

# Completed acquisition by Danspin A/S of certain assets and goodwill of LY Realisations Limited (formerly Lawton Yarns Limited)

## Decision on relevant merger situation and substantial lessening of competition

ME/6870/19

Please note that [X] indicates figures or text which have been deleted or replaced in ranges for reasons of commercial confidentiality.

### SUMMARY

1. On 12 June 2019, Danspin A/S (**Danspin**) acquired certain assets and goodwill of LY Realisations Limited (formerly Lawton Yarns Limited) (the **Target**) (the **Merger**).
2. The Merger was completed on 12 June 2019. Subsequently, the Target has been integrated into Lawton Yarns Limited (formerly K72 Limited, which Danspin created for the purposes of the Merger and then renamed to Lawton Yarns Limited) (**Lawton Yarns**). Throughout this document the acquired business is referred to as the **Target** except where the context requires otherwise. Danspin and the Target are together referred to as the **Parties**.
3. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of Danspin and the Target is an enterprise, that these enterprises have ceased to be distinct as a result of the Merger, and that the share of supply test is met. The four-month period for a decision, as extended, has not yet expired. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.
4. The Target's parent company prior to the Merger, the Spin Group BV (the **Spin Group**) was facing financial difficulties due to its operations outside the UK and was heavily dependent on financial support from the Target. As a result, the Spin Group went into administration in May 2019 and the Target was sold as part of the administration process. The CMA has found that,

absent the Merger, the Spin Group would not have continued to operate the Target. However, the Target business was profitable. The CMA found that, absent the Merger, there were alternative and less anti-competitive purchasers of the Target that would have continued to operate the Target as pre-Merger. Therefore, the CMA believes that the appropriate counterfactual is equivalent to the pre-Merger conditions of competition.

5. The Parties overlap in the supply of woollen yarn<sup>1</sup> to carpet manufacturers in the UK. The buyers of woollen yarn are carpet manufacturers who use the woollen yarn to produce finished carpets, both for residential use and/or commercial use.
6. The CMA considered whether it would be appropriate to broaden the product frame of reference beyond woollen yarn to include other types of yarn such as synthetic yarn used in the manufacturing of carpets. CMA found that internal documents provided by the Parties to the CMA and third party evidence do not indicate that woollen yarn suppliers are significantly constrained by the threat of carpet manufacturers switching to synthetic carpets. While there has been a longer term decline in sales of woollen carpets (and hence woollen yarn) and an increase in synthetic carpets, the fact that this is sustainable in the face of materially lower prices for synthetic carpets suggests that there is a group of end-consumers who particularly value the characteristics of woollen carpets and are therefore prepared to pay a high price for these.
7. The CMA believes that, taken together, this evidence indicates that synthetic carpets are not currently a close substitute for woollen carpets. Given the preference of some customers for the characteristics of woollen carpets and higher price, woollen carpet manufacturers would not have the significant incentive to substitute synthetic for woollen carpets in response to an increase in the price of woollen yarn (ie limited demand-side substitution). The CMA also found that there was limited supply side substitution between the supply of woollen yarn and synthetic yarn.
8. On this basis, the CMA has not included synthetic yarn in the product frame of reference.
9. The CMA has not included the self-supply of woollen yarn by vertically integrated woollen carpet manufacturers in the frame of reference as it found little evidence of these manufacturers being willing to supply woollen yarn to others.

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<sup>1</sup> See definition of woollen yarn and woollen carpets in paragraph 63.

10. The CMA has not segmented the supply of woollen yarn by end user, but has considered any differences between the supply of woollen yarn for residential and commercial carpets in the competitive assessment.
11. The CMA found that the appropriate geographic frame of reference for the assessment of the Merger was the supply of woollen yarn to UK customers. The CMA has therefore assessed the impact of the Merger in the supply of woollen yarn to carpet manufacturers in the UK.
12. The Merger involves the two largest suppliers of woollen yarn to carpet manufacturers in the UK. The CMA estimated that, in 2018, Parties had a very large combined share in the supply of woollen yarn to UK carpet manufacturers ([70-80]%, with an increment of [10-20]% resulting from the Merger).
13. The CMA believes the Parties are each other's closest competitors, and that the competitive constraint exercised by the Parties on each other that would be lost as a result of the Merger would be substantial.
14. The CMA also found that the only two other effective competitors impose a weak constraint on the Parties. Other constraints, including from synthetic fibres and imported woollen carpets, are also limited.
15. The CMA found that neither entry or expansion by other woollen yarn suppliers nor any existing buyer power would prevent a realistic prospect of a substantial lessening of competition (**SLC**) from arising.
16. Given the above, the CMA therefore believes that the Merger gives rise to a realistic prospect of a SLC as a result of horizontal unilateral effects in the supply of woollen yarn to carpet manufacturers in the UK.
17. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (the **Act**). Danspin has until 12 November 2019 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to sections 22(1) and 34ZA(2) of the Act.

## **ASSESSMENT**

### **Parties**

18. Danspin is a Danish company engaged in the spinning and dyeing of woollen yarn. Danspin supplies woollen yarn to carpet manufacturers. Danspin has two production sites – one in Lithuania which is active in the spinning of woollen yarn and one in Estonia which is active in the dyeing of woollen yarn.

Danspin produces and sells woollen yarn to carpet manufacturers in the UK and across Europe. The turnover of Danspin in 2018 was approximately £12.6 million in the UK.<sup>2</sup>

19. The Target was part of the Spin Group prior to the Merger. The Target was the Spin Group's woollen yarn producer in the UK while the Spin Group produced man-made fibre (synthetic) in Belgium and Poland. The Target has a c. 250,000 sq. ft. manufacturing facility located in Dewsbury, Yorkshire in the UK. It is a woollen yarn producer and dyer, supplying woollen yarn to the carpet manufacturing industry. The turnover of the Target in 2018 was approximately £41.2 million in the UK.<sup>3</sup>

## Transaction

20. On 12 June 2019, Danspin purchased certain assets and goodwill of LY Realisations Limited (when it was formerly Lawton Yarns Limited) for approximately £4.68 million, in the context of the Spin Group administration.<sup>4</sup>  
<sup>5</sup> Moorfields Advisory Limited (**Moorfields**) was the appointed administrator.
21. The Parties informed the CMA that the Merger is not subject to review by any other competition authority.

## Rationale for the Merger

22. Danspin submitted that the rationale for the Merger 'was to avoid a material 'outage' in the Target's production'<sup>6</sup> and that its main concern was that carpet manufacturers would have reacted to the outage by permanently switching to synthetic yarns, harming Danspin's business. Danspin further submitted that any outage would have caused serious issues with its wool suppliers, who may have been left without a buyer for fleece already bought.
23. While there is some support for this stated rationale in the documents provided by Danspin to the CMA<sup>7</sup>, the CMA considers that some of the evidence from the documents provided by the Parties to the CMA during the

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<sup>2</sup> Danspin's response on 9 August 2019 to the CMA's s109 Notice dated 23 July 2019, paragraph 29.19.

<sup>3</sup> See [Danspin's response on 9 August 2019 to the CMA's s109 Notice dated 23 July 2019](#), paragraph 9.1.

<sup>4</sup> The assets acquired by Danspin were: (i) business and intellectual property; (ii) equipment and computer systems; (iii) the stock; (iv) vehicles; (v) 300 employees. While contracts with suppliers and customers were not novated or transferred to Danspin, Danspin acquired the right to step into the LY Realisations business' contracts with suppliers and customers on the completion of the Merger on 12 June 2019.

<sup>5</sup> Danspin also purchased two properties of LY Realisations Limited for approximately £2.7 million: Calder Wharf, Ravensthorpe, Dewsbury and Ravens Ing Properties Limited.

<sup>6</sup> [Danspin's response to Question 19 of the section 109 notice dated 23 July 2019](#).

<sup>7</sup> See, for instance [DS68](#), in which a third party states: 'If there was a collapse of the SG group we would have to act quickly to prevent disruption to our supplies.'

investigation (**internal documents**) does not fully support Danspin's stated rationale for the Merger.<sup>8</sup>

## Procedure

24. The CMA's mergers intelligence function identified this transaction as warranting an investigation.<sup>9</sup>
25. The Merger was considered at a Case Review Meeting.<sup>10</sup>

## Jurisdiction

26. Each of Danspin and the Target is an enterprise, as the assets and goodwill that are being transferred to Danspin enable the business activity associated with the Target to be continued by Danspin.<sup>11</sup> As a result of the Merger, these enterprises have ceased to be distinct.
27. The Parties overlap in the supply of woollen yarn to carpet manufacturers in the UK, with a combined share of supply in 2018 of [70-80]% by volume, with an increment of [10-20]% resulting from the Merger (see Table 1: Shares of supply in woollen yarn sold to UK carpet manufacturers (2018) below). The CMA therefore believes that the share of supply test in section 23 of the Act is met.
28. The Merger completed on 12 June 2019 and was made public on the same date. The four month deadline for a decision under section 24 of the Act is 15 November 2019, following an extension under section 25(2) of the Act.
29. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 11 September 2019 and the statutory 40 working day deadline for a decision is therefore 5 November 2019.
30. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

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<sup>8</sup> See, for instance, the Target's internal document, with comments from a third party about the Merger: 'RIM, under your control, continues to run as normal but as soon as the site is prepared in Lithuania two cards, four spinning frames and two winders (possibly using the Baltic ones) are transferred.' (see [LY future 230519.docx](#) ).

<sup>9</sup> See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, paragraphs 6.9-6.19 and 6.59-60.

<sup>10</sup> See [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, from paragraph 7.34.

<sup>11</sup> See s129 of the Enterprise Act 2002 and the [Mergers: Guidance on the CMA's jurisdiction and procedure](#), paragraph 4.8. In particular, the Merger involves the transfer of goodwill, intellectual property, assets, employees and the right to step into customer contracts, all of which are highlighted as relevant considerations in the CMA's assessment of whether a merger enables a particular business activity to be continued under [Mergers: Guidance on the CMA's jurisdiction and procedure](#), paragraph 4.8.

## Counterfactual

31. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For completed mergers the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.<sup>12</sup>
32. As explained in more detail below, Danspin submitted that the appropriate counterfactual is that, absent the Merger, the Target would have exited the market, the administrator would have liquidated its assets and most of its sales would have been diverted to Danspin (ie, an exiting firm scenario).
33. As set out in the CMA's [Merger Assessment Guidelines](#), for the CMA to accept an exiting firm scenario it would need to believe, on the basis of compelling evidence, that the following conditions were met:
  - (a) it is inevitable that the Target would exit the market through failure or otherwise, ie, in the context of this case, whether or not the Target would have continued to operate under the same ownership;
  - (b) There is no substantially less anti-competitive purchaser for the business or its assets; and
  - (c) The Merger does not represent a substantially less competitive outcome compared with what would have happened to the sales of the business in the event of its exit.<sup>13</sup>
34. The CMA's assessment of whether these conditions are met is set out below.

