

Anticipated acquisition by Koppers Inc of Cindu Chemicals BV

The OFT's decision on reference under section 33(1) given on 23 February 2010. Full text of decision published 22 March 2010.

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

PARTIES

1. **Koppers Inc. (Koppers)** is a multinational firm producing chemicals, carbon compounds, and wood treatment products for the aluminum, chemical, plastic, railroad, steel, and utilities industries. Koppers has manufacturing and distribution facilities in: Australia, China, Denmark (Nyborg), and the UK (Port Clarence, Middlesbrough and Scunthorpe). Koppers is active in the distillation of coal tar which it uses to produce: carbon black, carbon pitch, chemical oils (including creosote), refined tar, and roofing pitch. In 2008, Koppers' worldwide turnover was £837m of which £[]m was earned in the UK.
2. **Cindu Chemicals B.V. (Cindu)** is active in the distillation of coal tar for binding agents in the steel and aluminum industries. Cindu's coal tar distillation facility is based in Uithoorn, Netherlands. Cindu produces: carbon black feedstocks, carbon pitch, creosote oils, electrode-binder pitches, and tar compounds. In 2008, Cindu's worldwide turnover was £31m, of which £[] was earned in the UK.

TRANSACTION

3. Koppers, either by itself or through a wholly owned subsidiary, intends to acquire 100 per cent of the issued share capital of Cindu.

4. The parties notified the transaction on 18 December 2009 and the extended administrative deadline is 23 February 2010.

JURISDICTION

5. A relevant merger situation arises when two or more enterprises cease to be distinct and either the UK turnover test or the share of supply test set out in section 23 of the Enterprise Act 2002 (the Act) is met.
6. The UK turnover generated by Cindu in 2008 was approximately £[]; the turnover test in the Act is therefore not met. However, the parties overlap in the supply of creosote, special pitch and carbolic oils in the UK and the share of supply test in section 23 of the Act is met in relation to all these products as the parties have in excess of 25 per cent of UK supplies in each of these.
7. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RATIONALE FOR THE TRANSACTION

8. Koppers told the OFT that the merger will [] as well as granting Koppers access to Cindu's terminal facilities in Amsterdam. Koppers believes this will enable it to provide a more efficient distribution of its (UK produced) products to customers in France, the Benelux countries and Germany. As part of the transaction, Koppers will enter into a long term coal tar supply contract with Corus, a 50 per cent shareholder in the target firm and upstream supplier of coal tar. Because of the importance of security of supply of coal tar the supply contract with Corus is not an insignificant part of the transaction.

COUNTERFACTUAL

9. In line with its normal approach, the starting point for the OFT's assessment in this case is that the appropriate counterfactual against which to assess this case is the pre-merger market structure. No

evidence has suggested that it would be appropriate to deviate from this counterfactual in this case.¹

MARKET DEFINITION

10. The parties purchase coal tar² and distill it into the following proportions of organic chemical products: **pitch** (around 50 per cent including small quantities of special pitch) of the output from the distillation process; aromatic oils (around 40 per cent including relatively small amounts of **creosote**), and naphthalene oils (around 10 per cent including relatively small amounts of **carbolic oil**). The motivation to distill coal tar is essentially to produce and market/sell pitch³ which is primarily used in the aluminum and graphite electrode industries. Products other than carbon pitch emanating from this process are considered to a greater or lesser extent as by-products some of which have an economic value either as standalone products or as a result of their constituent components.
11. Within the UK, the parties overlap in the supply of creosote, carbolic oils, and special pitches for roofing applications (the overlap products). The parties also both supply carbon pitch but not to the UK. However, this product is considered (in the context of a potential competition theory of harm) with the overlap products below.
 - A. creosote
 - B. carbolic oil
 - C. special pitch
 - D. carbon pitch.

¹ The parties emphasised to the OFT that, absent this merger, Cindu would have continued to operate in the market on the basis of its supply of coal tar from Corus. As such, there is no realistic possibility absent the merger of a competing supplier gaining access to the Corus coal tar supply such that the merger could be said in some way to lessen competition by raising rivals' costs compared to an alternative counterfactual.

² Coal tar, produced primarily by the steel industry, is a sticky liquid mixture of organic chemical compounds. It is produced as a by-product of the production of coke from bituminous coal, which is used in the production of steel. Coal tar production is dependent on the production of coke, and consequently the production of steel given it is a by product. The characteristics of coal tar make it impractical and uneconomic to store either in large quantities or for long periods of time.

³ Also referred to as tar pitch or carbon pitch.

A. Creosote

Product market

12. Creosote is used to protect wood against harmful insects and fungi and against water damage. The sale of creosote is subject to certain restrictions in many European countries. For example, restrictions in the UK mean that since 2003 creosote can only be sold to professional users.
13. The merging parties submitted to the OFT that, following the analysis of the European Commission in the Elf/Rutgers case⁴ in 1994, creosote should be regarded as forming part of a wider market for wood treatment products, and that oil borne preservatives;⁵ water borne preservatives;⁶ and solvent based preservatives⁷ are all, to some degree, substitutes (for example, Tanalith E). Indeed, the parties submitted that creosote accounts for less than five per cent of all wood treatments in the UK (by volume). They told the OFT that while the alternate products are not perfect substitutes for creosote for all applications (or life spans of treatment), they are nevertheless enough of a substitute for enough applications to act as a competitive constraint on creosote.
14. The OFT notes that since the Elf/Rutgers decision, there have also been changes in legislation in relation to wood preservation products and these changes materially alter the use of certain substances for the treatment of wood.
15. In the Elf/Rutgers decision the Commission noted that customers may be using creosote for very specific purposes and may not perceive any other product as being suitable for these purposes. However, the Commission indicated that this was a market in which it may be appropriate to rely

⁴ European Commission Decision case No. IV/M.442 – Elf Atochem/Rutgers.

