it was now less so because of exchange rate movements. In fact the reverse was now true in that the UK had become more attractive for German and other European manufacturers.

6.51. On the costs of transporting drums from overseas to the UK, see paragraphs 6.46 to 6.47; flat-packing resulted in an overseas manufacturer's costs being little different from those of a UK drum manufacturer who needed to import raw material timber. There was a large supply base for drums

outside the UK. Even the threat of possible imports exerted considerable price constraints on drum manufacturers, as customers frequently used Continental and other benchmarks to demand price reductions. There were no essential any differences in specification between drums required in Europe and overseas and drums required in the UK. There was a history of a significant proportion of drums being exported from the UK and, in the light of these considerations, Pentre Askern submitted that the geographic market for drums extended at least as far as Europe and in some cases beyond. We asked if there were wide variations in the prices of drums in different countries in Europe. Pentre Askern said that it did not believe this to be the case. Apparent price differences were due to differences in transport costs or product specifications. We asked about standardization of drums in Europe. Pentre Askern said that batch sizes of drums in the UK were much smaller than in Europe and demand tended to be for a wider variety of specifications; production lines reflected this. We asked about the feasibility of importing or exporting flat-packed drums which could be assembled by a subcontractor; Pentre Askern said that it already exported drums in this way. There was also the possibility of subcontractors storing drums which were already assembled.

Conclusions on market definition

6.52. Pentre Askern concluded, in the light of the arguments set out in paragraphs 6.26 to 6.51, and having regard to the high degree of demand-side and supply-side substitutability, that the relevant market in which the joint venture competed was the market for products for the packaging and transportation of cable, wire and rope. This included not only steel, wooden, cardboard, plywood and plastic drums, but also alternative packaging methods and technologies. An important aspect of this market was the high, and increasing, degree to which products were reused as an alternative to the sourcing of new products. Reused products should therefore be included in the market definition. Furthermore, while UK customers were currently sourcing those products predominantly from the UK-based suppliers, it was clear that there was vigorous and increasing competition from overseas producers.

Size of the market

6.53. Pentre Askern estimated that, in 1999, the total value of sales of new packaging drums in the UK—that is, excluding drum management revenue—was approximately £34.5 million.

6.54. The value of sales of alternative packaging systems within the total market was estimated by Pentre Askern to be approximately £10 million annually. While drums were still the predominant products in the market, reel-less technologies were making significant inroads in particular sectors.

6.55. As set out in paragraph 6.18(d), cable producers were increasingly reusing drums, particularly wooden drums, for cable deliveries. Many cable producers operated drum management systems, sometimes in partnership with external suppliers, involving the collection and repair of used drums, thus further displacing demand for new product. Reused products represented a cost-effective alternative to new drums and should be taken into account in assessing market size and characteristics. The volumes involved represented a notional sales value of at least £31.8 million.

6.56. Imported drums and reels used to carry imported cable also needed to be taken into account in assessing the size of the market.

6.57. In-house production also needed to be considered; Pentre Askern estimated that the in-house production of one cable manufacturer amounted to £350,000 worth of timber drums annually. Potentially, an in-house producer could supply other cable manufacturers: this had happened in France.

6.58. Pentre Askern provided information on its own and competitors' market shares. Pentre Askern added that, while its share of the supply of new drums and reels—which it put at 72.5 per cent—was high, that did not mean that it did not face competitive constraints.

Competition

General

6.59. Pentre Askern submitted that the fundamental competition concern was whether it would have the ability to increase prices above the competitive level without having regard to the collective impact of a series of competitive constraints. In its view, it would have no such ability and would remain subject to a range of competitive constraints, notably: customers threatening to switch to refurbished drums; reel-less technologies; drum imports; small UK suppliers; new entrants; and in-house supply.

6.60. Pentre Askern strongly submitted that its cable company customers, most of whom were major multinationals, could, in aggregate, switch sufficient sales to alternatives and encourage new entry and expansion, so as to render a hypothetical price increase unprofitable and unattractive. Although the joint venture currently had a high market share of the sales of new drums, it nevertheless faced substantial competitive pressure in the market.