### ***Whether the Target would have exited the market (through failure or otherwise) absent the Merger***

35. The CMA's Merger Assessment Guidelines state that, in the context of a firm exiting for reasons of financial failure, consideration is given both to whether

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<sup>12</sup> [Merger Assessment Guidelines](#) (OFT1254/CC2), September 2010, from paragraph 4.3.5. The [Merger Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, Annex D).

<sup>13</sup> See [Merger Assessment Guidelines](#), from paragraph 4.3.8.

the firm is unable to meet its financial obligations in the near future, and to whether it is unable to restructure itself successfully.<sup>14</sup>

36. Where the firm is a part of a larger corporate group, the CMA will look at the nature and value of the transactions within that group to determine the extent to which the losses were caused by intra-group charges, and whether the transactions were on arm's length terms. The CMA will apply the same principle in determining whether a particular subsidiary or division would have exited the market without the merger.<sup>15</sup>
37. Danspin submitted that, prior to the Merger, the operations of the Spin Group in Belgium and Poland were underperforming and that in order to continue the trading of these companies, the Spin Group utilised cash reserves of the Target.<sup>16</sup> It submitted that in May 2019, the Spin Group concluded that it could not raise the investment necessary to continue trading and, due to the lack of cash in the Target and the financial difficulties faced by its overseas operations, the directors of the Target considered insolvency options leading to the appointment of an insolvency administrator, Moorfields.<sup>17</sup>
38. Danspin further submitted that the Target may have been trading profitably but that it would inevitably have exited, because it was not sufficiently profitable to borrow the money it needed to carry on its day to day operations.<sup>18</sup>

### *CMA assessment*

39. The CMA believes that the Target was acquired from administration because the Spin Group was undergoing financial difficulties.<sup>19</sup> The wider Spin Group utilised the Target's cash reserves to the point that it was no longer able to meet its debts as they fell due.<sup>20</sup>
40. The CMA found that while the Spin Group was in administration, the Target was profitable on the basis that:

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<sup>14</sup> See [Merger Assessment Guidelines](#), paragraph 4.3.14.

<sup>15</sup> See [Merger Assessment Guidelines](#), paragraph 4.3.15.

<sup>16</sup> See [Danspin's response on 9 August 2019 to the CMA's s109 Notice dated 23 July 2019](#), paragraph 18.3.

<sup>17</sup> See [Danspin's response on 9 August 2019 to the CMA's s109 Notice dated 23 July 2019](#), paragraph 18.6 and paragraph 18.7.

<sup>18</sup> Danspin's response on 14 October 2019 to the CMA's issues letter dated 7 October 2019 (Issues Letter).

<sup>19</sup> See [Amended administrator's proposals pack](#), which was provided by Moorfields as well as Danspin in its response on 9 August 2019 to the s109 Notice dated 23 July as annex 10.

<sup>20</sup> See [Amended administrator's proposals pack](#), which was provided by Moorfields.

- (a) The financial accounts of LY Realisations Limited (the Target) also show that it was profitable;<sup>21</sup>
- (b) Moorfields told the CMA that the Target was a profitable company, although its parent company was going through financial difficulties;<sup>22</sup>
- (c) Moorfields confirmed that the Target was funding the wider group and the consequences of the losses of the group caused an overall insolvent position such that the Target could no longer trade;<sup>23</sup>
- (d) Moorfields, in its communication to interested purchasers, observed that [REDACTED].<sup>24</sup>
41. Danspin submitted that the Target could no longer raise the necessary finance to continue trading. After a previous injection of shareholder funds intended to turn the business around, in May 2019 the Spin Group concluded that it could no longer raise the investment necessary for continued trading.<sup>25</sup>
42. Danspin's submissions above are supported by Moorfields who confirmed that the Target was unable to meet its debts as they fell due. Moorfields concluded that rescuing the Target as a going concern was not achievable as there was no alternative funding or solvent offer obtained, which did not require a significant write off of the secured debt, within the necessary timeframes.<sup>26</sup>
43. Based on the evidence described above, the CMA considers that the Target was unable to obtain further financing from its current banking facilities. The CMA has found that the cash position the Target was left in as a result of the actions of the rest of the Spin Group rendered it unable to meet its debts as they fell due. As a result, the Target was insolvent.
44. The CMA believes that the Target was a profitable business and could have continued to be a financially viable business on a standalone basis absent the financial position created by its interactions with the wider Spin Group. However, given the Spin Group's financial difficulties and ultimate administration process, although the Target business was not "failing", it was part of a failing group which should not, in the circumstances of this case, be separated from the Target for the purposes of the counterfactual assessment. The CMA therefore believes that, as a result of the financial difficulties of the Spin Group, the Target was unable to meet its financial obligations in the near

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<sup>21</sup> See [LY Realisations Limited financial statements 2017](#).

<sup>22</sup> Moorfields also provided *Financial Statements of LY Realisations Limited* for the year ended 31 October 2017.

<sup>23</sup> Note of call with Moorfields of 14 August 2019.

<sup>24</sup> See [Danspin's response to the CMA's section 109 notice dated 23 July, 11 Annex teaser project Ivy](#).

<sup>25</sup> See Amended administrator's proposals pack, which was provided by Moorfields, section 2.

<sup>26</sup> See Amended administrator's proposals pack, which was provided by Moorfields, section 3.



future and was not in a position to be able to restructure itself successfully. The Target would have exited and would not have continued to be operated by the Spin Group.

***Whether there would have been an alternative purchaser for the firm or its assets to the acquirer under consideration***

45. Where the CMA considers that, as here, a target business would have exited absent the merger under consideration, there may be other purchasers whose acquisition of the firm as a going concern, or of its assets, would produce a better outcome for competition than the merger under consideration.<sup>27</sup>
46. In assessing this, the CMA will look at available evidence supporting any claims that the merger under consideration was the only possible merger. The CMA will take into account the prospects of alternative offers above the liquidation value. The possible unwillingness of alternative purchasers to pay the seller the asking purchase price would not rule out a counterfactual in which there is a merger with an alternative purchaser.<sup>28</sup>
47. Danspin submitted that:
  - (a) The only possible alternative to an administration sale of the Target to Danspin was the Target's exit from the market by way of winding up proceedings;
  - (b) The other bidders could not have been suitable purchasers if their offers were under the liquidation value of the Target;<sup>29</sup> and
  - (c) Absent a sale to Danspin, the administrator would have opted for the liquidation of the Target rather than sell it as a going concern to any of the bidders who made an initial offer. In particular, Danspin submitted that 'all other bidders' offers appear below the liquidation value of £6.1m, that they would have been rejected by Moorfields, and that absent a sale by Danspin, Moorfields would have chosen to break up the Target in a liquidation process rather than sell it as a going concern to any of the bidders who made an initial offer.'<sup>30</sup>

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<sup>27</sup> See [Merger Assessment Guidelines](#), from paragraph 4.3.16.

<sup>28</sup> See [Merger Assessment Guidelines](#), paragraph 4.3.17.

<sup>29</sup> See [Danspin's response on 9 August 2019 to the CMA's s109 Notice dated 23 July 2019](#).

<sup>30</sup> Danspin's response of 14 October 2019 to the CMA Issues Letter.

## *CMA assessment*

48. Moorfields told the CMA that it carried out a marketing process in May 2019 following its appointment to sell the Target.
49. The CMA received evidence from Moorfields that there were four alternative purchasers (other than Danspin) that submitted offers to acquire the Target from administration. Moorfields provided the CMA with details of the shortlisted five companies that offered to purchase the Target.<sup>31</sup>
50. Moorfields told the CMA that, of these, there were two potential purchasers that it considered to be the next-best alternatives to Danspin from an administrator's perspective. Moorfields' assessment reflected the fact that these two bidders had offered the next best financing offers, and Moorfields would have considered their bids further if Danspin's bid had not existed. Danspin was chosen over these companies because it was the best overall in terms of financing requirements, consideration and timescales to complete.
51. The CMA spoke to three of the potential purchasers. All three told the CMA that they: (i) had serious intentions and plans to acquire the Target; (ii) had the necessary funds to finance the acquisition; and (iii) could have executed the transaction promptly.
52. In addition, all three told the CMA that: (i) there was a profitable underlying business that needed rescuing from its parent Group due to the problems at the non-UK Group level; and (ii) the Target was an attractive business that was able to survive. Although the potential purchasers were also aware of the challenges of maintaining customer and supplier relationships, they told the CMA that they believed they could overcome these challenges. All three potential purchasers proposed to operate the Target as a business, as it was run pre-Merger.
53. None of the three potential purchasers have activities which overlap with those of the Target business and, therefore, the potential acquisition of the Target by any of these purchasers would not raise any competition concerns.
54. As set out in the Merger Assessment Guidelines, the CMA takes into account the prospects of there being alternative offers above the liquidation value of the Target's assets. However, this is not determinative in concluding whether or not the target business would have been sold to an alternative purchaser.

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<sup>31</sup> Initially there were 61 interested companies, see [Amended administrator's proposals pack](#).

55. Moorfields told the CMA, of the two purchasers that it identified as the best alternatives to Danspin, at least one had submitted an offer above the liquidation value and that, subject to financing, this offer was preferable to liquidation.<sup>32 33</sup> The CMA understands that, at the time of the administration sales process, this potential purchaser required more time than Danspin to secure finance and execute the acquisition. However, as explained above, this purchaser told the CMA that it was in a position to secure all the necessary financing to acquire the Target and promptly execute the acquisition.
56. In relation to the other potential purchaser, while it would offer a lower return to creditors than Danspin's offer, Moorfields had not ruled out that the sale to this purchaser could have been preferable to liquidation. Moorfields did not carry out a comparison of this offer against a potential liquidation because this was not necessary, given there were better offers available at the time.
57. On the basis of the facts set out above, the CMA believes there is sufficient evidence to conclude that a liquidation route would be less favourable than at least one of the other offers open to Moorfields.<sup>34</sup>
58. The above reasons that led Moorfields to prefer Danspin's offer to the alternative offer are not relevant to the counterfactual assessment.
59. In light of the above, the CMA does not consider that the second limb of the 'exiting firm' counterfactual is met, because the CMA believes that there is at least one alternative purchaser of the Target that would result in a substantially less anti-competitive outcome than Danspin's acquisition of the Target.
60. As a result, the CMA does not need to consider what would have happened to the sales of the business in the event of the Target's exit (see paragraph 40(d)).

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<sup>32</sup> Note of call with Moorfields of 15 October 2019.