⁵ Creosote distilled from tar other than coal tar; pigment emulsified creosote; EC 265; pentachlorophenol; copper naphthenate; chlorothalonil; chlorothalonil combined with chlorpyrifos; oxine copper; zinc naphthenate; Bis (tri-n-butyltin) oxide; 3-iodo-2-propynyl butyl carbamate; alkyl ammonium compound; propiconazole; tebuconazole; chlorpyrifos

⁶ chromated copper arsenate; acid copper chromate; ammoniacal copper zinc arsenate; ammoniacal copper quat; copper bis(dimethyldithiocarbamate); ammoniacal copper citrate; copper azole-type a; inorganic boron (borax/boric acid).

⁷ Light Organic Solvent Preservative ('LOSPs').

supply side substitution. For the present case, in reaching a view on product market scope it may be that customers purchase products which have been formulated for each of them in particular. This would not necessarily lead to the conclusion that each of these product permutations would form a separate market.

16. Customers commented to the OFT that they believed that there were no complete/close substitutes for creosote. They stated that creosote has very particular qualities⁸ which meant that they could not use any of the products the parties submitted were substitutes. Customers' views were largely confirmed by firms producing the putative substitutes who confirmed they did not believe they competed with creosote. Comments made to the European Commission as part of its consultation on the Biocidal products Directive 'Various views upon alternatives (to creosote)' concluded that most of the putative substitutes do not fulfill the demands of customers fully.⁹

17. More specifically, in relation to each of the proposed alternatives third parties commented as follows:
 - a. Unlike creosote, **oil borne preservatives** are not suitable for risky usage such as ground and water contact and may only be suitable for use in mild conditions. The OFT has received information indicating that many of these products are now banned in the EU.

 - b. **Water borne preservatives** contain a biocide because of their copper content. They preserve wood for a significantly shorter period than creosote. One third party told the OFT that water borne preservatives are not suitable for use on transmission poles because of the conductivity of their copper content. In addition the OFT notes that since the Elf/Rutgers decision the use of some copper based water borne preservatives deemed substitutes at the time - in particular Chromated Copper Arsenate - are now banned in the EU.

⁸ Importantly, creosote is water-repellent, a biocide, and extremely durable.

⁹ 'Outcome of stakeholder consultation on creosote'

http://ec.europa.eu/environment/biocides/pdf/creosote_report.pdf

- c. **Light organic solvent preservatives** are not suitable for heavy duty uses such as fencing and transmission poles and they are not water repellent.
18. By way of corroborative pricing data, several customers noted that there had been a sharp increase in the price of creosote in 2005/2006 which had not resulted in customer switching to alternative products. The parties explained that the reasons for this were that there was a significant increase in coal tar costs over this period which impacted the entire coal tar distillation industry and the raw material costs. As a result input prices increased by between 10 and 20 per cent. Koppers submitted that it was unable to pass the whole of these cost increases onto customers and as a result its gross margins decreased. Koppers submitted to the OFT that this is indicative of the fact that it was constrained in some way. However, the OFT did not receive evidence from third parties that indicated that there was any resultant customer switching to other products as might be expected if any of the other products were effective substitutes.
19. In relation to supply side substitution respondents informed the OFT that the equipment and the technology used to produce creosote does not overlap with the equipment and technology used to produce the putative substitutes. Significantly, creosote is a by-product of the coal tar distillation process, and it is inconceivable that those not already in the coal tar distillation industry would enter it in order to begin to produce creosote. Evidence from the parties suggests that it may be possible for existing tar distillers to produce increased (up to around five per cent more) levels of creosote from the tar distillation process but volumes produced are entirely dependent on the primary coal tar distillation process which is largely dictated by the amount of pitch distillers wish to produce.
20. Given the poor performance efficacy of the putative substitutes, legislative restrictions on their use (which have come into effect since Elf/Rutgers), and no evidence of customer switching to those products following significant price increases in creosote, the OFT takes as the basis for its analysis creosote as a distinct market.

Geographic scope

21. The parties submitted that an analysis of transport costs and current patterns of supply - in particular that Cindu supplies the UK from its plant in the Netherlands - strongly support a Western European market. Rutgers – the parties’ main competitor in Western Europe – has plants in Belgium, closer to the UK than Cindu’s plant in the Netherlands, and Germany.[] Further, the parties argued that creosote can be imported into the UK from Spain at competitive prices. They submitted that the shipment of creosote from continental Europe to the UK is neither complicated nor costly and that the tank containers necessary to transport creosote would be readily available to all coal tar distillers. The parties provided indicative pricing data including transport costs in support of their arguments.
22. The parties submitted an example to the OFT of a UK customer receiving a quote from both Belgium (Rutgers) and the Netherlands (Cindu) for the supply of creosote into the UK.
23. The Elf/Rutgers case looked at geographic market definition for coal tar distillates. The OFT notes that the Commission concluded that there may be a Western Europe market, ‘although some national or local realities are perceptible, due in particular to the size of purchasers, the small quantities concerned and the effect of transport costs on those quantities’.
24. The OFT gave due consideration to the arguments made by the parties; however it concluded that there was mixed evidence as to whether, and to what extent, the parties would post-merger be constrained by provision (or the threat of provision) from mainland Europe in general. []
25. Some larger third parties indicated that if they were faced with a significant price rise they may seek to obtain supply from Rutgers[]. One third party suggested (although the OFT has no evidence of this given Rutgers does not supply into the UK) that given the freight costs from

Belgium,¹⁰ Rutgers could be as much as 30 per cent more expensive than Koppers. The OFT did not receive any third party support for the proposition that supply from other parts of Europe, such as Germany or Spain, were viable alternatives.

