On 30 January 2008, following an in-depth investigation, the Commission approved the acquisition of Kerling ASA (‘Kerling’) — the polymer division of the Norwegian company Norsk Hydro — by the UK-based INEOS Group Limited (‘Ineos’). Ineos is a leading global manufacturer of petrochemicals, specialty chemicals and oil products. Kerling is mainly active in the production, marketing and sale of polyvinyl chloride (‘PVC’) and caustic soda, in North-Western Europe.

The deal was notified to the Commission on 19 July 2007 and, after having rejected first phase commitments submitted by the parties, the Commission opened an in-depth investigation on 7 September 2007. No statement of objections has been sent to the notifying party in this case.

This case presents several particularities not only in terms of the scope of the second phase market investigation, which was almost exclusively confined to the geographic market definition, but also in terms of procedure, as it gave rise to the first Commission inspections under the Merger Regulation since 1999. Hence, it is mainly these aspects of the case that are discussed in this article.

I. Products concerned by the transaction

The Commission analysed the impact of the transaction on the markets for the sale and production of commodity S PVC, S PVC compounds, PVC films, caustic soda and several other chemicals which are by-products of PVC production and that were only marginally affected by the transaction.

As the first-phase market investigation did not identify concerns on any of the abovementioned markets except for the commodity S PVC market, the second phase market investigation and therefore this article focus exclusively on issues related to commodity S PVC, which is a type of S PVC mainly used in the production of plastic products such as PVC tubes, window frames and PVC films.

II. Market for the production and sale of the commodity S PVC

A. The importance of defining the geographic market

The parties submitted that, as S PVC is an inert and homogeneous commodity product which is readily and safely transportable, normally shipped in sacks or tankers with transportation costs representing only around 5% of the ex-factory price, the geographic scope of the S PVC market is at least EEA-wide. To support these claims, the parties provided, at a late stage of the first-phase market investigation, some additional evidence on cross-border trade flows within Europe and submitted a price correlation study which, according to them, showed that the prices in different EEA countries move closer together over time, and hence indicate the ability of the product to move freely between countries. However, the correlation analysis was spurious, as it failed to take account of common costs (that is to say, costs incurred by all producers in the business, such as costs of raw material, energy cost, etc.) and thus could not serve as a basis for Commission’s argument.

Indeed, the scope of the geographic market was crucial for assessing the present case as the parties’ combined strength differed substantially depending on the definition of the geographic market. Whereas on the basis of an EEA-wide market the parties’ combined market shares amounted to [20-30]%, on some national markets their combined shares were substantially higher, reaching [60-70]%, [90-100]% and [90-100]% in the UK, Norway and Sweden respectively. Accordingly, the Commission conducted a far-reaching market investigation in order to determine the scope of the geographic market.

The Phase I market investigation had disclosed evidence indicating that markets may be national, at least with respect to the countries geographically isolated from the rest of Europe, that is to say the UK, Norway and Sweden. In particular, the first-phase market investigation suggested that prices, margins, customers’ needs and preferences, as well as logistic and transportation costs, may differ substantially amongst various countries, and between these countries and those located...
in mainland Europe in particular. This led the Commission to examine during Phase II whether, despite the fact that major producers are active in most member states, the conditions of competition in the UK, Norway and Sweden are different from those in continental Europe.

In the UK, in particular, the deal was to create a market player which would be the only local supplier, with a production capacity close to [60-70]%, and a market share of over [60-70]% of the UK demand. During the first phase market investigation a majority of UK customers claimed that the UK market was national in scope and that continental suppliers currently importing into the UK would not be able to substitute themselves to local suppliers in the case of a price increase. This was mainly because, according to the respondents, third party importers would not have sufficient spare capacity and would be unable to respond to the needs of UK customers. In this respect some UK customers expressed a clear preference for local suppliers, as the level of security of supply in terms of lead times, flexibility in ordering additional volumes and the technical assistance that local suppliers could offer would be higher than that offered by continental suppliers. Thus, according to these respondents, distance and the fact of having to cross the Channel, coupled with higher transportation costs, would place continental suppliers at a competitive disadvantage vis-à-vis local producers.