<sup>33</sup> Danspin submitted that Moorfields carried out a direct comparison between Danspin's bid and the value of a liquidation (Notice of Administrator's Proposals, Annex 7, Table under heading "Valuation", on the 43<sup>rd</sup> page). However, Moorfields explained that the table Danspin refers to is not establishing a comparison of each offer with the liquidation value. Moorfields confirmed that it is not required to disclose the liquidation outcome in its report.

<sup>34</sup> Moorfields highlighted that the liquidation of the Target would have required an immediate cessation of trade and close down of operations. This would have produced some negative effects on creditors: (i) goodwill would have reduced to nil; (ii) the net amount realised from the sale of plant & machinery would have been significantly lower than the value obtained in a sale, due to holding, removal, marketing and sale costs; (iii) book debts would have yielded a lower realisable value due to loss of continuity and an increased risk of counter claims, together with a lack of cooperation from key staff had they been made redundant rather than transferred with the sale; (iv) all staff would have been made redundant with immediate effect from the date of the liquidation, and a preferential claim of c. £[REDACTED]k would have arisen. Additionally, retention of title claims on stock would have reduced the funds available for creditors substantially, as all costs/returned stock would have been borne by the estate. The submission from Danspin that the valuation in the administrator's report represents the value of a liquidation is therefore incorrect (see email from Moorfields of 22 October 2019).

## ***Conclusion on the counterfactual***

61. The CMA found that the exiting firm counterfactual is not satisfied to the required legal standard in a phase 1 investigation because there were alternative, less anti-competitive purchasers of the Target that would have continued to operate the Target as pre-Merger. Therefore, the appropriate counterfactual is equivalent to the pre-Merger conditions of competition.

## **Industry background**

62. This section explains the composition of carpets, the different stages in the production of carpets and the relationship between carpet manufactures and yarn producers. Different types of fibre can be used in the manufacture of carpets such as nylon, polypropylene, polyester, wool and sisal. Woollen yarn is typically a blend of sheep wool with a small proportion of synthetic fibre such as nylon or polypropylene, although the yarn could also be pure wool. Woollen carpets are either pure woollen carpets made up of only woollen yarn or a woollen blend carpet that is typically a blend of 80% wool and 20% synthetic yarn. The majority of third parties that responded to the CMA said that woollen carpets were mostly produced using woollen blend yarn, typically 80% wool and 20% synthetic. Some carpet manufacturers also produce pure woollen carpets, but in smaller amounts in order to supply a particular group of end customers such as cruise ships and hotels. A small number of carpet manufacturers also produce 100% synthetic carpets. The Parties both produce and supply pure woollen and woollen blend yarn to carpet manufacturers and they do not produce 100% synthetic yarn.
63. Throughout this document: (i) **woollen yarn** refers to pure woollen yarn and woollen blend yarn (a mix of woollen and synthetic yarn); (ii) **woollen carpet** refers to carpet composed of pure woollen yarn or woollen blend yarn; (iii) **customer** refers to carpet manufacturers that acquire woollen yarn from yarn producers; and (iv) **end-consumer** refers to the consumers that purchase carpets from retailers.
64. There are several stages and processes in the production of woollen yarn:<sup>35</sup>
- (a) The production of woollen yarn starts with the purchase of fleece which has been cleaned and scoured;<sup>36</sup>

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<sup>35</sup> See Danspin's response on 9 August 2019 to the CMA's section 109 notice dated 23 July 2019, paragraphs 11.7.

<sup>36</sup> This process is where contaminants such as grease, dirt, sand, and dry sweat have already been removed and excess water squeezed out.

- (b) The fleece is then carded to produce slivers;<sup>37</sup>
- (c) These slivers are then spun, twisted and wound onto a bobbin;
- (d) The yarn may then be dyed, although often the dyeing can be done prior to spinning, to produce complete, dyed yarns ready to be incorporated directly into finished woollen carpets.
65. The spinning process can be adjusted to produce yarn of different weights, twist (number of twists per cm), colours, suitability for certain carpet types etc. These differences require only minor changes to the spinning process, and are typically altered to the specification of the customer.
66. The customers of woollen yarn are carpet manufacturers who use the woollen yarn to produce finished carpets, both for residential use and/or commercial use. A small number of carpet manufacturers have their own spinning facilities, these manufacturers are referred as **vertically integrated carpet manufacturers**.<sup>38</sup>
67. The Parties submitted that carpet manufacturers typically decide on a type of carpet that they want to produce based on their customers' requirements. These carpet manufacturers then request prices and samples from the yarn producers for the type of yarn they require. The Parties, as well as a number of third parties, submitted that carpet manufacturers select a provider based on the quality of the sample and the quoted price, as well as factors such as the provider's quality record and ability to meet orders as and when required.<sup>39</sup>
68. The Parties and third parties submitted that carpet manufacturers tend to be reluctant to change a supplier for a specific line of yarn already in production.<sup>40</sup> This is mainly because switching increases sampling costs as the task of matching colours between different suppliers can be difficult, and because switching provider for in-production carpets creates risks in terms of price, quality of the yarn and lead times, which are important factors of competition.

## Frame of reference

69. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the

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<sup>37</sup> This process is where the wool fibres are passed through machines to straighten and blend them into slivers.

<sup>38</sup> Such companies include Ulster Yarns Limited and Brintons Carpets Limited.

<sup>39</sup> Paragraph 11.16, Parties' S109 response Questions 9-34.

<sup>40</sup> Slide 16, [Danpin's response to the Issues letter](#).

market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.<sup>41</sup>

### ***Product frame of reference***

70. The Parties overlap in the supply of woollen yarn to carpet manufacturers in the UK.
71. The CMA's approach to the frame of reference typically begins with the products where the Parties overlap. The CMA pays particular regard to demand-side factors (ie the behaviour of customers and its effects). However, it may consider supply-side factors (ie the capabilities and reactions of suppliers in the short-term) and other market characteristics.<sup>42</sup>
72. As a starting point, the CMA took the frame of reference to be the production and supply (hereinafter **supply**) of woollen yarn to carpet manufacturers in the UK, in which the Parties overlap. The CMA considered whether it should be widened to include:
  - (a) Other types of yarn, ie synthetic used in the manufacturing of carpets; and
  - (b) Self-supply by vertically integrated carpet manufacturers.
73. The CMA also considered further segmentation of the production and supply of woollen yarn to carpet manufacturers by reference to the end use of the carpet manufacturer's customers, ie carpets for residential or commercial use.
74. Most of the Parties' customers are carpet manufacturers. However, in some instances, a few customers procure yarn from a yarn producer and outsource the manufacturing of the carpet to another carpet manufacturer.

### ***Demand-side substitution between woollen yarn and synthetic yarn***

75. As mentioned above, Danspin submitted that carpet manufacturers can make carpets from natural products, most commonly sheep wool, or from synthetic products such as polypropylene. It submitted that some carpet manufacturers

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<sup>41</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

<sup>42</sup> [Merger Assessment Guidelines](#), paragraph 5.2.6.

make both synthetic and woollen carpets, while others focus solely on producing woollen carpets.<sup>43</sup>

76. Danspin submitted that the appropriate product scope is the supply of all carpet yarn, including both woollen and purely synthetic yarn.<sup>44</sup> Although neither of the Parties produce entirely synthetic yarn, Danspin submitted that different types of yarn are highly substitutable for both end-consumers and carpet manufacturers.<sup>45</sup> Danspin also submitted that ‘synthetic carpets have evolved in recent years and are now very difficult to distinguish from wool, and that the historic preferences for wool as the quality choice have eroded almost completely’.<sup>46</sup>
77. In determining whether synthetic yarn should be included as part of the product frame of reference, the CMA has considered demand-side and supply-side factors.<sup>47</sup>
78. The CMA has considered whether a small but significant non-transitory increase in the price (**SSNIP**) of woollen yarn would become unprofitable due to demand-side substitution of synthetic yarn for woollen yarn.<sup>48</sup>
79. The CMA notes that demand-side substitution could theoretically occur due to switching by immediate customers, that is woollen carpet manufacturers; or due to switching downstream by distributors, retailers or end-consumers. In all cases, substitution will tend to occur only if the end-consumers regard woollen and synthetic carpets as close substitutes, ie they would switch between woollen and synthetic carpets in response to a small change in relative prices. This is because it is the expectation of switching by the end-consumers which drives the profitability of switching by intermediate suppliers including carpet manufacturers, distributors and retailers.
80. The CMA has considered the following evidence on demand-side substitution:
  - (a) The Parties’ submissions;
  - (b) Internal documents;

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<sup>43</sup> See [Section 5 response dated 25 June 2019](#), paragraph 6.4

<sup>44</sup> See [Section 5 response dated 25 June 2019](#), paragraph 3.1.

<sup>45</sup> See [Section 5 response dated 25 June 2019](#), paragraph 3.5.

<sup>46</sup> See [Section 5 response dated 25 June 2019](#), paragraph 6.5.

<sup>47</sup> As explained in paragraph 104 below, the CMA may aggregate several markets on the basis of supplier responses. (see [Merger Assessment Guidelines](#), paragraph 5.2.17.).

<sup>48</sup> See [Merger Assessment Guidelines](#), paragraphs 5.2.8-5.2.16. The CMA uses the hypothetical monopolist test as a tool to define the relevant product market: the CMA assesses whether a hypothetical monopolist could profitably raise the price of at least one of the products in the candidate market by at least a SSNIP.

- (c) Third party evidence;
- (d) The price difference between woollen and synthetic carpets; and
- (e) End-consumer preferences and differing characteristics of woollen and synthetic carpets.

### *Parties' submissions*

81. Danspin submitted that carpet manufacturers could easily switch from producing woollen yarn to producing synthetic yarn as there are immaterial costs involved in switching, for example the same machinery can be used to produce both woollen and synthetic carpets with minimal set-up required. Danspin told the CMA that customers commonly use the same machines to produce woollen yarn and synthetic carpets.<sup>49</sup> Danspin further submitted that, although carpet manufacturers avoid switching a yarn supplier during the lifetime of a range, these carpet manufacturers do regularly redesign and relaunch ranges. As such, they would easily phase out producing woollen carpets in the event of a price increase of woollen yarn.<sup>50</sup>
82. The CMA notes that it is not only the ease of switching by carpet manufacturers that is relevant, but also whether carpet manufacturers would find it profitable to switch in response to a SSNIP on woollen yarn, given the demand for woollen carpets. The CMA has therefore considered the Parties' representations in the light of the evidence from internal documents and third parties, as well as evidence on the extent to which end-consumers regard woollen and synthetic carpets as close substitutes.

