

***Case No COMP/M.1796 -
BAYER / LYONDELL***

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**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 21/02/2000

***In electronic form on the EUR-Lex website under document
number 32000M1796***



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21.02.2000
SG(2000)D/171717

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying party

Dear Sirs,

Subject: Case No COMP/M.1796 - Bayer/Lyondell

Notification of 18.01.2000 pursuant to Article 4 of Council Regulation No 4064/89

1. On 18.01.2000, the Commission received the notification of a proposed operation by which the German based Bayer Aktiengesellschaft will acquire sole control over the polyether polyols business of the US based company Lyondell.
2. After examination of the notification, the Commission has concluded that the notified operation falls within the scope of Council Regulation (EEC) No. 4064/89 and does not raise serious doubts as to its compatibility with the common market and with the EEA Agreement.

I. THE PARTIES

3. Bayer Aktiengesellschaft ("Bayer"), headquartered in Germany is a group comprising about 350 companies world-wide with about 10.000 different products and with the following principal manufacturing operations: health care (prescription and over the counter medications, diagnostic systems and house hold insecticides); agriculture (crop protection and animal health products), chemicals (chemical feedstocks, raw materials and intermediates) and polymers (plastics, rubber, polyurethanes, coating, special raw materials and fibers). Bayer Corporation of the U.S.A. is also a party to the operation.
4. Lyondell Chemical Company ("Lyondell") is a manufacturing company headquartered in the U.S.A. having its main business activities in intermediate chemicals and derivatives (mainly propylene oxide, propylene glycol, polyether polyol, styrene monomer) and in manufacturing of basic feedstocks like ethylene and propylene and their derivatives. Lyondell operates about 30 manufacturing plants world- wide. It has acquired part of the chemicals business from ARCO Chemical Company in 1998, including the propylene oxide and polyether polyols business.

II. THE OPERATION

5. The proposed concentration is an operation under which Bayer will acquire all assets of Lyondell's world wide polyether polyols business by purchase of assets and securities. This business includes production facilities in the U.S.A and in the EU (Fos sur Mer, France and Rieme, Belgium) and sales facilities world wide. Bayer thus acquires all of the business assets, liabilities, properties and goodwill comprising research, development, manufacture, marketing and sale of polyether polyols for urethane applications, including Lyondell's polyurethane customer contracts and technologies in the polyether polyols bussines. Bayer also acquires control of two indirect Lyondell subsidiaries with production facilities in Asia. Bayer does not acquire any security interest in Lyondell Company itself.
6. Economically, the above operation is directly linked to another transaction, also notified on 18/1/2000. This notification was made pursuant to Article 4 of Council Regulation No 17/62¹ and concerns a number of Joint Venture agreements between the Parties. The object of these agreements is principally the production in the USA of propylene oxide and associated co-products styrene monomer and tertiary butyl alcohol. In addition, the agreements also cover a technology partnership providing for technology licenses and co-operation between the parties in research and development as well as a logistics arrangement for swaps in propylene oxide. Through these agreements, Bayer intends to use the majority of its share of the propylene oxide produced by the joint venture, supplied to it at cost, captively in its polyether polyol business newly acquired from Lyondell's, while Lyondell intends to carry on its merchant market business in propylene oxide, co-products and derivatives. Since the Joint Venture is considered by the Parties to not perform all functions of an independent economic entity, they have decided to notify the agreements under Regulation 17.

¹ OJ 13, 21. 2. 1962, p. 204.

III. CONCENTRATION

7. The acquisition by Bayer of all assets of Lyondell's world wide polyether polyols business and of all shares in Lyondell's subsidiaries active in the polyether polyols market results in acquisition of sole control by Bayer over the respective part of the undertaking Lyondell. Therefore the operation constitutes a concentration within the meaning of Article 3(1)(b) of Council Regulation (EEC) No. 4064/89.

