

Anticipated acquisition of the cellulose acetate flake, tow and filament business of Acetate Products Limited by Celanese Corporation

The OFT's decision on reference under section 33(1) given on 8 November 2006. Full text of decision published 28 November 2006.

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

**PARTIES**

1. **Celanese Corporation** (Celanese) is a global chemicals company active in the production and supply of cellulose acetate products, among other chemicals. Through its subsidiary Celanese Acetate LLC, Celanese is active in the production and supply of cellulose acetate flake (flake) and cellulose acetate tow (tow). Celanese exited the cellulose acetate film (film or filament) business in 2005. Celanese is partially vertically-integrated upstream in the production and supply of acetic acid and acetic anhydride to produce flake and tow.
2. **Acetate Products Limited** (APL), the cellulose acetate business of Corsadi BV, is active in the production and supply of flake, tow and filament. APL is partially vertically-integrated upstream in the production of acetic acid and acetic anhydride but all of its production is used internally. APL's turnover in the UK for the financial year ended 31 December 2005 was approximately [ ].

**TRANSACTION**

3. Celanese intends to acquire, by means of a business sale, the APL business for the manufacture, distribution and sale of flake, tow and film,

including related freehold and leasehold property, equipment, stock, contracts, goodwill and intellectual property rights (the APL business).

4. The transaction was announced on 29 August 2006. On 8 September 2006, the parties notified the proposed acquisition to the OFT. The administrative deadline is 3 November 2006. The parties have informed the OFT that in the EEA the transaction has also been notified to, and cleared by, the German Federal Cartel Office, the Austrian Federal Competition Authority and the Lithuanian Competition Council.

## **JURISDICTION**

5. Celanese and the APL business will cease to be distinct as a result of these arrangements. The acquisition satisfies the share of supply test set out in section 23(3) of the Enterprise Act 2002 (the Act), and therefore gives rise to a relevant merger situation, since the parties together will have a share of supply of over 25 per cent in the supply of tow in the UK.

## **PRODUCT MARKET**

6. The parties overlap in the production of acetic acid and in the production and supply of flake and tow.
7. Cellulose acetate products are chemicals derived from the combination of acetic anhydride, which is derived from acetic acid, another base chemical, and cellulose, a natural raw material derived from wood pulp.<sup>1</sup> Acetic anhydride and cellulose are combined to produce flake, which is used to produce primarily tow by dissolving flake in acetone, filtering it and spinning it into filaments which are collected to form a tow band or rope. Flake is also used in the production of filaments and yarn and, to a lesser extent, small amounts of engineering plastics. Tow is principally used as the primary component in cigarette filters.
8. The parties submit that acetic acid, flake and tow should each be considered separate product markets. Market participants confirm that each of these products lacks demand-side or supply-side substitutes. The OFT has therefore conducted its competitive assessment on this basis.

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<sup>1</sup> Acetic anhydride is also used in the production of various other chemicals including acetate esters.

## GEOGRAPHIC MARKET

### Acetic acid and flake

9. The European Commission in *Blackstone/Acetex*<sup>2</sup> concluded that the relevant geographic market for supply of acetic acid is global. The parties' combined share on this basis is low, and the OFT received no substantiated concerns in this case. Accordingly, the market for acetic acid is not considered further.
10. Flake is predominantly produced for captive use by vertically integrated suppliers of downstream products. Celanese does not own flake production sites in the EEA, instead supplying its tow site in Belgium by importing flake produced at its US facility. A significant part of the rationale for this transaction is to reduce Celanese's variable costs post-merger by shipping flake from APL facilities in the UK to Belgium instead of across the Atlantic. Celanese had the smallest position in EEA merchant sales ([ ] per cent), and five suppliers will remain post-merger. For these reasons, issues of market definition can be left open as the transaction raises no competition concerns. Flake is therefore not considered further.