### *Internal documents*

83. The CMA assessed the Parties' internal documents, including internal and external emails exchanged between their employees, and between those employees and third parties. The internal documents indicated that the Parties are not significantly constrained in their behaviour by the threat of customers switching<sup>51</sup> from woollen yarn to synthetic yarn. The CMA found: (i) limited evidence in the Parties' emails of their customers threatening to switch from woollen yarn to synthetic yarn; and (ii) while there are some references in the Parties' internal documents to the possibility of volume being shifted to

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<sup>49</sup> Danspin's issues meeting presentation slides.

<sup>50</sup> Danspin's issues meeting presentation slides.

<sup>51</sup> By 'switching' the CMA refers broadly to both the carpet manufacturer changing suppliers of woollen yarn for an existing product line or deciding not to produce a new line for woollen yarn carpets.



another woollen yarn producer, there were limited mentions of synthetic competitors.

84. In particular:

- (a) The CMA reviewed a large number of emails of the Target discussing a price rise that had been applied to all customers in 2018. Of these, only one email from a customer mentioned, and in relatively muted terms, the possibility of a customer switching from woollen yarn to other fibres.<sup>52</sup> In contrast, there were several references to the possibility of volume being shifted to other woollen yarn producers;<sup>53</sup>
- (b) Internal documents of the Target that discuss Danspin and other competitors include references to other woollen yarn competitors. However, the CMA found no documents that discuss synthetic competitors;<sup>54</sup>
- (c) Danspin's internal documents focus mainly on woollen yarn. There are very few references to the woollen market declining in general due to synthetic carpets.<sup>55</sup> The CMA did not identify any instances of Danspin discussing synthetic competitors in internal documents.<sup>56</sup>

85. Danspin submitted that:

- (a) The Parties' internal documents did not mention synthetic yarn producers because the threat of synthetic yarn is generally known in the industry;
- (b) The Target's internal documents did not indicate any concern about switching to synthetic yarn as the Spin Group were also supplying synthetic yarn through another subsidiary;
- (c) Most of the internal documents used as evidence by the CMA were emails from customers; customers are more likely to focus on in range switching when negotiating with customers and are, therefore, unlikely to mention switching from woollen ranges to synthetic ranges, which requires the discontinuation of a woollen range and the starting of a new synthetic range.

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<sup>52</sup> LY18.

<sup>53</sup> LY40 email, LY38 email, LY30 email.

<sup>54</sup> For example LY104, LY102, LY108.

<sup>55</sup> See, for instance, DS12, in which the CEO of Danspin states in correspondence with a customer [REDACTED].

<sup>56</sup> There is one email - DS70 - from [REDACTED] mention of polyester becoming more widely used in the carpet production. However, the CMA did not find any relevant emails where Danspin has felt threatened by synthetic yarn suppliers.

86. With regard to Danspin's submissions on the weight that should be placed on communications sent by third parties as evidence of the limited constraint imposed by synthetic yarn and synthetic carpet, the CMA notes:
- (a) If synthetic yarn were such a close alternative to woollen carpets, the CMA would expect this to be reflected, at least to some extent, in the Internal documents of the Parties relating to negotiations with its customers. The CMA would expect customers to refer expressly to the threat of switching to synthetic carpet or the loss of business to synthetic carpet manufacturers;
  - (b) There were no references in the Target's internal documents to the possibility of the Target's customers purchasing synthetic yarn from competitors of the Spin Group;
  - (c) The internal documents reviewed by the CMA included not only emails from customers, but also other internal documents such as site visit reports<sup>57</sup> and market share estimates. In any event, communications from the Parties' customers remain a valuable source of evidence for understanding their requirements and willingness to switch to purchasing synthetic yarn.
87. While some internal documents refer to switching within a range (eg the possibility of taking over certain colours on a range of carpet), there are, for instance, many documents from the Target relating to its attempt to increase prices to all of its customers across almost all of its yarns, affecting more than a specific range. This could, in theory, impact the Target's customers' willingness to discontinue ranges and switch to synthetic yarn.
88. Therefore, the CMA considers that the Parties' internal documents overall and the specific emails from customers which it has reviewed do have probative weight. Such internal documents do not support the submission that carpet manufacturers had considered or threatened switching from woollen yarn to synthetic, in particular in reaction to price increase. They do not as a result indicate that woollen yarn and synthetic yarn are close alternatives for carpet manufacturers.

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<sup>57</sup> The Target's internal documents included numerous reports on visits made to their customers.

### *Third Parties*

89. The CMA received mixed evidence from customers regarding whether they would be able to switch from wool to synthetic yarn:
- (a) The majority of customers informed the CMA that there were significant costs associated with switching from producing carpets with synthetic yarn to producing carpets with woollen yarn.<sup>58</sup> These costs included new manufacturing machinery, additional warehousing (as synthetic yarn is a much bulkier product than woollen yarn), obtaining the necessary expertise, sampling and other costs associated with creating new ranges that would need to go out to around 2000 retailers. Several of these customers were woollen carpet specialists that did not produce any synthetic carpets. However, one of these customers who already produced some synthetic carpet stated that it would be difficult and costly to switch a substantial portion of their production from woollen to synthetic carpets;
  - (b) However, other customers including two customers of the Parties, stated that there were no additional costs associated with switching from using woollen yarn to using synthetic yarn. These two customers already produce both synthetic and woollen carpets.
90. Danspin submitted that the CMA had received information from woollen carpet specialists who may not have the necessary expertise to assess the cost of switching between using woollen and synthetic yarn. The CMA accepts that some evidence was received from woollen carpet specialists. However, regardless of whether woollen carpet specialists are able to judge how much it would cost to switch production, their perception that the cost is high indicates that these customers would not switch their production to synthetic carpets. Furthermore, one customer who is currently producing synthetic carpets suggested switching a significant proportion of its woollen yarn to synthetic yarn would impose significant costs. In any case, as noted above, in assessing demand-side substitution the more important issue is whether customers would switch in response to a SSNIP in the price of woollen yarn.

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<sup>58</sup> In particular, (i) one third party considered a hypothetical scenario in which it would switch half of its production towards synthetic carpets and concluded that this change would be challenging, requiring a significant investment and change in strategy. However, third party evidence indicates that for those already producing synthetic carpets, switching production to synthetic carpets would not involve such significant additional costs; (ii) another third party explained that producing synthetic carpets requires significant scale, including more or larger warehouses with the capacity to stock a larger quantity of synthetic yarn.

91. The majority of third parties that responded to the CMA submitted that synthetic yarn is not a good alternative to woollen yarn. No third parties told the CMA that they had threatened to switch from woollen to synthetic yarn.<sup>59</sup> The CMA found that the reported difficulty in switching from woollen yarn to synthetic yarn is particularly strong in relation to manufacturers that specialise in producing woollen carpets. Third parties cited several reasons for this, including an already saturated market for synthetic carpets, a currently strong market and demand for woollen carpets, and the resulting reduction in end-consumer options.<sup>60</sup>
92. The CMA notes that some third parties observed that there has been a decline in the sales of woollen carpets (and yarn) over time and an increase in the sales of synthetic carpets (and yarn).<sup>61</sup> Third parties explained that these trends were associated with increases in sales of hard flooring and, more recently, with the development of new polypropylene filaments used in synthetic carpets. The CMA also notes that two customers submitted that there was an implicit threat to switch to synthetic carpets because of this trend. However, the CMA has found, based on evidence from third parties, that synthetic yarn is not considered an alternative for many of them. Given the above reasons, the CMA believes that the evidence does not support the Parties' submission that this trend suggests a wider product frame of reference.

#### *The price of woollen and synthetic carpets*

93. Estimates provided by third parties show that woollen carpets were on average 60%-70% more expensive. This is in line with evidence received from the Parties based on Carpet Foundation estimates which showed an average price difference of 71%.<sup>62</sup> Danspin has not contested that woollen carpets are substantially more expensive than synthetic carpets.

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<sup>59</sup> In particular, none of the third parties that responded to the CMA's questionnaire said that they had threatened to switch from woollen yarn to synthetic yarn in the negotiations with woollen yarn spinners: (i) one customer told the CMA that such a threat would not be believable; (ii) some customers specialise in woollen carpets so synthetic carpets would not be an alternative (eg one of the customers said that the synthetic carpets market was already saturated, that there was still a strong market for woollen carpets and would not want to restrict consumer options). Another said that synthetic carpets would serve a different area of the market. However, the CMA notes that two customers stated there was an implicit threat that they could switch to synthetic carpets.

<sup>60</sup> The CMA notes that there are numerous mentions of woollen yarn competitors (including the merger party) who are also presumably well known to the Parties' and their customers.

<sup>61</sup> For example, one third party informed the CMA that while in 2008 around 80% of the carpets sold were woollen, now that figure has dropped to around 30%.

<sup>62</sup> The carpet foundation provided estimates on the proportion UK carpet sales that come from woollen carpets. The carpet foundation estimated that woollen carpets accounted for 20% by volume and 30% by value (from these figures the CMA has derived an average price difference between woollen and synthetic yarn of 71%). [Carpet foundation estimates \(provided by the Parties\)](#).

94. The maintenance of this large price difference at the retail level suggests that synthetic carpets impose a limited constraint on woollen carpets and that there is a substantial group of end-consumers who are willing to pay a large premium for woollen carpets.

*End-consumer preferences and differing characteristics of woollen and synthetic carpets.*

95. Danspin submitted that the price difference between woollen and synthetic carpet is not indicative of limited substitution and that the historical trend towards an increased share of synthetic carpets suggests substitutability. It also noted that the type of fibre is not an important factor in the end-consumer's choice. In particular, Danspin quoted a consumer survey,<sup>63</sup> which reports that only 8% of end-consumers consider the fibre type to be an important attribute when selecting a carpet.<sup>64</sup>
96. However, evidence from third parties suggests that this large premium paid by woollen carpet consumers is a result of distinct preferences. Several of the Parties' customers mentioned that there is a separate demand for woollen carpets at the consumer level often focusing on mid to high-end end-consumers.
97. A UK carpet industry report also suggests that wool is primarily used to produce high-end carpets.<sup>65</sup>
98. These differing consumer preferences appear to be due to the different characteristics or perceived characteristics of woollen carpets:
- (a) Some third parties told the CMA that a group of end-consumers value the quality of wool and certain of its features such as fire-retardancy, durability and environmental credentials;
  - (b) The consumer survey submitted by the Parties mentioned above<sup>66</sup> reports that woollen carpet ratings for quality (54%) and comfort (57%) are much higher than synthetic carpets for the same parameters (quality 21% and comfort 27%). This survey shows that some attributes, such as comfort and quality, are highly associated with woollen carpets and that these attributes are identified by end-consumers as being some of the most important attributes when purchasing flooring. The CMA therefore considers that the limited

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<sup>63</sup> LY113.

<sup>64</sup> Danspin response to the Issues Letter.

<sup>65</sup> See IBIS World Industry Report, *Carpet & Rug Manufacturing in the UK*, 2019.