Competition from reused and refurbished drums

6.61. Pentre Askern told us that, over the last five years, UK purchasers had very substantially switched to using recycled and second-hand drums, thus achieving significant cost savings. The cost of recycling drums typically amounted to no more than [\$] per cent of the price of a new drum. In 1999, use of recycled drums made of steel, timber and plastic was equivalent to [\$] per cent (by value) of UK usage of new drums. Recycled plywood drums accounted for [\$] per cent of total usage but there was scope for reuse to increase. Cardboard drums were not reused.

6.62. Unlike other durable products such as cars, there was no question of reused drums becoming technically obsolete, nor did customers have strong preferences for new products over reused products. Pentre Askern believed that if the market price of new drums were to increase by 5 to 10 per cent, demand for new drums would fall by a significantly greater proportion due to customers switching to reused drums. Thus, such a price increase would be unprofitable. The reasons for this belief were:

- (a) It was economical for cable manufacturers to make greater efforts to recover and refurbish drums. With proper management, the most popular sizes of timber drums might be used several times a year over a five-year period. Drum management in the UK was still relatively unsophisticated compared with Germany or Scandinavia. On average, each drum made of steel, timber and plastic was reused less than twice but there was scope for reuse to increase.
- (b) It was cost-effective for cable companies to use refurbished drums. There was a considerable supply of such drums due to cable imports and end-users' desire to dispose of drums.

6.63. The stock of timber drums available for reuse was estimated to be in the region of 500,000 to 1,000,000 as contrasted with sales of 100,000 new timber drums in 1999. Drum reuse had increased over the last five years. New drums' share of total UK usage had fallen by 14 per cent in the case of steel drums and 23 per cent in the case of timber drums, despite the substantial decline in the real price of new drums over this period. This average masked the switching that had occurred at the level of certain individual customers (see paragraph 6.41).

6.64. In 1999, Pentre and Askern together accounted for 43 per cent of third party drum management services, excluding in-house provision by customers. Barriers to entry to drum management services were negligible and entry costs were £10,000 to £20,000. The contestable nature of drum management services was shown by the fact that Askern, which had been the market leader in 1995, had seen its share of drum management services nearly halving from 48 per cent in 1995 to 23 per cent in 1999. Pentre had successfully commenced the provision of these services only in 1997. The current market leader was CDR which accounted for 55 per cent of these services by value.

Competition from reel-less technologies

6.65. Pentre Askern told us that reel-less products were a direct substitute for cardboard, plastic and plywood drums and were promoted by their suppliers as offering cost savings and environmentally friendly features. The 1999 sales of these products, which Pentre Askern believed to be £10 million, compared with total UK sales of new plywood and cardboard drums of £14.9 million. Competition from alternative technologies posed a substantial competitive threat (see paragraphs 6.30 to 6.34).

Competition from overseas producers

6.66. Pentre Askern stated that there were no material barriers to trade throughout Europe. It gave us information about 5 manufacturers of cable drums in Belgium; 8 in France (besides Askern); 13 in Germany; one in Holland; 6 in Italy; 2 in Portugal; 7 in Spain; 6 in Sweden; and 1 in Switzerland. Pentre Askern stated that, although its UK market share was high, it nevertheless faced international competition (see paragraph 6.51). Over recent years, Pentre and Askern had maintained export sales by accepting lower margins and introducing substantial cost cutting through better material purchasing and local assembly operations. More generally, there was very considerable trade in comparable wooden, plastic, cardboard and steel products.

6.67. Direct imports of drums were at a relatively low level but the threat of imports had affected prices. As a result, there had been a substantial decline in UK prices in recent years, and Pentre and Askern had had to reduce prices significantly to retain business. Other European manufacturers were generally local businesses which had previously been satisfied with their home markets, and, as a result of a decline in domestic business, were now looking more to exports.

6.68. Pentre Askern gave us examples of competitive threats posed by imports (see paragraph 6.47). The fact that importers might not be successful at present did not undermine the price pressure exerted on Pentre Askern.