IV. COMMUNITY DIMENSION

8. The combined aggregate world-wide turnover of the undertakings concerned is more than EUR² 5,000 million. (Bayer: €26,900 million and Lyondell's polyether polyols business: €[...] million.) The aggregate Community-wide turnover of at least two of the undertakings is more than EUR 250 million (Bayer: € 12,000 million and Lyondell's polyether polyols business: €[...] million) and the undertakings concerned do not attain more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. Hence the concentration has a Community-wide dimension.

V. COMPETITIVE ASSESSMENT

A. Relevant Product Markets

Polyether Polyols.

9. Polyols are intermediate chemicals and are, together with di-isocyanates, a major component in the production of polyurethane foams ("foam"). The Parties submit that the relevant product market is the market for polyether polyol, a different product market from the market for polyester polyol. Market investigation carried out by the Commission confirms that these are two distinct product markets. However, since the parties' activities only overlap on the market for polyether polyols, an alternative product market need not be defined for the purpose of this case.
10. The principal use of polyols is the fabrication of polyurethane foam, a minor proportion (9%) being used for production of coatings, adhesives, sealants and elastomers ("CASE" applications). Based on their principal use for foam, it appears from market investigations by the Commission that within the group of polyether polyols a distinction may be made. Depending on whether these polyols are used for either rigid polyurethane foam ("short chain" polyether polyols) or for flexible polyurethane foam ("long chain" polyether polyols), they have a different technical specification and different physical properties, and users therefore consider them to be non-substitutable.³ Some competitors consider the production switch between the polyether polyols used for production of rigid foam and that used for flexible foam to be technically problematic and economically unattractive. Each type of polyol is sold

² Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25). To the extent that figures include turnover for the period before 1.1.1999, they are calculated on the basis of average ECU exchange rates and translated into EUR on a one-for-one basis.

³ The polyurethane foam market was the subject of a previous Commission Decision in case M. 835-Recticel /Greiner, decision of 19 March 1997.

to different groups of end users who generally consider "short chain" polyether polyols and "long chain" polyether polyols to be non-substitutable for the uses they make of them. This view is shared by competitors. As to polyols used in CASE applications, the majority (90%) of these are of the long chain type and thus similar to those used in flexible foam applications.

However, for the purpose of this case it is not necessary to further define the market, since based on any alternative market definition, the proposed operation would not lead to the creation or strengthening of a dominant position.

Propylene Oxide.

11. The parties define one vertically affected market, i.e. the market for Propylene Oxide ("PO"). PO is a liquid commodity chemical used in the production of derivative products, including polyether polyols, propylene glycol, propylene glycol ethers and various other products. Together with a small volume of ethylene oxide, this is the main raw material for polyether polyols. Of volume produced 60% is used for polyols production, and the manufacture of flexible polyols contains more PO (80%) than the manufacture of rigid polyols (60%). PO is a "fungible" chemical with same characteristics regardless of production method used, and constitutes one product market. This is in line with the Commission's previous decision in Case No. IV/M. 591-Dow/Buna.⁴

B. Relevant Geographic Markets.

Polyether Polyols.

12. The notifying Party is of the opinion that for polyether polyols, both in their rigid and flexible form, the relevant geographic market is EEA-wide. From the Commission's market investigation it appears that general conditions of competition are homogeneous, that prices within the EEA do not differ to an appreciable extent and that polyols are imported into and from EU Member States in large quantities. They are easily and safely transported and transport cost is modest, deliveries over a distance of 2000 kilometers or more not being exceptional. There are no non-tariff barriers to trade. The main producers within the Common Market are present with plants in the UK, France, Spain, Italy, Germany, Netherlands and Belgium, from which they supply their customers located in Member States other than where producers have plants. Many large customers with production sites located in different Member States purchase the same types of polyols to be supplied to their different production locations. Intra- EU imports were 880 kts and intra-EU exports were 842 kts in 1997.⁵
13. It may therefore be concluded that the geographic market for polyether polyols is at least EEA- wide.

⁴ Decision of 04.07.1995

⁵ Source: Chemical Economics Handbook-SRI International (1999).