26. Third party evidence does, however, confirm at least some imports into the UK, from Cindu in the Netherlands. This combined with third party comments on Rutgers discussed above, indicate that the Netherlands and Belgium may be in the same geographic market as the UK. This is not dissimilar to the Competition Commission's (CC) findings in Greif/Blagden (steel drums). After considering evidence on pricing and transport costs, the CC concluded in that case that imports from at least Belgium and the Netherlands should be included in the geographic market together with the UK.¹¹
27. In light of the above the OFT has assessed the transaction in relation to a candidate markets comprising the UK, Belgium and the Netherlands and also on a narrower market just comprising the UK. The OFT has not, however, needed to conclude on market definition any more precisely than this as it does not materially affect the substantial lessening of competition (SLC) assessment in this case.

HORIZONTAL ISSUES

Shares of supply

28. On a cautious UK-wide market the parties have a combined share of supply in creosote of 100 per cent (with an increment of six per cent) and the merger would thus create a monopoly in the supply of creosote in the UK. Notably, Rutgers (the next largest producer) does not currently supply into the UK. This raises obvious concerns for the OFT that the merger may remove any competition that currently exists, entirely.

¹⁰ An important aspect in the current case is the cost of transportation, and how this affects relative prices and therefore the competitive landscape. Evidence seen by the OFT suggests that at least some coal tar distillates are considered to be hazardous substances and therefore transportation costs can form a significant part of the delivered price.

¹¹ A report on the acquisition by Greif Inc of the steel drum and closures business of the Blagden Packaging Group, 17 August 2007, paragraph 5.58.

29. Based on a wider market (incorporating UK, Belgium and the Netherlands) which would also include Rutgers, the OFT estimates that the parties would have over 50 per cent combined share of supply of creosote with Rutgers holding the remainder. Third parties informed the OFT that they perceived Rutgers as being the only other European firm capable of supplying them with the appropriate quality creosote.
30. Based on market shares, either geographic market definition is capable of raising competition concerns. The OFT has proceeded to examine the closeness of competition between the parties, as well as the constraint from third party producers.

Closeness of competition between the parties

31. The parties are currently each others only actual competitors for UK customers. Post-merger this competition will be lost. Third parties commented that they have used pricing of one of the merging parties to obtain better pricing from the other and that the potential ability to dual supply from the parties ensures security of supply (although the OFT understands from the parties that no customers actually dual source at present).
32. The parties submitted that they are not particularly close competitors given that Cindu is a small player, both in relation to creosote in the UK and the coal tar distillation industry in general. Koppers characterised Cindu as a marginal player in the UK creosote market - supplying only about six per cent – and as such it exerts a limited constraint on Koppers activities.
33. In support of this proposition, the OFT notes the difference in the pricing of the parties' creosote – with Cindu pricing at around [] per cent more than Koppers. This might suggest that Koppers' prices are not meaningfully constrained by Cindu.
34. Third parties have submitted that Cindu's creosote is of somewhat higher quality than that of Koppers' (Grade C rather than Grade B). This may reflect some of the differences in relative prices between the parties.¹²

¹² The parties told the OFT that the main difference between their creosotes is that Cindu's is more suitable for certain storage conditions.

The parties were relatively supportive of this view although they pointed out that the price difference cannot be entirely explained by reference to the differing qualities of the parties' respective products. Each of the parties produces creosote to the recognised EU standard: EN 13991. Whilst there may be some small differences in quality these are not significant given the requirement to meet a common standard in order to legitimately market creosote for use as a wood preservative in the EU. The remainder of the difference is likely to be explained by transportation costs and the effects of the exchange rate with the Euro.

35. In addition, the OFT views the parties as being closer competitors to one another for customers in the UK than are potential suppliers from further afield (such as Spain or Germany). The parties argued that Rutgers is also a close competitor by virtue of its location; however, [] the nature of any competition constraint it imparts (if any) is purely based on its potential to compete.

Constraint on the parties from European producers

36. On the basis of the information available to it, the OFT does not consider that the merged entity would be effectively constrained by the presence of other providers, such as Rutgers. UK customers believe that Rutgers' prices would be substantially higher than current prices offered by the merging parties.
37. Although at least four firms in the EEA other than the parties can meet the minimum required standard, customers were concerned that the merging parties are the only actual competitors in the supply of creosote in the UK. Customers were particularly concerned about security of supply if using other firms based in Europe and (apart from Rutgers) the lower quality standard of creosote produced by other potential suppliers.
38. Several other producers indicated to the OFT that they would be less willing to supply into a country which already has a tar distillery as there was a perception that they would be at a disadvantage and that freight costs would make them more expensive. This goes some way in explaining why other European producers are not supplying into the UK.