### Tow

11. Four suppliers produce tow in the EEA: Celanese (Belgium), APL (UK), Rhodia (Germany) and Eastman (UK). Celanese and [ ] also ship significant volumes of tow from production sites in North America and imports from North America account for approximately 20 per cent of EEA consumption. The OFT therefore believes it unlikely that a hypothetical EEA monopolist could profitably raise price, and, on balance, that supply sources in the Americas should be included within the relevant geographic market. (Note, though, that the relevant concentration and share data do not materially change if the transaction were examined on an EEA rather than transatlantic basis.) A key issue, however, is the degree to which actual or potential supply from Asia constrains EEA suppliers such as the merging parties.
12. The relevant evidence on this point is not universally consistent. On the one hand, several EEA customers indicate that the combination of transport

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<sup>2</sup> Case No. COMP/M.3625 - Blackstone/Acetex.

costs and import duties may present material barriers to trade flows, particularly from Asia into the EEA. Some contend that Asian producers, such as the Japanese producers Daicel and Mitsubishi and the Korean producer SK Chemicals, are not alternatives to transatlantic suppliers due to the level of Asian demand, capacity constraints and the combination of transport costs and import duty. Moreover, historical imports of tow from Asia into the EEA appear to have been low up to 2005.

13. On the other hand, most suppliers and a number of customers support Celanese's submission that the relevant geographic market is global. Daicel already supplies customers within the EEA, as to a lesser extent does Mitsubishi. In addition, the duty on tow imports into the UK is exactly the same for both Asian and US imports and the difference in transport costs is minimal. Overall, based on the parties' estimates, import duty and transport costs add [4-6] per cent to US import prices and [6-8] per cent for tow imports from Asia into the UK. Assuming the incentive to supply the EEA (discussed further below) the [2-4] percentage point differential on freight and duty charges suggest that Asian importers could not be discounted as constraints on transatlantic suppliers on grounds of cost-competitiveness, not least because current Asian prices are cheaper than EEA prices, which can be attributed to lower input (energy and labour) costs in Asia than in the EEA and North America.
14. In the light of the above considerations, the OFT believes that it is appropriate to consider the constraint posed by Daicel and other Asian suppliers directly within the competitive assessment rather than reach a binary conclusion on geographic market definition that either includes or excludes Asian-origin supply. As noted, however, the evidence does support a geographic market for tow that is at least transatlantic in scope.

## **HORIZONTAL ISSUES**

### **Share and concentration data**

15. As shown in the table below, the transaction combines two of the five principal global suppliers to give the merged entity [40-50] per cent of capacity (increment [ $< 10$ ] per cent) and reduce the number of current principal suppliers from five to four. At a transatlantic level, the transaction is a four to three giving the merged firm [40-50] per cent of capacity (increment [ $< 10$ ] per cent). Sales data are unavailable on a transatlantic

basis, but based on EEA data, the merged entity would have [40-50] per cent of capacity (increment [ $< 10$ ] per cent). These concentration levels are such as to give rise to prima facie competition concerns but no presumption that the merger will substantially lessen competition.

#### Tow capacity, 2005

Supplier	Transatlantic Capacity kt	Share of Transatlantic Capacity per cent	Global Capacity kt	Share of Global Capacity per cent
Eastman	[ ]	[30-40]	[ ]	[20-30]
Celanese	[ ]	[30-40]	[ ]	[30-40]
Rhodia	[ ]	[20-30]	[ ]	[10-20]
APL	[ ]	[10-20]	[ ]	[0-10]
Daicel	[ ]	[0-10]	[ ]	[0-10]
Other Asian	[ ]	[0-10]	[ ]	[0-10]

Note: Celanese global capacity includes [ ] from joint ventures with China National Tobacco Corporation (CNTC)

#### Tow sales, 2005

Supplier	EEA sales kt	Share of EEA Sales per cent
Eastman	[ ]	[10-20]
Celanese	[ ]	[20-30]
Rhodia	[ ]	[40-50]
APL	[ ]	[10-20]
Daicel	[ ]	[0-10]
Mitsubishi	[ ]	[0-10]