<sup>66</sup> LY113.

proportion of end-consumers who directly mentioned fibre type as an important attribute does not indicate that woollen and synthetic carpets are close alternatives. Rather, the survey indicates that, while some end-consumers may not value the type of fibre *per se*, they value the characteristics that are associated with woollen yarn.

99. Therefore, the CMA believes that the large price differential between woollen and synthetic carpets is consistent with a strong preference for woollen carpets held by a significant proportion of carpet end-consumers.
100. Even with the significant price differences between woollen and synthetic carpets, the group of end-consumers that purchases woollen carpets is substantial, with 30% of the value of all carpets sold in the UK coming from woollen carpets.<sup>67</sup> This suggests that a substantial number of end-consumers value the qualities of woollen carpets and are willing to pay a higher price for this product.
101. The presence of those end-consumers would allow the hypothetical monopolist to impose a SSNIP notwithstanding the observed growth in demand for synthetic carpets, following the development of new polypropylene filaments.<sup>68</sup>
102. The CMA acknowledges that some more price-sensitive end-consumers may be willing to reduce the proportion of the wool in the carpet that they purchase, which could impact the value of the yarn sold to carpet manufacturers. However, there appears to be limited demand for woollen carpets with lower percentages of wool, with the majority of woollen yarn sold in the UK being 80% wool and 20% synthetic mix. Furthermore, such wool would still need to be purchased from a woollen yarn producer.

*CMA's conclusion on the demand-side substitutability between woollen yarn and synthetic yarn*

103. Overall, the CMA considers that the available evidence is consistent with there being a group of end-consumers with a preference for woollen over synthetic carpets due to their differing characteristics. Therefore, there is a limited degree of substitution between woollen and synthetic carpets at end-

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<sup>67</sup> [Carpet Foundation estimates \(provided by the Parties\)](#).

<sup>68</sup> The CMA also notes that the financial difficulties of the Spin Group were associated with the production of synthetic yarn, not woollen yarn where the Target operation remained profitable.

consumer level, which does not support the inclusion of woollen yarn and synthetic yarn in the same product frame of reference.<sup>69</sup>

104. For the reasons set out above, the CMA has found that there is limited demand-side substitutability between woollen yarn and synthetic yarn.

*Supply-side substitutability between woollen and synthetic yarn*

105. The boundaries of the relevant product market are generally determined by reference to demand-side substitution alone. However, the CMA may aggregate several markets on the basis of supplier responses when firms have the ability and incentive quickly to shift capacity between different products, when the same firms compete to supply the different products and the conditions of competition are the same for each product.<sup>70</sup>
106. The Parties submitted that the processes for producing synthetic yarn require different machinery and follow a different process than the production of woollen yarn.<sup>71</sup>
107. This view is supported by some third parties who submitted that it would not be possible to switch to from producing synthetic yarn to producing woollen yarn using the same machinery.
108. In particular, evidence from third parties indicates that it is costly and difficult for synthetic yarn producers to switch capacity for the production of woollen yarn, especially if they are not present in the supply of woollen yarn. The CMA understands from third party submissions that different machinery and processes are used for making extruded synthetic yarn and woollen yarn, that these machines cannot be easily repurposed, and that businesses that do not already have the necessary technology to produce woollen yarn, including manufacturers of synthetic yarn, cannot easily switch production. The CMA also understands from third party submissions that the cost of woollen spinning machinery of the type used by yarn producers, like the Parties, can reach at least Euro 2.0 million.<sup>72</sup>
109. Furthermore, submissions from some third parties suggest that the customer relationship and security of supply are important. In particular, one third party noted that moving to a new supplier of woollen yarn generally would require careful consideration because of risks relating to continuity of product ranges

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<sup>69</sup> This means that imported synthetic carpets also do not impose a significant constraint on woollen yarn suppliers to the UK.

<sup>70</sup> See [Merger Assessment Guidelines](#), paragraph 5.2.17.

<sup>71</sup> See [Section 5 response dated 25 June 2019](#), paragraph 3.1.

<sup>72</sup> The CMA was also told by a third party that it would be even more expensive to purchase machinery used for producing dry spun heat set yarn.

(such as colours). The CMA considers that the importance of an established customer relationship and the reluctance of carpet manufacturers to switch woollen yarn suppliers suggest that customers would not easily or quickly switch capacity to synthetic yarn suppliers. The CMA believes that this may be a barrier to synthetic yarn suppliers gaining business from woollen carpet manufacturers.

110. The CMA, therefore, considers that there is limited supply side substitution between woollen yarn and synthetic yarn, which does not justify widening the product frame of reference.

*Conclusion on whether to include synthetic yarn and synthetic carpets in the product frame of reference*

111. Given the limited demand-side and supply-side substitution from woollen yarn to synthetic yarn, the CMA considers that the appropriate frame of reference for the assessment of this Merger includes only the supply of woollen yarn to carpet manufacturers.

*Self-supply by vertically integrated carpet manufacturers*

112. The CMA considered whether self-supply of woollen yarn by vertically integrated carpet manufacturers should be included in the frame of reference. The CMA generally follows the principle that captive production will be included in the market only if it can be demonstrated that it would be profitable for the vertically integrated manufacturer to forgo its use and sell to other non-vertically integrated carpet manufacturers in response to a SSNIP.<sup>73</sup>
113. Danspin submitted that the Parties are constrained by vertically integrated carpet manufacturers who produce their own yarn in-house, and that these manufacturers both buy and sell yarn.<sup>74</sup>
114. The CMA did not find evidence of significant constraints on non-vertically integrated suppliers of woollen yarn from vertically integrated carpet manufacturers being willing to start selling woollen yarn to other carpet manufacturers (who currently purchase from non-vertically integrated woollen yarn suppliers). The CMA did not find any evidence indicating that vertically integrated carpet manufacturers are supplying a significant volume of woollen yarn to another carpet manufacturer in the UK.<sup>75</sup> Nor did the CMA also did not find any evidence in the Parties' internal documents that customers had

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<sup>73</sup> [Merger Assessment Guidelines](#), paragraph 5.2.20, 4<sup>th</sup> bullet.

<sup>74</sup> [Section 5 response dated 25 June 2019, paragraph 3.7](#).

<sup>75</sup> The CMA found in a very small number of cases, certain customers purchased a small amount of yarn that makes up a minority of their requirement.



switched to any vertically integrated carpet manufacturer. A few third parties told the CMA that vertically integrated carpet manufacturers typically do not sell yarn to other carpet manufacturers.

115. The CMA considered whether carpet manufacturers that do not currently self-supply would start doing so in response to a SSNIP.<sup>76</sup> However, based on evidence from third parties, the CMA understands that self-supply would be costly and would require highly skilled labour to run the machinery. The CMA found that setting up costs could require approximately £15-30 million investment, along with the development of the necessary skill set.

*Conclusion on the treatment of self-supply by vertically integrated carpet manufacturers*

116. For the reasons set out above, the CMA therefore does not include self-supply of woollen yarn by vertically integrated carpet manufacturers in the frame of reference.

*Further segmentation of production and supply of woollen yarn to carpet manufacturers by the end use*

117. The CMA considered whether the product scope should be segmented by reference to the end use of woollen yarn, in particular between residential and commercial carpets.
118. The CMA notes some differences in the conditions of competition between the supply of woollen yarn; for example, the supply of woollen yarn for residential carpets appears to be more concentrated and smaller producers tend not to supply yarn for commercial carpets.
119. However, owing to the fact that the major suppliers of woollen yarn supply to manufacturers of both residential and commercial carpets and to the existence of some evidence of supply-side substitutability, the CMA considers it appropriate to assess the effects of the Merger against a product frame of reference comprising both residential and commercial end-use. This approach is consistent with the Parties' submissions on frame of reference.<sup>77</sup>
120. The CMA has, however, considered any differences between these end-uses in the competition assessment, where relevant.

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<sup>76</sup> See [Merger Assessment Guidelines](#), September 2010, from paragraph 5.2.20 .

<sup>77</sup> The Parties submitted that the appropriate frame of reference is broader than woollen yarn and they have not proposed any distinction by reference to end-use.

### *Conclusion on product frame of reference*

121. For the reasons set out above, the CMA considers it appropriate to assess the impact of the Merger by reference to the supply of woollen yarn to carpet manufacturers. The CMA has considered in the competition assessment the constraints imposed by synthetic yarn and the differences in the end uses of woollen carpets.

### **Geographic scope**

122. The CMA considered the appropriate geographic frame of reference for the assessment of the effects of the Merger.

123. Danspin submitted that both yarn and carpets are globally traded products and that imports often enjoy a lower cost base.<sup>78</sup> Danspin also submitted that all UK customers source yarn from a range of suppliers for different carpet ranges including both UK-based suppliers and those based abroad.<sup>79</sup> In its response to the Issues Letter, Danspin also submitted that it was unrealistic to ignore imports of woollen carpets as a constraint. This point is considered in the competitive assessment below, see paragraphs 183 to 188.

124. The CMA found that the price of woollen yarn is negotiated between woollen yarn producers and carpet manufacturers and hence prices may differ between geographies. The CMA also found that the conditions of competition currently appear different in the UK to elsewhere, with the Target being more important in the UK.

125. Third party evidence also indicates that that woollen yarn suppliers that are not currently active in the UK are not able to switch capacity quickly to start supplying the UK nor establish the necessary customer relationships easily.

126. The CMA considers that the evidence set out above indicates that it is appropriate to assess the effects of the Merger on the basis of supply of woollen yarn to UK carpet manufacturers.<sup>80</sup>

127. The CMA considered whether suppliers of woollen yarn based outside of the European Economic Area (**EEA**) which currently serve UK customers should be included in the geographic frame of reference.

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<sup>78</sup> See [Section 5 response dated 25 June 2019](#), paragraph 3.6.

<sup>79</sup> See Danspin's response dated 9 August to the section 109 notice dated 23 July 2019, section 17.

<sup>80</sup> When prices differ between geographies, it may be appropriate to define the geographic frame of reference according to customer, rather than supplier, location (see [Merger Assessment Guidelines](#), September 2010, paragraph 5.2.27).