Customer Switching

39. Third party evidence indicates that this is not a market in which customer switching is commonplace. Some customers believed that they benefitted from being able to play the merging parties off against one another – but that post merger this constraint would be lost. However, as noted above, Cindu is [] more expensive than Koppers for UK supply; hence this raises questions about the degree of the constraint being posed by each of the parties' product on the other, and may also be limited given Cindu's limited capacity. Some (generally larger) UK customers also believed they could obtain supplies from Rutgers, although this does not happen at present. This may be explained by the substantial perceived differences in prices between Koppers and Rutgers for UK supply (although Rutgers had supplied the UK effectively in the past). Koppers made the point that Rutgers had retained its HSE licence to import creosote into the UK. Market testing indicated that larger customers while still concerned about the merger overall believed they were in somewhat better position to exert power to resist price rises in a way which smaller buyers would be less able to do given the volumes they purchased.
40. Some third parties indicated that creosote produced by the parties – in particular Cindu - is perceived as being of a higher quality than that of other producers because of the EU standards it complies with and would therefore not consider supply from other European producers. This distinction seems to be important for the majority of buyers who said they were unwilling or unable (because the Spanish producer did not deliver to the UK) to switch to, for example, creosote produced by Spanish producers which was perceived as being of inferior quality. Therefore, there appears to be mixed evidence as to whether the level of switching that currently takes place would be possible post-merger.

Countervailing buyer power

41. In markets where prices are negotiated bilaterally, strong buyer power by one customer will not lower prices for other customers. In the current case, larger creosote customers (accounting for around 80 per cent of Koppers UK sales) believed that they could obtain supply from Rutgers in Belgium. In part, such buyer power may come from the fact that

customers could be obtaining creosote across a number of countries – thus it might be possible to link the negotiation of supply to the UK with competition for supply in another European market where there are more alternative suppliers. Smaller customers advised that their ability to negotiate prices is based on threats to switch between the merging parties.

42. Despite the presence of buyer power to some extent in relation to larger customers, the merger increases concentration within an already concentrated market. Therefore, whether customers are small or large, the merger with Cindu reduces buyers' ability to leverage a competitor against Koppers.

Conclusion

43. The merging parties are the only actual suppliers of creosote to UK customers although some customers advised that they could reasonably obtain supply of creosote from Rutgers in Belgium following an increase in prices. Even to the extent that the geographic market is defined to include imports from at least Belgium and the Netherlands within the geographic market together with the UK, the merger would still result in a reduction of potential suppliers from three to two.
44. On the basis of all of the above, the OFT believes that the merger creates a realistic prospect of an SLC in the supply of creosote in the UK, with the effect of the merger being particularly pronounced for smaller customers.

B. Carbolic oil

Product market

45. In the UK, the parties overlap in the supply of carbolic oil (which contains the active ingredient phenol). This is primarily used to make 'black' disinfectants. The merging parties are the only suppliers of carbolic oils to the UK.
46. It is the OFT's understanding that while primary distillation splits coal tar into coal tar pitch and wide fraction oil, further distillation of the latter produces amongst other derivatives, carbolic oil. Carbolic oil itself is a

compound made up of other derivatives (such as cresols, phenols, and xylenols) but the purity of the oil is not fixed and varies with the distillation process. The parties have stressed (and as is noted above) that their primary motivation of the distillation process is the production of pitch. Carbolic oil is very much a by-product of this process, it is difficult and uneconomical to store, and as a result, it is imperative for them to []. This appears to be consistent with the low margins achieved by the parties for this distillate and that both parties supply across Europe including to direct competitors (Rutgers and Bilbaina).

47. Carbolic oils are mainly bought by customers as a source of phenols which are available in greater concentrations from other refined products produced from further distillation or alternative chemical compounds. The parties therefore suggested that a product market might be one covering the supply of feedstocks for disinfectant purposes.
48. The parties also advised that other chemicals have very similar properties, and that it is possible to dilute the stronger chemical to match closely the properties of the weaker. They submitted that cresols could be substitutes. The parties advised that the fact pattern on carbolic oils, cresols, and phenols is particularly problematic: customers have very specific input requirements but could substitute between the inputs to achieve the same quality of output by reformulating the mix of other inputs.
49. Although the parties submitted that some other products containing phenol were substitutes for carbolic oil, the OFT has little supportive evidence of this view either from third parties or from the parties themselves. Some customers said they would not use more concentrated phenols (in smaller volumes) to replace the equivalent level of phenols. They did not perceive there to be any substitutes for carbolic oils and they would not be able to switch easily to using other products. The OFT therefore believes that it is appropriate to take the narrower view of the product market than that postulated by the parties.

Geographic market

50. The parties submitted that the market should be EU-wide because of the relative ease in which the product can be transported, although carbolic oil is hazardous there are not believed to be significant road

transportation issues – all that is required is access to road tankers which are approved for transportation of hazardous substances. As evidence for this they pointed out that they supply over mainland Europe. However, the OFT was unable to identify any alternative supplier of carbolic oils that confirmed that it would be interested in supplying into the UK.

51. As only the parties supply carbolic oil to the UK and there is no evidence of potential entry by the other tar distillers, the OFT takes as its starting point for geographic analysis the UK. In light of the analysis for creosote above the OFT has also assessed the transaction in relation to a candidate market comprising the UK, Belgium and the Netherlands. The OFT has not, however, needed to conclude on market definition as it does not materially affect the substantial lessening of competition (SLC) assessment in this case.