Note: sales data only available for EEA

#### Dynamics of demand and supply

16. The demand side of the market for tow has two key features relevant to the competitive assessment.
17. First, the tobacco industry, the principal purchasers of tow, has consolidated over the last decade down to five principal global manufacturers: Philip Morris (US); Japan Tobacco (Japan); and three UK

multinationals, British American Tobacco, Imperial Tobacco and Gallaher. Another large UK customer of tow is Filtrona, which manufactures speciality filters. These suppliers deal with the same principal global suppliers, tending to multi-source demand and to split their contracts and volumes to serve the various production plants.

18. Second, the global pattern of demand for cigarettes and in turn tow has been shifting. Demand for cigarettes has fallen markedly in UK as well as elsewhere in Western Europe and North America. At the same time, the production of cigarettes has been shifting out of this area. As a result, UK domestic demand for tow fell almost 30 per cent in just three years (2003 to 2005) to only 2.3 per cent of global demand (16.6 Kt). Overall, however, substantially increased demand in Asia, particularly China, as well as Eastern Europe contributed to a net increase in global demand for tow of 17 per cent during the same 2003 to 2005 period. Cigarette manufacturers have therefore set up sites in Asia in order to satisfy regional demand. Demand in Asia has also recently shifted from non-filtered to filtered cigarettes, thus increasing demand for tow.
19. As tow demand has increased, it has outpaced new capacity in recent years, with capacity utilisation rising from [80-90] per cent in 2003 to [90-100] per cent in 2005.<sup>3</sup> Tow manufacturers are also following tobacco producers to Asia: Celanese has set up joint venture production in Asia, and other EEA suppliers are in the process of evaluating plans to invest in capacity there.
20. Figures provided by the parties indicate that China has until recently been satisfying its tow demand principally through imports from North America and Japan. However, more recent estimates for 2006 demonstrate that tow imports into China, especially from Japanese producers have declined year to date. In contrast, Japanese exports to North America and the EEA have increased. This is partly due to capacity expansion in China by Celanese's joint ventures with the China National Tobacco Corporation (CNTC), which have made China proportionately more self-sufficient and less reliant on imports.

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<sup>3</sup> Parties' estimates.

## Unilateral effects

21. The principal theory of harm tested by the OFT is whether the acquisition of APL by Celanese will result in prices rising to UK and other EEA customers, given that this will only leave three major transatlantic suppliers, all of whom are capacity-constrained, and therefore may unilaterally have the ability and incentive to raise prices without fear that others will undercut them on prices, and without fear of losing substantial sales.
22. After careful consideration and as set out in more detail below, however, the OFT believes that the theory of harm is not sustainable beyond, at most, the short term. It is the OFT's judgment that within the short term and certainly beyond it, customer-driven competitive responses by Asian suppliers will be able to replicate the competitive constraint provided by APL and therefore restore marketplace dynamics to those that would have prevailed absent the merger. More specifically, the evidence available leads the OFT to expect that, in response to a post-merger price increase, the parties' UK (and other EEA) customers will discipline Celanese (and in turn Rhodia and Eastman) by increasingly leveraging the credible threat of switching greater proportions of their demand to Daicel and potentially other Asian suppliers who, despite their Asian focus, will have an increasing ability (capacity) and incentive to supply UK and other EEA demand if profitable to do so. This conclusion is based on the following principal considerations:
  - **Multinational tobacco customers can be expected to adjust their global procurement strategies to facilitate resisting price increases wherever possible.** The evidence available to the OFT supports the view that tobacco customers operate sophisticated procurement strategies, using global tenders on an annual basis to select their suppliers and allocate contract quantities between them. Customers keep contracts short, typically to one year duration, to avoid being tied into a supply agreement for long periods. Third party evidence suggests that multi-sourcing by some customers extends across three suppliers within the EEA and up to four or five globally. Several customers said that they would look for an alternative supplier if the merging parties increased their price by 5-10 per cent, although some were concerned that capacity constraints would limit them to switching small volumes. The overall weight of the evidence suggests that customers that deal with