Therefore, the Commission concluded at the end of first phase that the proposed transaction raised serious doubts as to its compatibility with the common market and the EEA Agreement, mainly owing to competition concerns identified on the commodity S-PVC market in the United Kingdom. On 17 August 2007 the parties submitted commitment proposals which, in the light of the market test, proved to be insufficient to dispel the serious doubts raised by the Commission. The Commission therefore adopted a decision to open an in-depth investigation on 7 September 2007.

B. In-depth market investigation

The main focus of the second phase market investigation was to determine the geographical scope of the market for S-PVC.

Although some of the customers located in Norway and Sweden considered the market to be the Nordic Region, the majority considered it to be either North-Western Europe or EEA-wide. A number of these customers have actually been sourcing part of their S-PVC requirements from suppliers located in mainland Europe. Moreover, the sales made out of the plants of the only local producer in Norway and Sweden, Kerling, are evenly spread throughout the EEA. All of this evidence supports the view that neither the Nordic Region as a whole nor Sweden and Norway constitute separate markets within the EEA.

With respect to the United Kingdom, whilst all competitors were unanimously claiming that the market for commodity S-PVC is EEA-wide, most UK customers considered the market to be national in scope for the reasons detailed above, and many of them expressed concerns about the effects of the transaction on competition within the UK.

In order to verify the claims expressed by UK customers during the first phase market investigation, and in particular the claim that the UK should be considered as a separate geographic market due to its isolated geographical position affecting the ability of continental suppliers to reliably supply the UK market, the Commission conducted very thorough qualitative and quantitative analyses.

At the end of the first phase it became apparent that reliability and flexibility of supply were major issues in the commodity S-PVC market. However, the in-depth market investigation, consisting of detailed questionnaires and numerous interviews with the UK customers, revealed that purchasing patterns and customers’ sensibility as regards the reliability and flexibility of supply tend to depend on the annual volume purchased by each customer. This led the Commission to divide the customers into two main categories: small customers and large/medium-sized customers, the latter category being further subdivided into local customers (with production plants located exclusively in the UK) and pan-European customers (with production plants located in various countries throughout Europe).

Small customers indicated that they can and do easily procure the totality of their needs from continental Europe, which is also consistent with the fact that a large majority of these customers consider the market to be EEA-wide. Conversely, medium/large customers tended to have different views and generally considered the geographical scope of the S-PVC market as national. In fact, for these customers, reliability and security of supply was stated as being a key concern. They therefore argued that they cannot rely wholly on continental suppliers and need to have at least one local supplier. As the transaction under examination would have led to a “two into one” merger with respect to a potential UK market, this appeared to be problematic.

The Commission conducted a very detailed analysis of the sourcing patterns of these customers and discovered that almost all of them multi-
source and the majority of them source from at least one continental supplier. Besides, it turned out that some medium/large customers single-source from importers. Furthermore, the historical analysis of UK customers’ purchasing patterns revealed that switching between local suppliers and importers is a fairly common practice in the industry as it does not entail any significant costs, since contracts are typically concluded for one year. The market investigation also brought about some contradictory statements from some UK customers, who were claiming that the UK market is national while stating that in the event of a small but significant lasting price increase in the UK they could and would switch an average of 20-30% of their purchasing needs to importers. One UK customer even indicated it could switch up to 60% of its requirements to continental suppliers. This confirmed that, despite the claims of some customers, UK customers undoubtedly arbitrate between UK and non-UK suppliers and that this is a general feature of UK customers’ behaviour.