Competitive assessment

52. The merging parties are the only firms active in the supply of carbolic oil in the UK. Cindu began supplying carbolic oil in the UK in 2008. The value of the parties' combined sales of carbolic oil was [below £1 million] in 2008. Around 13 per cent by volume of this was supplied by Cindu.
53. There are relatively few customers for this product and therefore it is difficult to build a rounded picture of market conditions as each customer accounts for a large proportion of sales. Some customers were concerned that the merger would reduce their options from two suppliers to one. Another was not aware that Cindu had begun supplying in the UK and so was unaware that its supply options would be reduced by the merger.
54. One customer confirmed that it is possible to reformulate its output so that it can use substitutes for carbolic oils in its output, but that reformulation is complex and costly and may take some time. Another customer advised that it had an ongoing research program to develop a substitute for carbolic oil as it was not content to only have two suppliers – the merging parties – available to them.
55. It would appear as though in the short-run the merging parties' customers cannot immediately use alternative products or concentration of phenol in their disinfectants although they may be able to develop

alternatives within a three to five year period should they have to due to unavailability of carboic oil in the UK. On the relevant geographic market, no customers identified any alternatives to the merging parties following a SSNIP.

56. None of the respondents identified Rutgers or the other European coal tar distillers as competing with the merging parties. Since Rutgers [] this might suggest Rutgers is unlikely to have the spare capacity be able to supply the UK market.
57. The merger reduces the number of suppliers to the UK from two to one although the increment (like the size of the markets itself) is modest. There is no evidence that Cindu's recent entry has had any price effect. It would appear that customers may have some buyer power as coal tar distillers are keen to dispose of this distillate quickly, although this was not fully appreciated by customers themselves. The parties' relatively low [] gross margins are consistent with the parties' suggestion that they prefer to offload carboic oil as quickly as they can. On the other hand the merger eliminates any prospect that customers may, in the future, have been able to play off the parties against each other to a greater extent than currently.
58. Taking all these factors into account the OFT believes that there is a realistic prospect that this merger would give rise to a substantial lessening of competition in the supply of carboic oil in the UK.

C. Special Pitch

Product market

59. The parties submitted that they only overlap in the production and supply of special pitches used for roofing applications¹³ (and anti-skid products which in turn form only a relatively small amount of each of their special pitch sales in the UK). The parties further submitted that whilst special pitches might be viewed as uniform from a supply-side perspective they are best assessed from a demand-side perspective by reference to their specific end-usage, taking account of other substitutes. The postulated

¹³ This differs from special pitch used in road surfacing applications.

product scope was products used in connection with roofing applications (that is, coal tar and petroleum special pitches).

60. However, some customers indicated that they would have no alternative to the merging parties for the supply of special pitch and could not switch to bitumen based products which were described by the merging parties as being substitutes to special pitch products.
61. The parties' customers use special pitch to (among other things) produce anti-skid and roofing products. For UK end consumers, bitumen based roofing and anti-skid products such as asphalt and roof felt are substitutes for coal tar pitch and, according to one asphalt producer, sell in much greater volumes because they are cheaper and because of environmental reasons. A competitor confirmed that this is the case throughout the EEA. However, the intermediate¹⁴ special pitch customers whom the OFT spoke to advised that their end-use customers are based in hot climates – such as the Middle East - where mastic asphalt and felt would soften when exposed to the heat. One special pitch customer explained that bitumen cannot be used in its production process.
62. Further, using the same natural experiments in price increases in 2006 described above in the section on creosote, the parties' customers did not switch to bitumen based products. The OFT therefore concludes that the correct product scope is special pitch for roofing and anti-skid products.

Geographic market

63. The parties submitted that the market is at least as wide as Western Europe in accordance with the decision in Elf/Rutgers.
64. In ELF/Rutgers the Commission concluded that: 'some national or local realities are perceptible, due in particular to the size of purchasers, the small quantities concerned and the effect of transport costs on those quantities.' UK demand for special pitch is likely to fit the Commission's characterization of 'local realities' given that total UK sales value in 2008 was approximately [below £1 million].

¹⁴ That is the merging parties' customers.

65. As discussed in the geographic market definition for creosote, transportation costs are an important factor in determining which firms are reasonably in the same market as the merging parties. On the basis of prices provided by the parties, given the high value of special pitch [] even a small price increase would be unsustainable and would likely encourage imports from Europe and wider afield. However, special pitch customers who responded to the OFT indicated that transportation costs would be too high to make it economic to switch away from the merging parties following a five to 10 per cent price rise. In terms of potential suppliers, Rutgers advised that, because there is not a critical mass of demand for special pitch in Europe, it would be unlikely to switch to supplying special pitch to UK customers following a five to 10 per cent price increase in the UK.
66. The OFT has considered special pitch using both a UK and a wider (UK, Belgium and Netherlands) geographic scope. It has not been necessary for the OFT to conclude on geographic market scope given that this does not affect the assessment of the competition concerns arising from the merger.

Horizontal Assessment

67. The only two actual competitors in the UK in the supply of special pitch for roofing applications are the merging parties. The merging parties therefore have 100 per cent of the supply of coal tar special pitches in the UK. Koppers' internal documents identify Cindu as Koppers' closest European competitor.
68. In terms of the threat from potential competition [] does not produce special pitch for use in roofing applications. [] view is that, in European usage at least, bitumen has completely replaced pitch in roofing applications for environmental reasons and because bitumen is significantly cheaper than tar pitch based products. Documents supplied to the OFT by Koppers indicate that it does not view Bilbaina (a Spanish producer) as a strong constraint on its pitch pricing as it appeared to have a local customer focus.
69. The parties submitted that there were two potential constraints that would continue to apply: first, that the merged party would be unable to discriminate between its customers for special pitch (most of them) that

had a choice of other alternative products and those that were captive to special pitch; and second, non-EU special pitch producers who could easily begin to import into the EU.