the same suppliers across the globe for their demand are in the position to adapt their procurement to protect themselves from durable merger-related price increases, including by increasing their use of Asian suppliers such as Daicel. Given the record of multi-sourcing, this leverage does not depend on switching the entirety or even the majority of a customer's demand to Daicel; in the OFT's judgment it will suffice to discipline Celanese or a rival supplier if that customer reduces – or can credibly threaten to reduce – its volume commitment by a significant degree.

- **Daicel will be a credible substitute to APL post-merger in negotiations between customers and suppliers in the UK and the EEA.** Daicel is a Japanese supplier slightly larger in global size than APL. There are several reasons for concluding that customers will increasingly leverage supply from Daicel to discipline Celanese's competitive conduct post-merger.
  - First, Daicel has already demonstrated that it can meet customers' European needs, having supplied some quantities of tow to [ ] in the UK and [ ] in Western Europe; the parties also provided the example of one US customer switching its supply from Celanese's USA production site to Daicel's Japanese production site in order to source its tow more cheaply.
  - Second, Daicel, in an interview with the OFT, has itself confirmed that [ ].
  - Third, certain other EEA customers also indicated to the OFT that they regard Daicel as a potential supplier, and all transatlantic competitors regard Daicel as a credible rival.
  - Fourth, even allowing for the slight differential in freight charges relative to transatlantic supply, Daicel (and other Asian suppliers) are cost-competitive because of relatively low energy and raw materials costs in Asia: data provided by the parties suggest that currently tow produced and sold in Europe is priced about [4-6] per cent higher than that at which Asian produced tow could sell for, once adjusted for import duty and transport costs. Any increase in price by the merging parties or across the EEA as a whole would therefore

further increase the incentive for Asian suppliers to compete in the EEA, as capacity becomes available to do so.

- Fifth, there is also objective support for the view that not all Asian capacity, including new capacity, will be reserved for Chinese and other regional supply. China is becoming increasingly self sufficient following a large capacity expansion plan in China in the period of 2005 and 2006, suggesting that suppliers currently exporting to China (from North America, the EEA or Japan) will need to find alternative markets for their products. This has already been seen, to a certain extent, in 2006. For instance Chinese imports from Germany decreased 96 per cent between 2004 and 2006 (January to August), and decreased 43 per cent from Japan over the same period. Moreover, Chinese demand for tow is expected to grow at a slightly slower rate over the next few years, as the rapid acceleration witnessed in the past few years has mostly been due to a shift in consumer demand from non-filter to filter cigarettes. As this shift has now taken place to a large extent, the rate of increase of demand is expected to slow. In addition, at least one global producer has stated that they currently have plans, albeit uncommitted, to build new tow production sites in Asia, which may reduce imports from North America and the EEA further.
- Sixth, given the high fixed costs associated with the production of tow, there is no rational reason why Daicel, for example, would not supply contracts for supply in the EEA given that not all of its capacity is committed to serving China and other regional demand and that, aside from the purely Chinese manufacturers, the globally-active tobacco companies are the same customers in Asia as in Europe and elsewhere and therefore supply relationships may already be in place. Overall, the competitive constraint posed by Daicel does not depend on its entire capacity being dedicated to European supply; it is sufficient that it represents a credible option for a portion of EEA customer demand in their negotiations going forward.
- **Celanese's rivals aside from Daicel will also be less capacity-constrained in the near to medium term.** The tight supply/demand balance within the EEA can be expected to slacken in the next several years as capacity expansion and declining demand take greater effect. Data available to the OFT indicate a [5-10] per cent capacity increase over