Competition from existing UK suppliers

6.69. Pentre Askern strongly submitted that its market share provided no guide as to the threat posed by existing small suppliers or potential new entrants (see paragraphs 6.18(b) and 6.46 to 6.49). As customers would still traditionally look for two suppliers, this would continue to encourage the smaller manufacturers. We asked how important it was for suppliers to be able to supply the full range of drums and reels. Pentre Askern said that UK competitors at the moment tended not to supply the full range, but it believed that competitors were looking to extend their range of products; for example, CDR had moved from drum management into the supply of both wooden and steel drums. Marlin Industries, which owned both CDR and Cable Reels, was capable of supplying steel, timber and plywood drums as well as a full range of services. Customers which bought more than one type of drum did not necessarily buy all types from Pentre Askern. Furthermore, supply arrangements were often highly localized: particular sites, for example Knowsley, supplied particular customer sites, through individual historical arrangements. Pentre Askern estimated that approximately 28 per cent of its customers bought more than one type of drum from its range.

Buyer power and in-house supply

6.70. Pentre Askern stated that, for each of Pentre and Askern before the merger, the majority of sales of UK drums of specific materials were made to only ten customers. Those customers enjoyed very considerable countervailing buyer power. They were able to switch to alternatives; could play off existing suppliers against one another; could 'king make' by awarding major contracts to new or small suppliers; and could produce drums in-house. Major customers in the UK had manufactured their own wooden drums in the past. The top five UK wooden and steel drum customers made purchases of sufficient scale such that a dedicated production facility would be a cost-effective alternative to buying drums from Pentre Askern. We asked if, before the merger, each of Pentre and Askern had been the main competitor to each other. Pentre Askern said that that was generally true, although only 40 per cent of products had overlapped before the merger, and there was also active competition from a range of other

UK and overseas suppliers. Other competitors were increasingly in evidence (see paragraph 6.18(a) and (b)). There had been instances of success by determined new entrants, sometimes as a result of pricing which was not permanently sustainable. These new entrants had tended to be encouraged by customers both with finance and with orders. This competitive situation would not change as a result of the merger.

6.71. It followed that the joint venture's sales would collapse if it were to seek unjustified price increases. Where customers had bought ranges of products from both Pentre and Askern, their leverage was yet further increased as they could threaten to reduce the purchases of one product in order to force down the price of another. Accordingly the creation of the joint venture would not have detrimental effects on UK customers or end-users, or give rise to any other public interest issues. Pentre Askern added that written price contracts were rare, but where they did exist, they typically contained clauses about meeting competition, which meant that customers could force down prices to any lower price that they had been offered. Customers themselves were typically under pressure from end-users of cable who demanded constant cost reductions.

6.72. We asked if it were possible that the joint venture could maintain aggressively low prices for long enough to put new competitors out of business. Pentre Askern submitted that this was highly unlikely, for the following reasons:

- (a) The presence of competitors had been sufficient to cause the parties to reduce their prices.
- (b) Pentre Askern had actually recently lost a number of its sales to one of its competitors.
- (c) Prices had declined because of pressure from customers.
- (d) The joint venture was subject to strong shareholder and financial discipline and would not have sufficient economic power to sustain a pricing policy aimed at excluding competitors.

Benefits of the merger

6.73. Pentre Askern stated that the merger had been necessary to cope with demand for greater value from cable producers, and to safeguard the competitiveness of the businesses of Pentre and Askern Group. Pentre Askern listed the synergies and benefits which were expected to result from the merger and these are set out in paragraphs 3.98 to 3.113. It said that reorganization and rationalization of manufacturing activities would eliminate duplicated resources and reduce overcapacity. Some cost reductions would be achieved by purchasing raw materials on a larger scale and these would make it possible to increase investment in product development and innovation. Resources would also be focused on value-added service initiatives for customers. Overseas development would be assisted by a more integrated sales and support network and export operations could be more easily promoted.

6.74. Pentre Askern saw its business as making a transition from a commodity-based product offering to a commodity- and service-based offering. Services that the joint venture could offer its customer base were those such as cable-cutting, distribution, and waste management and recovery. While Pentre had developed drum management services, Askern had many physical locations in Europe. New possibilities were arising for the joint venture, for example recovering waste from the regional electricity companies. As a result of these developments, Pentre Askern was likely to set industry standards which its small competitors and, indeed, its customers would follow.