128. The CMA found evidence from the Parties<sup>81</sup> and third parties indicating that UK carpet manufacturers predominantly purchase from the woollen yarn producers based within the EEA.
129. Third party submissions generally indicate that these non-EEA suppliers impose an extremely limited constraint on the Parties and other EEA-based suppliers. This is mainly because a very small number of third parties purchase from outside the EEA, with some customers indicating that suppliers of woollen yarn from outside the EEA are not an alternative because of the low quality of woollen yarn they produce, the longer lead times required and higher transport costs. One third party also noted the applicable custom duty as a barrier for these suppliers to be competitive in the UK, along with higher transport costs. Only one third party told the CMA that it could easily switch to purchasing woollen yarn from suppliers outside of Europe.
130. The CMA notes, in any case, that there are a very limited number of woollen yarn suppliers beyond those that currently supply woollen yarn to UK carpet manufacturers. A few third parties told the CMA that the UK accounts for a significant proportion of the demand for woollen carpets in Europe.
131. Despite the evidence on the very limited competitive constraint imposed by non-EEA suppliers, the CMA has, on a cautious basis, included non-EEA woollen yarn suppliers that currently serve UK customers in the geographic frame of reference.
132. For the reasons set out above, the CMA has focused its assessment on competition for the supply of woollen yarn to UK carpet manufacturers, taking into account supplies from woollen yarn suppliers located both in the UK and outside the UK. The CMA has considered the potential for supply by manufacturers not currently present in the UK as part of its assessment of entry and expansion.

#### *Conclusion on geographic scope*

133. For the reasons set out above, the CMA has assessed the Merger by reference to the supply of woollen yarn to UK carpet manufacturers (including EEA and non-EEA woollen yarn suppliers).

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<sup>81</sup> [LY123 internal market share estimate](#) shows that the vast majority of woollen yarn sold to UK carpet manufacturers comes from EEA based spinners.

## ***Conclusion on frame of reference***

134. For the reasons set out above, the CMA has assessed the impact of the Merger on the supply of woollen yarn to carpet manufacturers in the UK for both commercial and residential carpets. Any differences within that frame of reference have been considered as part of the competitive assessment. The constraints imposed by synthetic yarn and synthetic carpets have been considered in the competitive assessment.

## **Competitive assessment**

### ***Horizontal unilateral effects***

135. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to degrade quality on its own and without needing to coordinate with its rivals.<sup>82</sup> Horizontal unilateral effects are more likely when the merging parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in the supply of woollen yarn to carpet manufacturers in the UK.

136. The concern under this theory of harm is that the removal of one party as a competitor could allow the Parties to increase prices, lower quality, reduce the range of their services and/or reduce innovation.<sup>83</sup>

137. In order to assess the likelihood of the Merger resulting in unilateral effects, the CMA considered:

- (a) Shares of supply;
- (b) Closeness of competition between the Parties; and
- (c) Other competitive constraints on the Parties.

### ***Shares of supply***

138. Based on customer and third party data, the CMA estimated the Parties' and their competitors' shares of the supply of woollen yarn to UK carpet manufacturers, by volume (tonnes), in 2018.

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<sup>82</sup> See [Merger Assessment Guidelines](#), from paragraph 5.4.1.

<sup>83</sup> See [Merger Assessment Guidelines](#), from paragraph 5.4.1.

**Table 1: Shares of supply in woollen yarn sold to UK carpet manufacturers (2018)**

	Total volume (tonnes)	Share of supply (%)
The Target	[X]	[50-60]%
Danspin	[X]	[10-20]%
<b>Combined</b>	<b>[X]</b>	<b>[70-80]%</b>
Semonte	[X]	[10-20]%
Lusolã	[X]	[5-10]%
Other	[X]	[5-10]%

**Source:** CMA's estimates based on information from the Parties and from competing yarn suppliers, supplemented with information from carpet manufacturers on their sources of yarn supply.

139. The CMA estimates that the Parties have a combined share of supply of [70-80]% in the supply of woollen yarn to UK carpet manufacturers with an increment of [10-20]%, as set out in Table 1. There are only two other competitors with a sizeable share of supply (Semonte and Lusolã), with all the other suppliers having a very small presence in the UK. Therefore, even if Semonte and Lusolã were to exercise a material constraint on the Parties (which as explained in paragraphs 162 to 179, is not supported by the evidence) the Merger would reduce the number of effective competitors from four to three.
140. The CMA has not received volume estimates from all potential third party suppliers which it contacted. However, the shares of supply estimated by the CMA are broadly in line with an internal estimate produced by the Target in 2018/2019,<sup>84</sup> which showed the Parties to have a combined share of supply of [70-80]% and an increment of [10-20]%. Any missing volumes are therefore likely to be very small.
141. The Parties submitted that their combined share of supply in woollen carpet yarn to UK customers was [30-40]%.<sup>85</sup> However, this includes self-supply by vertically integrated carpet manufacturers that the CMA has concluded above does not form part of the frame of reference (see paragraphs 112-116 above). The Parties also submitted an estimate based on the yarn component of all woollen carpets sold in the UK.<sup>86</sup> This further reduced the Parties' shares as it included an estimate for the yarn that is contained in finished woollen carpets which are imported into the UK, and which are not included in the frame of reference. While the CMA does not consider it appropriate to include finished carpets in the calculation of market shares, it has considered the out-of-market constraint from finished carpets below (see paragraphs 183-188).

<sup>84</sup> See [LY123 internal market share estimate](#).

<sup>85</sup> See [Section 5 response dated 25 June 2019](#), paragraph 4.3. The Parties also submitted an earlier estimate produced by the Target in 2015 that gave a combined share of 44%.

<sup>86</sup> See [Section 5 response dated 25 June 2019](#), paragraph 4.1.

Additionally, the CMA notes that such estimates are subject to large margins of error, as it is difficult to estimate the value of the yarn included in carpets. The CMA therefore does not consider these estimates to be a reliable indicator of the Parties' market strength, post-Merger.

142. The CMA also considered the shares of the Parties and their competitors in the supply of woollen yarn for residential and commercial carpets to UK customers separately, based on estimates made by the Target, as set out in Table 2 and Table 3 below.

**Table 2: Shares of supply in woollen yarn sold to UK carpet manufacturers for the production of residential carpets (Target's internal estimate), 2018/19**

The Target	[50-60]%
Danspin	[20-30]%
<b>Combined</b>	<b>[80-90]%</b>
Semonte	[10-20]%
Lusolã	[0-5]%
Calder	[0-5]%
Other	[0-5]%

**Source:** Target's internal document

143. With regard to the supply of woollen yarn for residential carpets to UK customers, Table 2 shows that the Parties have an estimated combined share of supply of about [80-90]% with an increment of about [20-30]%.<sup>87</sup> This suggests that the supply of this type of yarn is even more concentrated, as all suppliers other than the Parties and Semonte have very small shares.

**Table 3: Shares of supply in woollen yarn sold to UK carpet manufacturers for the production of commercial carpets (the Target's internal estimate), 2018/19**

The Target	[10-20]%
Lusolã	[30-40]%
Calder	[10-20]%
Pine Textile	[5-10]%
Other	[20-30]%

**Source:** Target's internal document

144. With regard to the supply of woollen yarn for commercial carpets, according to The Target's internal estimates indicate that Danspin is not active in the supply of woollen yarn for commercial carpets in the UK. However, Danspin told the CMA that, in 2018, it did supply yarn into the UK for the production of commercial carpets.<sup>88</sup>

<sup>87</sup> See [LY123 internal market share estimate](#).

<sup>88</sup> See Danspin's [response to RFI dated 30 September](#).

145. The shares of supply estimates above suggest that Lusolã and smaller suppliers have larger shares in the sale of yarn for commercial, than residential, carpets in the UK.
146. In total, the volume of woollen yarn sold for residential carpets is much higher than the volume of woollen yarn sold for commercial carpets. The Target's estimates imply that about [80-90]% of woollen yarn is sold to the UK for residential carpets against [10-20]% for commercial carpets.
147. The CMA believes that the Parties' combined shares of supply are high enough to raise significant *prima facie* competition concerns in the supply of woollen yarn sold to carpet manufacturers in the UK.
148. The Parties' higher share of supply and increment in woollen yarn sold for residential purposes is indicative of the parties competing particularly closely in this segment, this closeness of competition is discussed further in the closeness of competition section.
149. The Parties' lower shares of supply with respect to woollen yarn sold for commercial purposes suggests that the Parties' do not currently compete as closely in the supply of these types of yarns. However, in light of Danspin's submission that they are active in this segment and the scope for supply-side substitution between the two segments (as noted in paragraph 119), the CMA has not been able to exclude the possibility of *prima facie* concerns in relation to woollen yarn for commercial carpets.

#### *Closeness of competition*

150. The CMA has examined the closeness of competition between the Parties and has considered within the assessment the:
  - (a) Similarity in the Parties' woollen yarn;
  - (b) Evidence from internal documents;
  - (c) Switching data; and
  - (d) Third party views on closeness of competition.

#### *The Parties' woollen yarn*

151. Danspin submitted that there is a large range of woollen yarn that can be used to produce a large variety of different types of carpet (such as Saxony,

Berber, cut fibre, loop fibre, velvet, frieze and cut-and-loop).<sup>89</sup> These types of yarn will vary with respect to differences in weight, twist and in some instances suitability for certain carpet styles such as cut pile.<sup>90</sup>

152. The CMA has assessed whether there are any types of yarn that the Parties compete over particularly closely.
153. The CMA believes that the Parties compete particularly closely in the supply of dry spun heat set yarn used for residential carpets. The CMA has been told by third parties that the production of dry spun heat set yarn requires expensive Superba continuous heat setting machines, which are only owned by a small number of woollen yarn producers. The CMA understands that these machines allow the Parties to produce yarn for high speed tufting at higher quality and lower cost than competitors who lack such machinery. This is reflected in the Parties' combined shares in the supply of woollen yarn used in residential carpets shown in Table 2 (which is estimated to be [80-90]%).<sup>91</sup>

#### *Internal documents*

154. As part of its assessment of the extent to which the Parties view each other as close competitors, the CMA has considered the statements made in their internal documents, including emails between each of the Parties and their customers, internal emails between senior employees (including senior management) of each of the Parties, and the Target's internal weekly reports about its customers and site visit reports.
155. The CMA has found evidence from the Parties' internal documents that indicates that the Parties consider each other to be their closest competitor. For example:
- (a) Several emails between Danspin and its customers that refer to sales lost from its key customers to the Target.<sup>92</sup> There are also some internal emails between Danspin's employees that refer to the Target's

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<sup>89</sup> See Danspin's [section 5 response dated 25 June 2019](#), paragraph 3.4.

<sup>90</sup> See Danspin's [section 5 response dated 25 June 2019](#), paragraph 3.5.

<sup>91</sup> See [LY123 internal market share estimate](#).

<sup>92</sup> By way of example, the email chain between [REDACTED], in which Danspin raises concerns about the transfer of some shades from Danspin to the Target (see [DS11](#)). Another example is an internal email exchange between [REDACTED] about [REDACTED] ordering certain yarn from the Target only 'Today they order at [REDACTED] and [REDACTED] makes sure to order the yarn at Lawton. [REDACTED] (see [DS52](#)).