70. On the first point, while this presumption is intuitively attractive, the OFT cannot dismiss the possibility that the merged group could easily find out which of its customers were active in supplying roofing products to the Middle East, for example, and thus were likely to be 'captive'.
71. On the second point, the parties suggested that the only potential barrier to supply to the UK might be transport costs but that these would be insignificant given the high value special pitch is able to command. Having given this assertion due consideration, given that these providers do not currently choose to supply to the UK it is difficult given the lack of any third party evidence, for the OFT to accept that they would be any more inclined to do so after the merger.

Conclusion

72. The OFT's investigation suggests that it may be possible for the merging parties to raise prices post merger to UK special pitch customers that would not have any alternative to special pitch or any choice of supplier. Entry to the UK from EU or non-EU suppliers seems unlikely to be able to act as an effective post-merger constraint. On this basis, the merger creates a realistic prospect of a substantial lessening of competition in relation to the supply of special pitch.

D. Carbon Pitch

73. While both parties produce carbon pitch (in one form or another) there is no overlap in the supply of carbon pitch in the UK as only Koppers¹⁵ sells in the UK. However, as part of its investigation, and given this is the main product driving the transaction (see paragraph 8 above), the OFT has considered (i) how likely it was that Cindu might in future begin importation of its carbon pitch into the UK (that is, a form of actual potential competition), and (ii) whether its presence currently represents a

¹⁵ Koppers holds 99 per cent and Rutgers holds around one per cent of the UK supply of carbon pitch.

potential constraint on Koppers which would be lost as a result of the transaction (that is, a form of perceived potential competition).

74. The OFT did not obtain any evidence to indicate that Cindu planned to supply carbon pitch into the UK going forward. Of note, 75 per cent of Koppers' carbon pitch sales into the UK are of solid carbon pitch. Cindu does not produce solid carbon pitch and submitted that considerable (and prohibitive) investment would be required in order to begin to produce it because of the environmental/health issues associated with the dust from solid carbon pitch.
75. In terms of liquid carbon pitch, this is particularly difficult to transport¹⁶ and there was no evidence that Cindu plans to begin supply into the UK either from its internal documents or from third party evidence. It submitted that the costs of supplying into the UK would be prohibitive and supplied documents to the OFT to show this.
76. In conclusion, there was no evidence that Cindu is likely to begin supplying carbon pitch into the UK and that it, as a consequence, represents a potential constraint on Koppers. Nor was there any evidence that Koppers' current behaviour was constrained by the threat of entry into the market by Cindu. Therefore, the OFT does not believe this market is affected by the transaction and does not raise substantial lessening of competition concerns as a consequence.

COORDINATED EFFECTS

77. The key issue, when assessing coordinated effects, is whether the merger creates or enhances the likelihood of successful coordination (tacit or explicit) occurring or strengthens existing co-ordination. Coordination can occur on prices, volumes, capacity, customer or sales area allocation, or other aspects of competition.
78. In brief, the conditions for coordination to be successful and stable are that firms have the ability and mutual incentive to align their behaviour and sustain a coordinated outcome, and that such an outcome is also sustainable in the face of external factors. If these conditions are present

¹⁶ It has to be transported at very high temperatures and is therefore also costly to transport.

and a merger strengthens any of these elements, then coordinated effects may arise from the merger.

79. In this case, the OFT has not received any evidence of existing co-ordination whether in the UK or over some wider geographic area. It is worth noting that the increment to market share in the UK due to the merger is modest, at only around five per cent for creosote (representing [below £1 million] of sales) around 13 per cent for carbolic oils (representing below [£1 million] of sales) and although higher for special pitch at over 30 per cent in terms of sales this represents below [£1 million]. The scale of these increments might suggest that the merger is unlikely to give rise to a change in market structure in the UK such that coordinated effects would become more likely.
80. In the European context the merger would result in the loss of a relatively small player but not one that appears to be a 'maverick' or disruptive influence. The merger does not increase the markets or areas over which Koppers and Rutgers will face each other and all the indications are that they are and will continue to be effective competitors. In relation to special pitch the increment is more significant (over 30 per cent) but given Rutgers does not produce special pitch for roofing applications and the merging parties are the only two suppliers in the UK the OFT does not believe co-ordination is likely.
81. Customers did not raise concerns to indicate that the merger would make uniformly timed/parallel price increases more likely for any of the three products in which the parties overlap.
82. Overall, the OFT therefore believes that the merger situation does not of itself increase the likelihood of coordinated behaviour.

BARRIERS TO ENTRY OR EXPANSION

83. The parties submitted that the extent of barriers to entry depend on the scale of entry envisaged. It considered entry on the scale of establishing a new coal tar distillation plant as unlikely in the foreseeable future¹⁷ - the

¹⁷ Barriers to entry appear to be high and entry is seen as very unlikely. One third party estimated that the cost of a new tar distillery would be somewhere between 50 and 100m euro. The products being considered would only form a small percentage of the output from the overall coal tar distillation process. There has not been any new entry for over five years.

OFT agrees with this analysis. They submitted that a more likely source of entry would be for an existing distiller to begin to import the overlap products into the UK.