6.75. Customers were likely to enjoy even lower prices through the service initiatives described in paragraph 6.73 which were designed to give lower costs per drum trip; and that process would happen more quickly as a result of the merger. Customers' assets tended to be underutilized and cable manufacturers needed to reduce their own costs as a result of pressure from the deregulated power and utility companies. The merger would contribute to keeping unit prices as low as possible. Pentre Askern expected that its greater size would enable it more readily to service multinational cable companies such as [\$] and others. It added that Askern had already been providing drum management services for European customers.

6.76. Pentre Askern further said that its decisions on rationalization would be affected by developments in its customer base; for example, if the merger between Pirelli and BICC led to relocation of cable manufacturing sites, this could have implications for the location of Pentre Askern's sites. Given that large customers tended to want two suppliers, it was also likely that other competitors, both in the UK and in mainland Europe, would be fostered for drum management services. Pentre Askern itself was looking to develop its just-in-time drum management services for certain mainland European customers.

6.77. We asked about purchasing synergies. Pentre Askern said that some benefits would be likely in the purchase of cardboard by the joint venture. The joint venture would have access to timber from MLM (see paragraph 3.89) but, in reality, Pentre had secured a lower average price of timber than Askern prior to the merger. On the question of loss of jobs, Pentre Askern said that inevitably there would be a significant reduction in the numbers employed in the UK, although the bulk of any reduction was likely to have happened as a result of the measures which the parties would have had to take in reducing capacity if the joint venture had not proceeded.

Possible remedies

6.78. We asked about possible remedies on the hypothetical basis that the merger might be found to be against the public interest.

Views of Pentre Askern on possible remedies

6.79. We asked Pentre Askern about hypothetical remedies concerning the freezing of prices and maximum prices (see Appendix 2.1). Pentre Askern gave us comments on the basis that (a) the remedies were intended to relate exclusively to its sales of new drums and would not affect drum management services, buying and selling of used drums, or the provision of drum rental services; (b) there was no question of the joint venture having any adverse effect in relation to the supply of new plastic reels, in relation to which only Pentre was active. Pentre Askern also stated that any price controls should exclude drums exported overseas.

6.80. Pentre Askern said that the price freezing model would be disproportionate and wholly undesirable in that it would hinder competition and would be contrary to customers' interests because it would not allow response to particular circumstances.

6.81. As to the practicability of the proposed price remedies, Pentre Askern made the following points:

- (a) Price caps for specific customers might be an appropriate and proportionate remedy.
- (b) In the light of what appeared to be the CC's concerns, Pentre Askern submitted that any price cap controls should focus solely on specified customers who buy smaller quantities of specified types of drums.
- (c) As prices to different customers would have been negotiated at different points in time, a base line price could benefit some customers over others, depending on when prices were last agreed. This problem could be resolved if Pentre Askern were permitted to give additional price cuts to individual customers to reflect such considerations without being required to offer identical price cuts to all customers.
- (d) Price undertakings needed to reflect the very wide range of individual drum sizes, specifications, and types, which were made to the customer's order.
- (e) Price differences needed to reflect costs, for example, of serving customers and therefore proposed price increases would need to be objectively justified in writing both to customers and to the OFT.

- (f) If prices were to be fixed, they should be fixed in real rather than nominal money terms. Any price cap should allow for a reasonable increase in line with inflation.
- (g) Prices would need to be varied in line with raw material costs. This could be done retrospectively or prospectively. However, in practice only the option of retrospective price variation would be workable. Published price indices might be useful, where they existed (see paragraph 6.85).
- (h) A price cap for one year should be more than sufficient.
- (i) Any implied obligation to supply should be made subject to circumstances such as availability of product, creditworthiness of the customer, force majeure events and other changes in circumstances.
- (j) If the CC believed that a price remedy was necessary, Pentre Askern was of the view that only the price cap remedy, that is, the setting of maximum prices, would be workable, provided it was limited in the ways indicated above.