See for example [DS3](#) titled [REDACTED]. In the email [REDACTED] asks [REDACTED]: 'Why do they purchase from Lawton, did she mention that?'. [REDACTED]: '[REDACTED].'



offering of low prices and how Danspin needed to react to such a price decrease;<sup>93</sup>

- (b) Several of the Target's internal documents (eg weekly reports or site visit reports) refer to winning product ranges from Danspin and discuss the Target's concerns regarding the product ranges as well as volume that it is in danger of losing to Danspin;<sup>94</sup>
- (c) Fewer internal documents of the Parties refer to other woollen yarn producers as a threat<sup>95</sup>; and
- (d) Other internal emails between Target's employees suggest that the Target is competing with Danspin with respect to innovation, for example in relation to mothproofing technology.<sup>96</sup>

156. The CMA therefore believes that each Party considers the other to be its closest competitor, and thus exercises a significant constraint on the other's business.

#### *Switching data*

157. The Target has provided data on all instances in the last two years where it has lost sales of yarn for a particular carpet product to a competitor. For each instance, it has provided the name of the competitor to whom it suspects the sales were lost. In five of the six instances these sales were believed to be lost to Danspin.<sup>97</sup>

158. The Target has provided all the instances in the last two years when it was in discussions with carpet manufacturers over the provision of yarn for a new carpet product.<sup>98</sup> For each of the instances, it has listed the names of the

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<sup>93</sup> In some emails Danspin comments on the loss of business from some of its customers as a result of the Target offering low prices and on how Danspin was planning to react. For example, in an internal email, there is discussion between [REDACTED] around the sales to [REDACTED].<sup>93</sup> This email shows that Danspin was concerned about [REDACTED] choosing the Target to produce woollen yarn for many of its lines, because Danspin's prices were higher than those charged by the Target. As a result, Danspin was considering [REDACTED] to keep the remaining [REDACTED] business. In another email chain, it is reported that two of the Parties' joint customers [REDACTED] (see DS51 and DS63).

<sup>94</sup> The CMA asked the Target to submit documents that discussed competitors. Many of these documents discuss the product ranges which the Target might be able to pick up from Danspin and those product ranges that it is in danger of losing to Danspin. For example, a 2017 sales report makes several prominent mentions of Danspin such as: [REDACTED]; [REDACTED] is the area of most opportunity. [REDACTED]. We get [REDACTED], all through [REDACTED]. [REDACTED]. There is good motivation from the team to give more business to LY'.

Also, in 2018, the Target attempted to increase its prices to all of its customers. The Target sent emails to all its customers, one of whom responded to these emails with specific reference to Danspin's prices. One internal email discussing these price increases showed the Target's concern about losing volume to Danspin.

<sup>95</sup> For instance, in 20 weekly reports of the Target and site visits, Danspin is mentioned 22 times. The next most commonly mentioned competitor is only mentioned five times.

<sup>96</sup> See for example, LY109: '[REDACTED].'

<sup>97</sup> Danspin's response to question 23 of [RFI dated 16 August](#).

<sup>98</sup> Danspin's response to question 24 of [RFI dated 16 August](#).

competitors with whom it believes it was competing to supply. The data shows the following:

- (e) In seven out of eight instances Danspin was competing to supply the product;
- (f) The only instance in which Danspin was not competing was when the Target had an exclusive relationship and therefore the product was not open to competition;
- (g) In five of the eight instances Danspin was the only competitor competing to supply.

#### *Third party comments*

159. Overall, the CMA's market testing indicates that the Parties compete closely and produce the same types of yarn. Some third parties told the CMA that they believe the Parties are particularly close competitors because both Parties are able to produce dry spun heat set yarn, that they are the two suppliers with the largest capacity, and that it would not be possible to switch away from them entirely to a third supplier. Some third parties also stated that the Parties are the only two significant suppliers of woollen yarn, and that this would be lost post-Merger. Furthermore, for a number of third parties, the Parties are the only two real alternatives in terms of buying carpet yarns on a commercial scale.
160. The CMA's market testing asked customers of the Parties to name the best alternative supplier for the woollen yarn they purchase from that Party. For the Target's customers, the most common alternative suppliers listed were Danspin and Lusolã. For Danspin customers, the most common alternative supplier listed was the Target.

#### *Conclusion on closeness of competition*

161. For the reasons set out above, the CMA believes that the Parties are one another's closest competitors for the supply of woollen yarn to UK carpet manufacturers.

#### *Competitive constraints*

162. Unilateral effects are more likely where customers have little choice of alternative supplier. The CMA has considered:
- (a) Whether and to what extent alternative suppliers would provide a competitive constraint on the merged entity; and

- (b) Whether and to what extent the merged entity will face other competitive constraints, including from synthetic yarns, vertically integrated carpet manufacturers and from finished carpets.

163. As part of this assessment, the CMA has considered evidence from the Parties' internal documents and third parties' views on the competitive constraints that Danspin would face after the Merger.

*Alternative suppliers of woollen yarn*

164. Danspin has stated that it does not have reliable information on the sales of competitors. It did however provide a list of competitors including a number of woollen yarn producers who sell to UK carpet manufacturers.<sup>99</sup>

165. As shown in Table 1, four woollen yarn suppliers (the Parties, Semonte and Lusolã) account for about [90-100]% of the woollen yarn supplied to carpet manufacturers in the UK. Semonte and Lusolã are the only other competitors mentioned in the majority of the Parties' internal documents and submissions from third parties.

166. Therefore, the CMA's current view is that Semonte and Lusolã are the only competitors that impose a plausible constraint on the Parties. The CMA has therefore focused its assessment on whether and to what extent these competitors constrain the Parties.

167. In assessing the constraint from Semonte and Lusolã, the CMA has taken into account:

- (a) Similarity of service proposition;
- (b) Evidence from internal documents; and
- (c) Third party views.

- *Constraint from Lusolã*

- Service proposition

168. Lusolã produces a wide range of yarns and has been identified by some customers as a viable alternative to the Parties. Evidence from third parties

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<sup>99</sup> The list of woollen yarn suppliers includes: Semonte; Atlantic Yarns; Woollen Spinners; Lusolã; FX Wang; Martinelli; Grentex; Bothra; Geetanjaa; Kapotex; Uscardes and Nun Mensucat.

indicates that it produces woollen yarn for both residential and commercial carpet and that it competes most closely with Danspin and the Target.

169. Table 1 above shows that Lusolā has a [5-10]% share in the supply of woollen yarn to UK carpet manufacturers. However, as shown in Table 3, the Target estimates that Lusolā has a higher share in the supply of woollen yarns for commercial carpets. This suggests Lusolā has a stronger presence in this segment and imposes a much less significant constraint in the supply of woollen yarn for residential carpets, in which the Parties compete more closely.

#### Internal documents

170. While the Parties refer to Lusolā, Lusolā is not mentioned as often in the Parties' internal documents as each other.
171. In particular, there is minimal discussion of Lusolā in Danspin's internal documents, which the CMA believes indicates that Lusolā is not perceived by Danspin as an effective competitor, nor by Danspin's customers as an effective alternative.
172. While the Parties seem to refer to Lusolā, Lusolā is mentioned far less often in the Parties' internal documents than the other Party. The minimal discussion of Lusolā in the Parties' internal documents indicates that Lusolā is not perceived as an effective competitor by either merger party.

#### Third party views

173. The CMA understands from third party evidence that some customers supplying carpets for residential use consider Lusolā to be an alternative supplier to the Parties. However, some third parties noted material differences in the varieties of yarn offered and differences in manufacturing method deployed by Lusolā. Based on the available evidence, the CMA believes that, even if Lusolā were able to increase capacity, it would not be able to increase to a scale that would meaningfully constrain the Parties post-Merger.
174. This is consistent with the shares of supply data described above which also shows that Lusolā has a small presence in woollen yarn for residential carpets, in which the Parties overlap and compete more closely.

- *Constraint from Semonte*

#### Service proposition

175. As set out in Table 1, Semonte appears to compete with both Parties to some extent, with a share of [10-20]% in the supply of woollen yarn to carpet manufacturers in the UK. Semonte is mainly present in the supply of woollen yarn for residential carpets.

#### Evidence from customers

176. The CMA understands from third party evidence that Semonte:

- (a) Has a strong relationship with a particular carpet manufacturer in the UK for the supply of woollen yarn. [REDACTED];
- (b) The vast majority of the third parties that responded to the CMA's questionnaire did not report purchasing from Semonte in 2018, nor considered Semonte to be a potential alternative supplier to the Parties; and
- (c) One third party told the CMA that Semonte is not a competitive option, mainly because of its small size, and that it cannot supply certain types of yarns that require specific processes.

#### Internal documents

177. In one email from a third party addressed to the Target, a third party states that 'Semonte is locked into Cormar',<sup>100</sup> which suggests that Semonte cannot supply other carpet manufacturers.

178. While the Parties seem to refer to Semonte,<sup>101</sup> Semonte is not mentioned as often in the Parties' internal documents as the other Party.

- *Constraint from alternative woollen yarn suppliers*

179. Given the above reasons, the CMA believes that Lusolã and Semonte only constrain the Parties to a limited degree and that the constraint imposed by these two woollen yarn suppliers is not sufficient to prevent the merged entity from increasing the price of woollen yarn or worsening other aspects of its offering.

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<sup>100</sup> See LY124.

<sup>101</sup> See for example DS14.

### *Other competitive constraints*

180. The CMA has also considered the competitive constraints on the Parties from outside the product frame of reference identified above (woollen yarn), including from synthetic yarn, vertically integrated carpet manufacturers selling into the merchant market and imported carpets. These were cited by the Parties as competitive constraints.<sup>102</sup>

#### *Synthetic yarn*

181. As discussed in more detail in the product frame of reference section, the CMA believes that synthetic yarn is unlikely to impose a significant constraint on the Parties, in particular because of:

- (a) The large price difference between woollen carpet and synthetic carpet;
- (b) The lack of evidence produced by the Parties that evidences direct losses of particular business to synthetic yarn;
- (c) The different characteristics of woollen and synthetic carpets;
- (d) End-consumers'-perceptions and preferences in relation to woollen and synthetic carpets; and
- (e) The inability of the Parties' direct customers to easily switch to using synthetic yarn.

#### *Vertically integrated carpet manufacturers*

182. As discussed above (see paragraphs 112-116) the CMA has not found sufficient evidence of material constraints on non-vertically integrated suppliers of woollen yarn, such as the Parties, from vertically integrated carpet manufacturers supplying other carpet manufacturers.

#### *Imported woollen carpets*

183. Danspin submitted that the price of woollen yarn is constrained by finished carpets which are imported into the UK, notably from India, Turkey and China. The Parties submitted that it was unrealistic to ignore imports of woollen carpets, which could be made by wholesalers, buying groups and retailers.<sup>103</sup> They also said that imports of woollen carpets are significant, referring to

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<sup>102</sup> See Danspin's response on 9 August 2019 to the CMA's section between n 109 notice dated 23 July 2019.

