COMPETITION COMMISSION

AKZO NOBEL N.V./METLAC HOLDING S.R.L. MERGER INQUIRY

Summary of provisional findings report

Published: 20 September 2012

1. On 23 May 2012, the Office of Fair Trading (OFT) referred the anticipated acquisition by Akzo Nobel N.V. (AkzoNobel) of Metlac Holding S.r.l. (Metlac Holding) to the Competition Commission (CC) for investigation and report under the Enterprise Act 2002 (the Act). We are required to publish our final report by 6 November 2012.

2. The reference requires us to determine:
   - whether arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and
   - if so, whether the creation of that situation may be expected to result in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

3. AkzoNobel has an existing stake of 49 per cent in Metlac Holding through its subsidiary Akzo Nobel Coatings International B.V. (ANCI). The remaining 51 per cent is owned by members of the Bocchio family (the Bocchio family). Metlac Holding owns 55.56 per cent of its subsidiary Metlac S.p.A. (Metlac), the operating company. The remaining 44.44 per cent of Metlac is indirectly owned by AkzoNobel.

4. ANCI has a call option to buy the remaining shares in Metlac Holding, which it has exercised. AkzoNobel does not currently have sole control of Metlac. Upon completion of the transfer of the shares (the anticipated merger), AkzoNobel's shareholdings in Metlac Holding and Metlac would increase to 100 per cent and AkzoNobel would obtain sole control of Metlac.

5. We found that the transfer of shares if completed would result in the creation of a relevant merger situation because it would result in the parties coming under common ownership and control of AkzoNobel and the share of supply test was met with the parties having a combined share of supply of 61 to 70 per cent of metal packaging coatings in the UK.

The products

6. AkzoNobel and Metlac both manufacture and supply metal packaging coatings and metal decorating inks in the UK. These are both intermediate manufacturing products in the production of metal packaging, principally cans for food and beverages. Coatings are designed to protect the package contents from reacting with the packaging and/or external contaminants. Metal decorating ink is used to decorate packaging.

7. Metal packaging coatings and metal decorating ink are not substitutable for each other, from a demand- or supply-side perspective, due to their different uses and different manufacturing processes. We did not receive any evidence that the proposed merger would be likely to create competition concerns in relation to metal decorating inks and, based on the evidence we were provided with regarding metal decorating inks, we provisionally found that the parties' combined market shares in metal decorating inks would not give rise to unilateral or coordinated effects in the UK and therefore did not consider metal decorating inks further.

8. Demand for metal packaging coatings is derived from the demand for metal packaging, which tends to be divided into four main categories, according to its end use: beverage cans, food cans, caps and closures (ie metal lids for glass jars and bottles) and general line metal packaging such as cans and tubes for a broad range of products such as aerosols, cosmetics, chemicals, paints and dry food products.

The range of coatings supplied is determined by end-use market, type of metal, coatings application technology, functional and decorative surface properties, final coating performance requirements and food contact regulations.

9. The table below sets out the four main types of metal packaging coating by end use: beer and beverage coatings (B&B); food coatings (Food); caps and closures coatings (C&C); and general line coatings (GL) and describes types of coatings within these segments. The latter three segments are together referred to as ‘FCG’.

10. Coatings differ depending on whether they are for the body of the can or the ends of the can and, in each case, whether they are for internal or external application. Coatings for internal application will need to withstand the contents of the packaging, whereas external coatings will need to withstand the external environment. Internal coatings which come into contact with food and beverages are subject to specific regulatory requirements.

Metal packaging coatings by end use

Metal packaging coatings	*End use*	*Segments*	*Sub-segments*
B&B	B&B	Beverage externals (B2E)	Aluminium or steel Rim coatings
		Beverage internals (B2I)	Aluminium or steel
		Beverage ends (BE)	Internal or external
FCG	Food	Food external Food internal Food ends	Often divided depending on whether two- or three-piece and by manufacturing process. Some beverage cans are three-piece and they may be included in this category. Other types of coatings required for two-piece food cans include side stripe coatings
	C&C	Twist-off caps Tamper-proof caps Other	As with Food and B&B, each different type of cap requires both internal and external coatings
	GL	General line Aerosol Collapsible tubes Aluminium monobloc	As with other categories each different type of packaging requires both internal and external coatings and, in the case of tins (eg for paint) and three-piece tubes, ends.

Source: CC.

11. The production of metal coatings is relatively concentrated at the global level with three large producers: AkzoNobel, PPG Industries, Inc (PPG) and The Valspar Corporation (Valspar). Metlac is an intermediate-sized producer with a strong presence in the European Economic Area (EEA) but limited activities elsewhere. In addition, there is a range of intermediate and smaller producers operating in the EEA which offer a more limited range of products than Metlac.