Views of Pentre Askern on a number of other possible remedies

6.82. We subsequently invited views on a number of other possible remedies (see Appendix 2.1). Pentre Askern made the following points:

- (a) Any remedies should be applied only if there were substantive evidence of adverse effects; they should be proportionate; they should be workable and flexible; and they should be designed so as not to impose undue cost or burdens on Pentre Askern or third parties.
- (b) In Pentre Askern's view, prices had been in steep decline in this market. Large customers accounted for over half of the parties' combined sales of timber, plywood and cardboard drums. The major purchasers in the drum market had considerable buyer power and ample scope to increase competition. There was also no prospect of the joint venture leading to discriminatory price increases for small purchasers. These small purchasers were nevertheless major companies with sophisticated procurement functions, and substantially greater resources than Pentre Askern. Any attempt by Pentre Askern to impose price increases would trigger procurement reviews. Pentre Askern faced considerable competition in supplying smaller accounts, particularly from smaller suppliers such as YCD.
- (c) Pentre Askern further submitted that unsustainable discriminatory price cuts were not possible. Pentre Askern said that it rejected any hypothesis that it could either selectively target the customers of smaller competitors with a view to forcing their exit or otherwise deterring them from competing; and that no evidence had been provided by the CC to support such concerns. As to Askern's cut in the price of timber drums to Draka in response to significant price cuts offered by a new entrant, YCD (see paragraph 4.72), Pentre Askern said that the margins made on sales to Draka were virtually the same as those made on sales to Pirelli and some difference in margins was inevitable given that prices had generally fallen since the Pirelli contract had been concluded. In any event, YCD was now a major supplier of timber drums to Draka.
- (d) Pentre Askern further submitted that there was no scope for the parties to respond to rivals' price cuts by selectively cutting prices to certain customers; the rivals would simply approach other customers of the Pentre Askern group. In addition, it was clear that prices were generally being renegotiated across the market as a result of competition from a variety of sources. None of the suppliers which had forced the main parties to cut prices had ceased to operate. In any event, sacrificing current profits by making unsustainable price cuts was a very costly and risky strategy because future profits would need to exceed the profits sacrificed for such a strategy to be profitable and the supplier in question would need to be very confident that profits sacrificed could be recouped.

- (e) In Pentre Askern's view, a price cap undertaking applying to individual small purchasers addressed the CC's concerns in relation to possible adverse effects. Any cap on prices should be carefully and precisely focused and should apply only to specified smaller customers of specified types of drums (see paragraph 6.81(b)). Pentre Askern considered that a price cap remedy would also deter unsustainable, loss-making price cuts: such behaviour was, by definition, profitable only if losses were more than recouped by future price increases. The price cap would limit any price increases to the pre-merger level for the customers in question and prices to other small customers would be strictly capped.

6.83. As to other possible remedies, Pentre Askern considered that publishing details of orders on a web site would be ineffective, costly to implement and would not serve customers' interests. Publication of prices would be ineffective owing to wide variation in product sizes, specifications, volumes and transport costs. As an example, if prices and margins for identical sized timber drums supplied to Draka and Pirelli were considered, Pirelli's timber drum was 19 per cent more expensive but this difference was due to differences in production costs due to specification differences and the difference in sales margin was only 1.7 per cent. Customers sought delivered prices and transport costs alone would justify significant different prices between orders. There were few comparable orders and comparing prices for various small orders could not reveal whether small orders were generally too expensive. The much easier way for customers to assess whether they were securing good value for money was to compare the prices offered by other suppliers.

6.84. Pentre Askern further submitted that it would be costly to set up such a web site and Pentre Askern would be uniquely disadvantaged against its competitors if it were compelled to publish detailed pricing information. Pentre Askern believed that customers would also be concerned by such an undertaking because it would be difficult not to reveal their identities and customers' ability to negotiate price cuts could be undermined.

6.85. As an alternative, if the CC considered that customers needed more information to judge whether any price increases were justifiable, Pentre Askern would be willing to publish on a web site an index of quarterly data on raw material costs for each type of product, with the base being March 2000, and thus customers could identify easily trends in raw material costs. Pentre Askern said it would also be willing to publish a similar quarterly index of wage costs. Index numbers published should be based where possible on external data rather than Pentre Askern's internal confidential cost data, as this would avoid any auditor verification costs and would provide the parties with an incentive to 'beat' the external index.