Propylene Oxide

14. The notifying Party submits that the relevant geographic scope for this product is at least EEA-wide. PO is being traded within the EU in substantial volume: imports intra-EU being 645 kilotonnes and exports intra-EU: 309 kilotonnes (1998). A significant proportion of PO derivative production capacity is located in Member States for which supply of PO is sourced from another Member State. Average PO prices appear to differ only slightly among Member States (source: Lyondell). PO is widely traded within the EEA without trade barriers and at reasonable transport cost. In recent years, shipments across EU Member States borders constituted approximately 45% of industry volume. Therefore, the geographic market appears to be at least EU-wide. Market investigation has indicated that the geographic market is at least EEA-wide. This is in line with the Commission Decision in the case M. 591-Dow/ Buna.⁶

C. Competitive Assessment.

Polyether Polyols

15. In the EEA, Bayer had a market share (1999) of [15-25%] of the polyether polyol market and Lyondell a share of [10-20%], resulting in an aggregate market share of [30-40%] on the market for all types of polyether polyols. These market shares do not differ significantly on the narrower relevant product markets of polyether polyols for, respectively, the rigid and flexible foam applications. Post merger, Bayer and Lyondell would have an aggregate market share of [30-40%] (Bayer: [15-25%] and Lyondell: [15-25%]) in the market for polyether polyols used for flexible foam and [30-40%] (Bayer: [25-35%] and Lyondell:[0-10%]) in the market for polyether polyols used for rigid foam. As to polyols used for CASE applications, market shares of the parties are not materially different from those in the overall polyether polyols market; these are estimated by the parties at [15-25%] for Bayer and [10-20%] for Lyondell, an aggregate share of [30-40%].
16. The combined entity would face several important competitors on the market for polyether polyol. These include several large chemical companies, such as Dow, BASF, Shell, Enichem, Repsol and Huntsman/ICI. Distinguishing between general polyether polyols and polyols for flexible and rigid applications, market shares are as follows (see table). All market shares are based on estimates by the Parties and based on information provided by their competitors.

⁶ See footnote 4

Company	Polyether Polyols in the EEA (1998/9)	Polyether Polyols for Flexible Applications in the EEA (1998/9)	Polyether Polyols for Rigid Applications in the EEA (1998/9)
Bayer	[10-20%]	[15-25 %]	[25-35%]
Lyondell	[15-25%]	[15-25%]	[0-10%]
Bayer/Lyondell	[30-40%]	[30-40%]	[30-40%]
Dow	[20-25] %	[20-25] %	[20-25] %
BASF	[10-15] %	[10-15] %	[10-15] %
Shell	[10-15] %	[10-15] %	[5-10] %
Enichem	[5-10] %	N/A	N/A
Repsol	[5-10] % (EU)	[5-10] % (EU)	[0-5] % (EU)
Huntsman ICI	[0-5] %	[0-5] %	[5-10] %

17. These companies have the resources to compete strongly in the relevant product market. Several producers have recently increased their production capacity of polyether polyols. Competitors like Repsol, Shell, and BASF have announced capacity expansion plans for the near future. The market for polyether polyols shows steady growth, amounting to approximately 3% to 5% per year, a rate that the merging parties expect to continue, as confirmed by competitors and customers. Capacity expansion is 40% from 1994 levels to 2002. The market is further characterised by large and sophisticated international purchasers, who practice multiple, international sourcing and are rather concentrated.
18. Commission investigations have shown that supply contracts do not run for more than one year (usually less) and there is significant supply-side substitutability and the price is the major factor in choice of supplier. Furthermore, new entry to the relevant market requires limited capital investment and few technological barriers exist. It can therefore be concluded that sufficient competition on the market for polyether polyols remains.
19. Given the above, the concentration does not raise serious doubts as to its compatibility with the common market or the functioning of the EEA Agreement, since it will not create or strengthen a dominant position on the market for polyether polyols through which effective competition in those markets will be distorted.