84. In this instance, the question for the OFT is whether entry is timely, likely and sufficient or whether expansion will occur in the supply of creosote, carbolic oils, and special pitch in the UK in order to mitigate any competition concerns arising from the merger – which should be borne in mind are by-products of the overall process.
85. The potential for entry into the UK by existing suppliers of these products has already been addressed above. In addition, it is unlikely that there would be de novo entry into the supply of these products.
86. In relation to **creosote** although the evidence from the parties suggests that customer demand is increasing there appear to be disincentives to entry and/or expansion. This market is highly regulated because of the safety implications related to the use of creosote. Indeed, customer and competitors noted that the future use of creosote is under consideration under the European Commissions' Biocidal Product Directive. Evidence from third parties suggests that regulatory approval for a new product could easily take several years and cost £500,000. New entry in this sector would therefore appear unlikely. As a by-product any possible expansion in the production of creosote would need to be linked to expansion in access to raw materials (coal tar to process) and for carbon pitch demand. Neither appears to be likely in the short term.
87. In relation to **special pitch** the parties submitted that it would not be difficult for an existing tar distiller to produce special pitch; no expensive equipment is required nor alternations to the tar distillation process. It simply requires the distiller to blend the product to the customer's specific requirement. There are limited technologic barriers to existing distillers producing special pitch although the OFT is not convinced that such entry is likely to occur in the near future.
88. In relation to **carbolic oil**, as discussed above, there is some evidence that customers are already investigating the potential for developing substitutes to carbolic oil, although this would be unlikely to occur for three to five years.

89. The OFT has no evidence supporting the likelihood of entry so as to eliminate concerns raised in relation to the three products in which the parties overlap.

THIRD PARTY VIEWS

90. Third party views have already been discussed in other parts of the decision where appropriate.

ASSESSMENT

91. The parties overlap in the supply of creosote, carbolic oils, and special pitches for roofing applications in the UK.

Creosote

92. The merging parties are the only firms supplying creosote to UK customers. While there is evidence that the market could be viewed as being UK wide, the balance of the evidence indicates that it is more appropriate to consider the main geographic area in which the parties compete as being the UK, Belgium and the Netherlands. However, as the OFT's decision does not turn on this point, it has not been necessary to conclude on geographic market definition.
93. Customers and competitors advised that there are no products which (a) can be lawfully be substituted for creosote, and (b) have the biocidal, water-proofing, and durability of creosote.
94. The OFT's investigation suggests that the only significant constraint on the parties is the threat of entry by Rutgers into the UK. The importance of reputation in terms of quality and security of supply, coupled with the prohibitive transportation costs, would tend to indicate that it is unlikely that customers would use other suppliers apart from the merging parties and Rutgers. The merger is therefore a '3 to 2' between the only two parties that are currently active in supplying into the UK. The merger would therefore reduce the competitive constraint on Koppers and creates a realistic prospect of a substantial lessening of competition.

Carbolic Oil

95. Koppers currently holds around 85 per cent share of supply in carbolic oil in the UK and the proposed merger would give it the remainder of supply in the UK. The OFT did not need to conclude on geographic scope given that this does not materially alter its competition assessment.
96. Although the parties submitted that there were alternatives to carbolic oil – such as cresols - customers told the OFT that there were no substitutes for carbolic oil. It may be possible to develop alternative products although this was unlikely to happen in the medium term.
97. The OFT is not satisfied that its concerns would be mitigated to any degree by the development of new products or the entry into the UK market by European producers and therefore believes the transaction creates a realistic prospect of a substantial lessening of competition in the supply of carbolic oil in the UK.

Special Pitch

98. The parties overlap in the supply of special pitch in the UK. Post-merger they will hold 100 per cent of this market (increment around 33 per cent).
99. Customers told the OFT that there were no substitutes for special pitch. The OFT's concerns are not mitigated to any degree by likely and timely entry into the UK market by existing special pitch producers either in continental Europe or further afield. Therefore the OFT clearly has concerns that customer choice will be eliminated by the transaction.

Carbon Pitch

100. The parties do not overlap in the supply of carbon pitch in the UK. Koppers supplies 99 per cent of the carbon pitch in the UK. However, given in particular that this is the main product driving the transaction, the OFT considered (i) how likely it was that Cindu would begin importation of its carbon pitch into the UK and (ii) whether its presence

currently represents a potential constraint on Koppers which would be lost as a result of the transaction.

101. The OFT did not obtain any evidence to indicate that Cindu planned to supply carbon pitch into the UK going forward and notes that it does not currently even produce solid pitch which makes up the bulk of UK supplies. Nor was there any evidence that Koppers' was currently constrained by the threat of entry by Cindu.

Conclusion

102. Consequently, in relation to creosote, special pitch and carbolic oil, the OFT believes that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.
103. On this basis, the OFT is under a duty to make a reference to the Competition Commission. However, the OFT has considered whether it would be appropriate to exercise its discretion to apply one of the exceptions to the duty to refer pursuant to section 33(2) of the Act to the facts of this case.

EXCEPTIONS TO THE DUTY TO REFER

Introduction

104. The OFT's duty to refer under section 33(1) of the Act is subject to the application of certain discretionary exceptions, including the markets of insufficient importance (or '*de minimis*') exception under section 33(2)(a).

Application of the markets of insufficient importance exception to this case

105. The OFT has considered in detail whether to apply the *de minimis* exception¹⁸ in this case. For the reasons explained in paragraphs 100 to 112 of its *Dunfermline Press/Trinity Mirror* decision (OFT decision of 4 February 2008), the OFT believes that it would be proportionate not to

¹⁸ OFT516b, 'Exception to the duty to refer: markets of insufficient importance' November 2007.

apply the 'de minimis' exception where the OFT considers that, in principle, a clear-cut undertaking in lieu of reference exists.