<sup>103</sup> Danspin slides for the Issues Meeting.

2018 figures showing imports of tufted woollen carpets of £50 million. The CMA notes that this represents only 20% of estimated residential UK woollen carpet sales, implying that UK woollen carpets account for the vast majority of residential UK woollen carpet sales.<sup>104</sup>

184. The CMA has not found evidence in the internal documents of the Parties that they are constrained by imported woollen carpets and the Parties have not produced other evidence to support the submission that they are constrained by imported woollen carpets.
185. Furthermore, with regard to imports from India, Turkey and China, as mentioned above (under the 'Geographic scope' section), some third parties stated that yarn from outside of Europe is of lower quality, because lower grade local wool is used, and this may be reflected in a lower quality of imported woollen carpets using that woollen yarn.
186. The Parties also submitted that carpet manufacturers choose whether to produce their own carpets from yarn or to buy finished (also referred to as white label carpets) depending on the availability and price of yarn and that of finished carpets.<sup>105</sup>
187. The CMA has therefore considered whether, and to what extent, the Parties are constrained by carpet manufacturers purchasing white label woollen carpets instead of purchasing woollen yarn to manufacture their own carpets. The CMA has found the following:
  - (a) The majority of the Parties' customers that responded to the CMA's questionnaire did not purchase finished woollen carpets;
  - (b) The Target's internal documents<sup>106</sup> did not mention customers switching to purchasing finished carpets. There were, however, several mentions of the possibility of shifting volume to other woollen yarn producers; and
  - (c) Danspin's internal documents did not mention customers switching to purchasing finished carpets.
188. For the reasons set out in this section, the CMA believes that imports of woollen carpets, whether by wholesalers, buying groups, retailers or

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<sup>104</sup> Based on Carpet Foundation estimate at manufacturers' selling prices, (response to RFI dated 16/8/2019, Annex 11). Residential woollen carpet sales are primarily of tufted woollen carpet.

<sup>105</sup> See Danspin's [section 5 response dated 25 June 2019](#), paragraph 6.8. and Danspin's response on 9 August 2019 to the CMA's section 109 notice dated 23 July 2019, paragraphs 26.1 and 26.2.

<sup>106</sup> See all internal documents received in response to Q21 of the internal document request that were identified as "Email about price increase".

manufacturers, will impose a limited competitive constraint on the Parties post-merger.

#### *Conclusion on other competitive constraints*

189. Therefore, for the reasons set out above, the CMA believes that out-of-market constraints including synthetic yarn, woollen yarn produced by vertically integrated carpet manufacturers and white label finished carpets impose a limited competitive constraint on the merger entity.

#### *Internal documents on the overall competitive constraints on the merged entity*

190. The CMA has found evidence from Danspin's internal documents that indicates that the merged entity will not face meaningful competition from other woollen yarn suppliers. In one email exchanged [REDACTED].<sup>107</sup>

191. Emails from third parties received by Danspin or the Target also show these third parties' perception that Danspin's will be the only remaining main woollen yarn supplier after the Merger:

- (a) In one email sent to Danspin by a third party states: 'At the end of the exercise there will be only ONE volume spinner in Europe'<sup>108</sup>; and
- (b) Another email from a third party to one of the Target's directors states: 'Danspin are the only spinners in Europe that are capable of high quality performance wool yarn' and 'This would be the final chapter of wool spinning in Europe – a company formed as above would completely dominate the market'.<sup>109</sup>

#### *Third parties' views on the competitive constraints on the merged entity*

192. A few third parties told the CMA that the merged entity would not be sufficiently constrained after the Merger. They told the CMA that this is because the merged entity would be able to command a substantial share of the market and would be able to control the market price to a large extent. The concerns also included the substantial reduction in competition and that smaller players would not be able to obtain competitive prices. The CMA notes that the majority of the third parties that responded to the CMA did not raise concerns regarding the Merger, however, the CMA understands, based on their submissions, that this was because these third parties were under the

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<sup>107</sup> See DS12.

<sup>108</sup> See DS72.

<sup>109</sup> See LY124.



perception that the Target would have exited the market absent the Merger and the Merger meant the Target was continuing to operate (see also the considerations in paragraph 205).

### *Conclusion on horizontal unilateral effects*

193. In the light of the evidence set out above, the CMA believes that the Merger raises competition concerns as a result of horizontal unilateral effects in the supply of woollen yarn to UK carpet manufacturers, because: (i) the Parties are the two main suppliers of woollen yarn to UK carpet manufacturers, with a combined share of [70-80]% (by volume) in 2018; (ii) the Parties are each other's closest competitors; and (iii) after the Merger, the merged entity will not be sufficiently constrained by other relevant woollen yarn suppliers or by other out-of-market constraints.

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

194. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.<sup>110</sup> In terms of timeliness, the CMA's guidelines indicate that the CMA will look for entry to occur within two years.<sup>111</sup>

195. The Parties submitted that, while there has been no new entry, in terms of the UK, as UK-based woollen mills have closed, suppliers of woollen carpet yarn from outside of the UK have moved to supply UK and a large number of suppliers of synthetic carpet yarn, particularly from India and Turkey have entered the market with relative ease.<sup>112</sup>

196. The evidence received by the CMA from third parties at this stage in the investigation does not indicate that entry or expansion will be timely, likely or sufficient to mitigate any SLC arising.

197. First, the barriers to entry and expansion are significant, the CMA understands from third party evidence that:

- (a) Entering the supply of woollen yarn would involve significant set-up costs, including buying the necessary machinery. As mentioned above, machinery has a significant upfront cost (at least £2 million). Third

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<sup>110</sup> [Merger Assessment Guidelines](#), from paragraph 5.8.1.

<sup>111</sup> See [Merger Assessment Guidelines](#), paragraph 5.8.11

<sup>112</sup> See Danspin's response on 9 August 2019 to the CMA's section 109 notice dated 23 July, section 31.

parties told the CMA that it can be difficult to obtain new equipment, as this is not produced anymore;

- (b) Obtaining the necessary expertise to run a competitive business may be a significant constraint on entry;
- (c) Establishing the necessary customers relationships and trust with customers may also be a barrier to entry.

198. Second, Danspin and some third parties have submitted that the market for woollen yarn has been in decline for an extended period of time. If this is the case, this makes entry less likely.
199. Third, Danspin has not submitted evidence that any woollen yarn suppliers are planning to enter or expand their presence in the UK. Competitors from outside the EEA are mentioned in some of the Parties' internal documents, however, customers told us they were often reluctant to switch to these yarn producers due to concerns over quality and delivery times.
200. For the reasons set out above, the CMA believes that entry or expansion would not be likely, to prevent a realistic prospect of an SLC as a result of the Merger.

### ***Countervailing buyer power***

201. With regard to any countervailing power that carpet manufacturers may have, the CMA notes that Danspin stated 'carpet manufacturers are able to scrutinise the pricing proposals which they receive from Danspin. Given the significant expansion of synthetic yarn manufacturers and the vast market penetration for synthetic yarns (and, indeed, white label synthetic and woollen carpets from vertically integrated operations globally) this power has only increased in recent years'.<sup>113</sup>
202. The CMA believes that buyer power will not be sufficient to offset any SLC arising from the Merger because:
- (a) There are very limited alternative suppliers of woollen yarn to which carpet manufacturers can credibly switch;
  - (b) The CMA has found no evidence, at this stage, to suggest that carpet manufacturers are willing to sponsor entry or enter the supply of woollen yarn themselves; and

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<sup>113</sup> See Danspin's response on 9 August 2019 to the CMA's s109 notice dated 23 July 2019, paragraph 26.2.

- (c) Any buyer power that the main carpet manufacturers may have would not protect the small and medium sized carpet manufacturers.

### **Third party views**

203. The CMA contacted customers, competitors and suppliers of the Parties. A few customers raised concerns that Danspin would dominate the market and would be able to control prices.
204. Some third parties raised concerns around the potential exit of the Target, in the light of its financial position prior to the Merger, and the potential consequences of such an exit for other businesses in the overall sector. One third party raised concerns in relation to the effect the CMA's investigation may have on the future of the Target, on the Target's customers and particularly on the jobs in the area where the Target has its production facilities. These concerns assumed that, absent the Merger, the Target would have exited the market. Third party comments have been taken into account where appropriate in the competitive assessment above.
205. During the course of its inquiry, the CMA was been made aware of communications taking place between stakeholders in the industry during the CMA's investigation that may have influenced the content of some of the third party submissions, with two third parties changing their evidence to the CMA. The weight which the CMA attached to this evidence took this into account.

### **Conclusion on substantial lessening of competition**

206. Based on the evidence set out above, the CMA believes that it is or may be the case that the Merger has resulted, or may be expected to result in an SLC as a result of horizontal unilateral effects in relation to the supply of woollen yarn to carpet manufacturers in the UK.

### **Decision**

207. Consequently, the CMA believes that it is or may be the case that: (i) a relevant merger situation has been created; and (iii) the creation of that situation has resulted, or may be expected to result, in an SLC within a market or markets in the United Kingdom.
208. The CMA therefore believes that it is under a duty to refer under section 22(1) of the Act. However, the duty to refer is not exercised whilst the CMA is considering whether to accept undertakings under section 73 of the Act

instead of making such a reference.<sup>114</sup> Danspin has until 12 November 2019<sup>115</sup> to offer an undertaking to the CMA.<sup>116</sup> The CMA will refer the Merger for a phase 2 investigation<sup>117</sup> if Danspin does not offer an undertaking by this date; if Danspin indicates before this date that it does not wish to offer an undertaking; or if the CMA decides<sup>118</sup> by 19 November that there are no reasonable grounds for believing that it might accept the undertaking offered by Danspin, or a modified version of it.

209. The statutory four-month period mentioned in section 24 of the Act in which the CMA must reach a decision on reference in this case expires on 15 November 2019. For the avoidance of doubt, the CMA hereby gives Danspin notice pursuant to section 25(4) of the Act that it is extending the four-month period mentioned in section 24 of the Act. This extension comes into force on the date of receipt of this notice by Danspin and will end with the earliest of the following events: the giving of the undertakings concerned; the expiry of the period of 10 working days beginning with the first day after the receipt by the CMA of a notice from Danspin stating that it does not intend to give the undertakings; or the cancellation by the CMA of the extension

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<sup>114</sup> Section 22(3)(b) of the Act.

<sup>115</sup> Section 73A(1) of the Act.

<sup>116</sup> Section 73(2) of the Act.

<sup>117</sup> Sections 22(1) and 34ZA(2) of the Act.

<sup>118</sup> Section 73A(2) of the Act.

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**Competition and Markets Authority**  
**5 November 2019**