12. A significant feature of the industry is that coatings need to be tested and qualified with the customer prior to use. Once a new coating formulation has been developed by a manufacturer, it must go through a rigorous process of testing, at both manufacturer and customer level, and qualification before it can be used commercially. Qualification is also required for coatings which differ slightly from

coatings already used by the customer or which have previously been used by the customer, but in a different plant or at a different time. The whole process from start to finish can take from four months for a general line product to more than two years for a food or beverage can coating. Less rigorous testing is required if a product is already qualified for a customer. The need for qualification prior to use by a customer results in relatively significant switching costs.

13. Because of the costs and the length of time required, switching to a previously unqualified product requires forward planning on the part of the customer and, in relation to product segments where qualification takes longer (eg B&B and Food), a level of customer sponsorship may be required for new suppliers to start supplying in these segments. There is an ongoing qualification cycle for suppliers and customers and qualification is one of the most crucial factors in the competitive dynamic of the metal packaging coatings industry.

14. The downstream metal packaging industry is also concentrated, with four global manufacturers and a small number of regional manufacturers in the industry. The global operators are The Ardagh Group (Ardagh), Ball Corporation (Ball), Crown Holdings Inc (Crown) and Rexam plc (Rexam). In Europe Can Pack SA (Can-Pack) also has a strong presence. Can manufacturers can generally be distinguished between those producing cans for B&B and those producing cans for FCG.

15. Ball, Can-Pack, Crown and Rexam account for all EEA demand for coatings for B&B can bodies. There are five further B&B customers which purchase coatings for beverage ends. Demand for FCG coatings is significantly more fragmented. Two large customers account for 31 to 40 per cent of demand (and 51 to 60 per cent in the Food segment). However, there are many smaller customers, reflecting the large

number of niche packaging products made for food, general line and caps and closures which are often tailored for a specific product and geographic focus.

16. A number of metal packaging companies, including all of the large companies listed above, have factories producing metal packaging in the UK.

17. AkzoNobel is among the largest suppliers of coatings for the protection of metal packaging. AkzoNobel manufactures metal packaging coatings globally, including at four sites in Europe, including in the UK.

18. From its Italian site Metlac supplies metal packaging coatings to customers throughout Europe and globally. It manufactures coatings for all of the main segments except B2I or BE coatings. Metlac traditionally focused on selling to customers based in Italy but its non-domestic sales have grown significantly since 2003.

Control and management of Metlac

19. The governance arrangements of Metlac Holding are set out in the 2007 Formation and Quotaholders Agreement (FQA) and associated by-laws. The governance arrangements of Metlac are set out in the 2007 Shareholders Agreement (SHA) and associated by-laws.

20. We sought evidence on the current arrangements for management of Metlac and whether these arrangements would change.

21. We considered whether the rights associated with AkzoNobel's current shareholdings in Metlac and Metlac Holding give AkzoNobel the ability to influence Metlac's commercial strategy, and whether AkzoNobel would have a greater or lesser ability in the future to influence Metlac's commercial strategy.

22. We found that the situation is unusual as, despite being a beneficiary of Metlac's profitability and having representation on the boards of Metlac and Metlac Holding, AkzoNobel does not have the ability to use its shareholding and associated rights in Metlac and Metlac Holding to significantly influence the commercial strategy of Metlac or to significantly constrain Metlac's ability to compete or the manner in which it competes.

23. Metlac's day-to-day management is controlled by the Bocchio family. As such, we have treated AkzoNobel and Metlac as independent competitors for the purposes of our competitive effects analysis.

Counterfactual

24. We considered the situation that would have prevailed absent the merger (the counterfactual). We found that, absent the merger, there were two possible counterfactuals:

- the status quo ante—ie AkzoNobel remains as a shareholder of Metlac Holding at the same level of shareholding as it currently has. We considered whether it would be likely to be a non-interfering 'benign' shareholder or a disruptive shareholder which attempted to limit the extent to which Metlac was able to compete; or
- AkzoNobel seeks an exit from its shareholding and sells its shares.

25. While both in our view are possible counterfactual scenarios, AkzoNobel submitted that the former was more likely. As the analysis does not change whichever counterfactual is used, because in either case Metlac would continue to compete against AkzoNobel, we have used the status quo counterfactual for our analysis. We did not find it likely that AkzoNobel would have the incentive to be a disruptive shareholder. Even if it were to attempt to be disruptive, we found that AkzoNobel's shareholdings in Metlac Holding and Metlac do not enable it to diminish Metlac's

ability to compete or prevent Metlac's management from being able to continue running the company.