In addition to the analysis of the demand-side features of the market, the Commission examined the supply-side perspective in order to assess the ability of and the incentive for continental suppliers to increase their presence in the UK market in the event of a rise in UK prices. To this end, the Commission collected substantial data from all importers into the UK (pertaining to planned capacity expansions, margins and transportation costs to the UK from each of their production facilities). It found that planned uncommitted capacity expansions would enable continental suppliers to increase significantly the supply to the UK in a context of low growth of demand in the coming years. Moreover, the data collected showed that, while transportation costs are certainly a consideration, they are no barrier to expansion because a small but significant price increase (2%-8% depending on the location of the plant) would make it profitable for continental producers to increase their supply to the UK market. The fact that sales to the UK are a profitable business, and would necessarily become even more profitable if UK prices were to increase, is clearly borne out by the reality that all major European producers are already supplying the UK market and that imports have consistently represented between 30% and 40% of the UK demand over the past five years.

As far as the flexibility of supply argument is concerned, the market investigation revealed that continental producers have the possibility to install storage facilities in the UK which act as a ‘virtual production unit’ and thus can compensate for inconveniences caused by the distance and the need to cross the Channel. Consequently, continental producers are able to offer a level of reliability and flexibility of supply comparable to that offered by local producers. Moreover, this proved to be a strategy which was feasible (commodity S PVC is stored in containers that can be superposed), low cost and successful in overcoming any handicaps in relation to local producers.

With regard to the pan-European medium/large UK customers who source primarily from local suppliers, it should be noted that they negotiate their contracts at European level. This confers on these customers significant purchasing power in relation to the parties (typically these are the biggest customers of the parties in the EEA) which would make it impossible for the merging parties to increase their prices in the UK without being penalised by a fall in sales in the other countries where these customers are located. As for local customers, these could easily switch a sufficient portion of their demand to continental suppliers, which would make any price increase unprofitable.

Moreover, in order to support a wider—than-national definition of the market, the parties submitted a corrected price correlation study which excluded common costs and which showed that prices are highly correlated between the EEA countries in which the parties are active. The parties also performed stationarity tests, which showed that there is a stable long-term relationship between prices, and that they tend to obey the ‘law of one price’.

Lastly, and taking account of the fact that the qualitative analysis seemed to produce some contradictory results, the Commission felt it necessary to conduct an extensive quantitative analysis on the basis of the parties’ and competitors’ sales data. This exercise appeared to be necessary in this case and was aimed to confirm that the geographical scope of the commodity S PVC market is wider than national. The results of the exercise are the subject of another article in this issue and therefore are not covered here.

Therefore, the conclusion of the market investigation was that, given that the majority of UK customers do already source (at least to some extent) from continental suppliers, that the transportation costs are not a barrier to the expansion of already substantial imports into the UK and that the inconveniences due to distance can easily be overcome through storage, the geographical market is wider in scope than national. The Commission did not find it necessary to conclude whether the market is, North Western Europe, Western Europe or the EEA, as ultimately the competitive assessment remains unchanged.
III. Merger inspections

Another interesting aspect is the fact that this case gave rise to the first Commission inspections under the Merger Regulation since 1999. During the second phase investigation, the Commission obtained information that the merging companies might be implementing the transaction in breach of the suspension obligation laid down by Article 7 of Merger Regulation. The allegations pertained to the fact that the acquiring party arguably intervened in the management of the target (which was its competitor at the time) through appointment of individuals and giving of instructions. Moreover, there were allegations that the two companies were sharing sensitive commercial information which might, in addition, have constituted an infringement of Article 81.

The Commission therefore conducted unannounced inspections at three locations in the UK, but did not discover any evidence of the alleged violations. On the contrary, the majority of documents collected during the inspections were exculpatory and indicated that the parties were aware of their obligations and had put in place systematic rules to avoid sensitive commercial information being exchanged prior to the Commission's clearance. The Commission concluded on this basis that the parties had complied fully with the suspension obligation.

IV. Conclusion

This case is an example of an in-depth analysis of the geographic scope of product markets. Also, it shows that the Commission is committed to vigorously monitoring compliance with all provisions of the Merger Regulation.