106. The OFT has, therefore, considered whether, based on an objective evaluation of the transaction, this case was a clear candidate for resolution by means of undertakings in lieu. The OFT will usually only consider that a structural remedy would be capable of being considered clear-cut. Any structural divestment in this case would have to be of an entire distillation plant which would be disproportionate to the level of harm created by the merger and would effectively amount to a full prohibition of the merger. Therefore, the OFT believes it is appropriate to consider the application of the de minimis exception and whether the expected impact of the merger outweighs the public cost of a reference to the CC.
107. The factors that the OFT considers in determining whether it should apply the de minimis exception have been set out in detail in a number of recent cases.¹⁹ The relevant factors are:
- the market size
 - the strength of the OFT's concern (that is its judgment as to the probability of the substantial lessening of competition occurring)
 - the magnitude of competition lost by the merger
 - the durability of the merger's impact, and
 - whether any value should be attributed to deterrence (in terms of deterring future similar potentially anti-competitive transactions).
108. The OFT has considered each of the above factors in determining whether to exercise its discretion in this case.

Market size – the value of the UK creosote, carbolic oil and special pitch markets on which the OFT has found a realistic prospect of a substantial lessening of competition in this case amounts (inclusive of delivery costs)

¹⁹ See, for example, OFT Decision *Anticipated acquisition by BOC Limited of the packaged chlorine business and assets carried on by Ineos Chlor Limited*, 29 May 2008 and OFT Decision *Completed acquisition by Capita Group plc of IBS OPENSsystems plc*, 19 November 2008, OFT Decision, *Acquisition by Govia Limited of South Central Rail Franchise*, decision of 6 August 20

to just below £4 million²⁰ per annum. This is clearly below the £10 million threshold above which the OFT has indicated that the 'de minimis' exception will not be applicable. The relatively small size of these markets is therefore an indicator in favour of application of the exception.

Strength of OFT's concerns – notwithstanding the fact that the merger will result in a reduction of competitors from two to one in relation to creosote, special pitch and carbolic oils, the OFT has differing levels of concern in relation to, on the one hand, smaller customers of creosote and customers of other products and, on the other hand, larger customers of creosote, with the former being materially more likely to suffer harm than the latter. In addition, the OFT notes that its investigation indicates that customers for carbolic oils may be in a position of strength vis-à-vis the parties given the parties' objective of disposing of the product expediently which is reflected in their profit margins. Overall, the OFT does not therefore consider that the strength of its concerns in this case would be an aggravating factor for the purposes of its 'de minimis' assessment.

Magnitude of harm arising from the loss of competition lost – in general terms the OFT considers that the level of harm arising from the merger has the potential to be significant across all the affected product groups. However, there are also some indications that a potential competitive constraint on the parties within the UK may be provided by the presence of Rutgers, which would continue post merger. In relation to creosote, Koppers made the point that its prices in the UK were significantly lower than those of Cindu and its returns were also lower in the UK than the rest of Europe. The OFT saw no evidence (including in the customer comments) to suggest that Cindu in fact constituted a competitive force beyond that suggested by its small share of supply. While smaller customers may be expected to be more vulnerable to price increases, sales to these smaller customers only represent around 20 per cent of Koppers sales (below £500,000) and there is no evidence that they have in the past been charged significantly higher prices because of their relatively weaker negotiating strength and/or their potential ability to coax

²⁰ The parties estimates of size of market were based on 2008 figures – the OFT has therefore used these figures to estimate current size of markets. It estimates that the market sizes are approximately as follows: The creosote market is valued at around £3 million in the UK, the carbolic oil market is valued at around £400,000, and the special pitch market is valued at around £400,000.

supplies in from the continent. Overall, the magnitude of competition lost (taking into account potential harm to both larger and smaller customers) as a result of the proposed merger, points towards the exercise of its 'de minimis' assessment.

Durability of harm – the OFT does not consider that any harm to competition arising from the merger is likely to persist for an unusually long period of time. Indeed there was some evidence to suggest that the harm to competition may cease in the medium term for a number of possible reasons. The OFT heard during its investigation of the possibility that substitutable products for carbolic oils could be developed should a sufficient need for them arise. Also, the European Commissions' Biocidal Product Directive is presently being debated and may alter which creosote products can be sold in Europe which may lead customers needing to seek alternative products and so reducing demand. Some customers suggested that if prices were to increase they would be able to encourage entry into the UK, perhaps from Rutgers (although this is not considered timely or likely enough to be considered a mitigating factor when considering the SLC decision). The OFT is mindful, however, that none of these factors is certain and therefore it views duration as a neutral factor in relation to the 'de minimis' discretion.

Consideration of any deterrence value – the OFT is mindful of the fact that the substantial lessening of competition arising in this case is in 'by-product' markets and there are no competition concerns in the primary market arising out of the distillation process, being that for coal tar pitch. Moreover, Koppers' rationale for the transaction (as evidenced in its internal documents) appears to be the opportunity to expand the Cindu plant in the Netherlands and gaining access to Cindu's terminal facilities in Amsterdam - which it states will enable it to provide more efficient distribution of its UK-produced products to France, Benelux countries and Germany – and so increasing competition in mainland Europe. The SLC concerns, therefore, could be said to arise in markets which are peripheral to the rationale of the transaction and form a small fraction of the value of the transaction as whole. Overall, the OFT considers that it would not be appropriate to factor in significant deterrence weight to this decision and this factor points away from the exercise of its 'de minimis' discretion.

Conclusion –the OFT is particularly conscious in this case that the

products in respect of which concerns have been found are by-products arising from the distillation process to produce coal tar pitch (over which the OFT has no concerns) and are each and collectively relatively modest in size. In addition, other factors the OFT takes into account when deciding whether to exercise its 'de minimis' discretion, were generally positive or neutral in favour of the exercise of this discretion. Accordingly, the OFT considers that this is an appropriate case for it to exercise its discretion not to refer because the markets concerned are of insufficient importance to justify a reference.

DECISION

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