6.86. As to the hypothetical remedy requiring the maintenance of price cuts, Pentre Askern submitted that this remedy was not required as the price cap remedy was sufficient to prevent the recoupment of any losses which would deter unsustainable price cuts (see paragraph 6.82(e)). Pentre Askern said that the new Chapter II prohibition of abuse of a dominant position under the Competition Act 1998 was a sufficient deterrent against the speculative possibility of future anti-competitive behaviour. In the light of the Act, Pentre Askern had instructed its lawyers to compile a competition law compliance programme. The Chapter II prohibition was a far more appropriate remedy because it enabled the OFT to focus on the actual market effects of Pentre Askern's behaviour as the market developed, rather than implementing an inflexible behavioural remedy which prohibited certain conduct regardless of its actual effects.

6.87. Pentre Askern said that any remedy requiring the maintenance of price cuts needed to allow for legitimate competitive initiatives. The period of the undertakings would need to be proportionate to the potential adverse effects identified and a period of one year ought to suffice. Pentre Askern was concerned that a lengthy period of three years would severely hamper its ability to compete in the market-place. It was very unlikely that any profits sacrificed through unsustainable price cuts would be recouped if price increases were to be limited to pre-merger price levels, adjusted for increases in costs (for example, raw material costs, inflation and the cost of specification changes). Pentre Askern proposed that any undertaking should not apply to percentage price cuts which did not exceed price cuts which had been applied in relation to a significant proportion, say 40 per cent or more, of Pentre Askern's sales by value over a specified period of, say, six months. The possible undertaking should be narrowed so that it applied only in relation to new price cuts which led to the exit of UK rivals.

6.88. In that regard, Pentre Askern said it should be noted that undertakings requiring the maintenance of price cuts had never been imposed in the UK outside the bus industry and in that industry

the obligation to maintain price cuts only started to apply once a new entrant had left the route in question. Price cuts which did not eliminate rivals did not raise prima facie anti-competitive concerns.

6.89. Pentre Askern added that the requirement to maintain price cuts should apply only to price cuts to the parties' existing customers which exceeded 10 per cent, as small price cuts were unlikely to prejudice rivals' businesses materially.

6.90. As to the hypothetical remedy of divestment, Pentre Askern submitted that divestment of facilities which the joint venture intended to close would be theoretically feasible. However, there was no basis for concluding that this would lead to the transfer of market share because there could be no transfer of goodwill, customer relationships or contracts; the parties and their existing UK rivals did not face any capacity constraints; and any purchaser would acquire only non-specialized second-hand equipment, which was readily available in the market place. It was also far from obvious that potential suppliers would want UK manufacturing facilities, given the strength of sterling and the cost advantages enjoyed by overseas suppliers. Pentre Askern strongly submitted that divestment would be a disproportionate remedy, given that price undertakings would be sufficient to address the CC's hypothetical concerns.

6.91. As to the proposed obligation to notify proposed mergers, Pentre Askern said that it would be prepared to give such an undertaking and that it should be limited to UK manufacturers. Pentre Askern added that it should be noted that the CC had not been investigating a merger where businesses had been integrated, thereby making divestment problematic. Pentre Askern considered that de minimis mergers of firms with new drum sales of under £250,000 a year should not be covered by the undertaking as they would be unlikely to affect market structure materially. Pentre Askern said that the undertaking should also not apply to transactions involving suppliers of reelless technologies or drum reuse which it understood the CC did not consider as forming part of the relevant product markets.

6.92. As to the proposed remedies regarding the publishing of price undertakings and compliance, Pentre Askern said that it had no objection to informing customers in writing or on a web site of price remedies. Pentre Askern considered that behavioural remedies relating to price increases were effectively self-policing, because customers had a strong vested interest in resisting price increases. It was therefore highly unlikely that the OFT would incur any substantive compliance costs. However, if an undertaking on prices were to require the parties to submit independently audited figures to the OFT on a periodic basis, Pentre Askern would expect to bear the cost of such an audit.

D P B KINGSMILL (*Chairman*)

S E BROWN

P MACKAY

P A BOYS (*Secretary*)

28 September 2000