Propylene Oxide

20. The Parties have identified the market for supply of PO as a vertically affected market. Bayer presently does not itself produce or supply PO, but is supplied by Erdölchemie, a joint venture jointly controlled together with BP Amoco, and also purchases PO from the merchant market. Through the PO Joint Venture agreements entered into by Bayer and Lyondell, Bayer will obtain a share of the venture's PO production, intended to cover Bayer's PO needs for the polyether polyols business it acquires from Lyondell.
21. After Bayer's acquisition of Lyondell's polyols business, there will however no longer be any structural link between the acquired business and Lyondell's PO business. Lyondell withdraws from the market for supply of polyether polyols and, according to

the notifying Party, remains active on the merchant market for PO. Since about [30-40%] of PO volume is used for other products than polyols, Lyondell will have an incentive to sell PO to third parties and there is no reason to assume that Lyondell would become less active on the merchant market. Lyondell remains free to sell PO to other polyols manufacturers competing with Bayer and active on the EEA market. Therefore the concentration will have no impact on the merchant market. The concentration does therefore not result in the creation or strengthening of a dominant position of the merged entity on the (merchant) market for supply of Propylene Oxide.

22. Neither will there be an effect of the concentration on the market of PO as raw material for polyether polyols producers competing with the merging parties. These competitors are mostly world wide producers that have their own captive supply or have otherwise secured supply of PO and will continue to have access to the merchant market. PO customers who manufacture polyols generally have not identified serious problems in obtaining PO as a result of the concentration, nor major negative effects on their position on the polyols market.
23. Under these circumstances, the concentration will not result in foreclosure of supply of PO to competitors. Therefore, the concentration will not result in the creation or strengthening of a dominant position of the new entity on the market for supply of polyether polyols. Thus, it does not raise serious doubts as to its compatibility with the common market or the functioning of the EEA Agreement.
24. The Commission takes note of the fact that Bayer and Lyondell have notified these joint venture agreements under Regulation 17/62 (Case Comp/E-2/37.769). The Commission decision in this present case is thus taken without prejudice to the outcome of these proceedings.

VI. ANCILLARY RESTRICTIONS

25. The parties request an assessment under the Regulation by the Commission of a non-competition and a non-solicitation clause contained in the Master Transaction Agreement. The non-competition clause prohibits Lyondell from engaging in any development, use, making or selling of polyether polyols, for a period of [...] from closing of the operation, except for sales of polyols in Seller's performance chemicals business and other non-polyurethane businesses. The non-solicitation clause prohibits Lyondell from soliciting the employment, recruitment, hiring or causing to leave, of any employees of the acquired polyether polyols business, for a period of two years from completion of the operation. In addition, this clause prohibits Lyondell from selling Propylene Oxide to any polyurethane foam manufacturer, except for sales to one U.S. foam manufacturer that operates under an existing PO supply agreement with Lyondell.
26. Insofar as these covenants are necessary to grant the acquiring party the full value of the acquired polyether polyols business, these can be considered to be directly related to and necessary to the implementation of the concentration. In view of the transfer of intellectual property rights and know how involved in the operation, the duration of [...] of the above non-solicitation covenant appears justified in this specific case. However, the duration of the non-competition clause was argued by the notifying Party among other because of the duration of "long term customer relationships" and "customer loyalty", which elsewhere in the notification were said to be of a much shorter duration and of much less importance. Therefore, the non-competition clause

has not been sufficiently justified as to its duration of [...]. Thus, in its present form, it cannot be considered ancillary to the concentration and is therefore not covered by the present decision. As far as the non-competition clause prohibits Lyondell from selling PO to any polyurethane foam producer interested in integrating backwards into polyols production, the Commission takes the position that a restriction on supply of other products by Lyondell to competitors of Bayer cannot be regarded ancillary to the concentration. Therefore this clause is not covered by the present decision.

VII. CONCLUSION

27. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the functioning of the EEA Agreement. This decision is adopted in application of Article 6(1) (b) of Council Regulation (EEC) No. 4064/89.

For the Commission,
Signed by M. Monti
Member of the Commission