the next three years, which, on the parties' figures, will reduce capacity utilisation. Eastman has recently announced plans to expand tow production in its UK site by 9kt, and Rhodia has confirmed that it will increase production in Russia by [ ] kt, representing approximately 1.8 per cent and [ ] per cent of transatlantic capacity, respectively. At the same time, as stated above, the parties' internal documents and third party evidence indicate that EEA demand for tow is expected to remain static or decline. Following the 30 per cent decline in UK demand for tow between 2003 and 2005, a major UK tow customer, who accounted for some 15 per cent of UK demand in 2005, is in the process of closing its UK cigarette manufacturing site and is relocating production mainly to Asia. This freeing up of capacity will further aid customers' ability to switch portions of their demand to discipline supply post-merger.

### **Coordinated effects**

23. The OFT believes that the merger will not create or strengthen coordination between tow suppliers. There is no substantiated evidence that the market is currently subject to supplier coordination. Nor does the OFT believe it appropriate to conclude that the merger will create a significant risk of coordination, as it is unclear that terms of coordination could be reached or collusion sustained given the procurement patterns (low price transparency in competitive tenders; multi-sourcing) and profile of the relevant customers – the major global tobacco companies, which could be expected to disrupt and deter coordination. No concerns about coordination were brought to the OFT's attention save for one concern raised late in the investigation. One customer characterised APL as a maverick which could be used as a negotiation tool against other suppliers. This was uncorroborated by other market participants. Moreover, given APL's operations are limited to the UK, where labour and energy costs are likely to be relatively high there is no basis to conclude that APL is a low-cost supplier with 'maverick' pricing incentives. Nor did pricing data support the view that APL consistently prices lower than its rivals, and there is no evidence to suggest that APL was planning to embark on substantial expansion absent the merger. Accordingly, it remains speculative to suggest that APL has disproportionately influenced industry prices and that its removal would facilitate coordination.

## **THIRD PARTY CONCERNS**

24. The majority of customers expressed varying degrees of concern about this merger consistent with the unilateral effects theory set out above. These concerns, and the validity of this theory, have been addressed in the above analysis. No competitor raised foreclosure concerns.

## **ASSESSMENT**

25. The OFT's inquiry focused on the parties' overlap in the production and supply of tow. The merger will result in a reduction of major global tow suppliers from five to four (four to three on a transatlantic or EEA basis) and the post-merger shares of capacity and sales and increment are significant, in an industry with substantial capacity constraints in recent years.
26. As developed in greater detail above, however, the OFT does not believe that the merger will lead to durable competitive harm to EEA – and in particular UK – customers. The OFT's unilateral effects theory found insufficient support in the evidence. The customers are principally global tobacco companies with the ability to leverage their global demand and adjust their procurement strategies to discipline post-merger price increases. This response is credible because customers can turn to Asian suppliers and in particular to Daicel, a Japanese importer, to replicate the competitive constraint that APL posed on Celanese and its principal transatlantic rivals, Rhodia and Eastman. Daicel has already demonstrated its ability to serve European demand, and has committed capacity expansion plans, which, given the dynamics of supply and demand in Asia, will include capacity available to serve European demand. Equally, the capacity constraints of Celanese's other rivals are also expected to slacken, thereby facilitating customers' ability to distribute and adjust their demand across suppliers to constrain price increases. Finally, there was a lack of evidence available to the OFT to support a cogent coordinated effects theory in this sector.
27. On the weight of the evidence, therefore, the OFT accepts the possibility that the merger may result in adverse effects in the very short term, but does not believe that these will be durable. As globally-active customers and competitors have the ability and incentive to discipline the merged

firm, any lessening of competition cannot in the OFT's judgment be described as substantial.

28. Consequently, the OFT does not believe that it is or may be the case that the creation of this merger situation may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

29. This merger will therefore not be referred to the Competition Commission under section 33 (1) of the Act.