The relevant markets

26. We found that the relevant product markets for the purposes of our inquiry were: the supply of metal packaging coatings for beer and beverage cans in the EEA (ie B&B market) and the supply of metal packaging coatings for metal packaging for food, caps and closures and general line in the EEA (ie FCG market).

27. There is no demand-side substitutability for the various different types of coatings products. However, there is a level of supply-side substitutability. We aggregated these products on the basis of supply-side substitutability. However, there are differences in the conditions of competition within both the B&B and the FCG markets. Therefore in our competitive assessment we considered the specific competitive constraints arising for segments within the markets (specifically the B2I, B2E and BE segments within B&B and the Food, C&C and GL segments within FCG) as appropriate.

28. We found that the geographic scope of this market was EEA-wide. Both Metlac and AkzoNobel currently supply metal packaging coatings for B&B and FCG in the UK. Supply is carried out on at least an EEA-wide basis and the factors set out below which affect competitive rivalry in metal packaging coatings supply therefore also affect supply in the UK, as part of the relevant EEA markets.

Competitive characteristics of the metal packaging coatings industry

29. We considered the current conditions of competition in the metal packaging coatings industry including: existing competitors to the merging parties, market concentration, growth, capacity, margins, switching and innovation. We found that the main factors

affecting existing rivalry in the B&B and FCG coating markets, and within segments of these markets, are supplier concentration and customer structure. Against this backdrop, we considered the level of competition between AkzoNobel and Metlac in the relevant markets, focusing on pricing pressure exerted by Metlac; switching; views from the parties, customers and competitors on the level of constraint Metlac places on AkzoNobel and other suppliers; and the strength of competition provided by Valspar, PPG and smaller suppliers.

30. The industry is characterized by spare capacity and margins which are not low. Over the last three years both AkzoNobel and Metlac have grown whilst Valspar and PPG have not. The evidence showed that Metlac competes against AkzoNobel in all main segments of the market apart from B2I and BE.

31. In the B&B market, the tender data covering a large proportion of purchasing in the market for recent years showed Metlac increasing its sales of B2E and AkzoNobel winning significant volumes of B2I sales. Information from the companies to which Metlac supplies B2E indicated that Metlac offers low prices compared with the other suppliers.

32. In relation to FCG there is a range of large and small suppliers, and Metlac generally offers low prices, which a number of customers submitted they use to bring down the offers of other suppliers. Metlac has grown more quickly than AkzoNobel, Valspar and PPG in this market in recent years, due in some degree to offering low prices.

33. These smaller suppliers have grown in the segments within which they were already active. This is consistent with our view that the customer switching costs are most relevant in relation to suppliers' ability to expand into new segments or product lines

where they do not have a reputation with customers, and where customer sponsorship may be required for growth.

34. Metlac's ability to grow sales with larger customers and expand into the B&B market, in contrast to other smaller FCG suppliers, was in part a consequence of its being able to benefit from working with Imperial Chemical Industries plc (ICI, acquired by AkzoNobel in 2008) to supply its customers in Italy, and then leverage those customer relationships to start competing with AkzoNobel and other suppliers outside Italy.

35. In an industry where suppliers have the manufacturing equipment to produce most coatings, their ability to switch production quickly to compete on price in particular segments is constrained by two factors: qualification costs and customer preferences regarding access to suppliers. Customers' supply choices are dictated by three particular factors: supplier's reputation; technological ability, including the ability to innovate and formulate coatings; and the supplier's own appetite to compete across the industry. In relation to reputation, only the three largest suppliers and Metlac have a reputation with customers for being able to provide high-quality coatings with strong service levels across the industry. Other suppliers' reputations are confined to particular market segments. The same applies in relation to technological ability. The final factor, appetite for growth, seems to be Metlac's particular strength compared with other smaller suppliers.

36. The evidence we were provided with, in particular on pricing policies, indicated that Metlac exerted a significant constraint on the behaviour of the larger suppliers. It had steadily gained market share by offering low-priced, technologically sound products, while remaining profitable. The evidence provided showed that it had priced aggressively whilst offering high-quality products, which was made possible by what

is perceived in the industry as a low-cost operation based on production efficiencies. There is evidence that its ability to provide nimble, innovative service is highly valued by customers, including those customers which make up a large proportion of industry demand in the EEA and the UK.

37. The evidence provided to us did not allow us to build up a complete picture of pricing or switching in the relevant markets. Our analysis of these markets is therefore based on this partial data, as well as pricing evidence and the views of customers, including all the main customers in the B&B market and a number of large customers and some key medium-sized customers in the FCG market, all of which are key customers for metal packaging coatings in the UK.

Competitive effects of the merger

38. In considering whether the merger may give rise to unilateral effects in the supply of metal packaging coatings in the UK, we considered:

- Loss of actual competition in the B&B and FCG markets. We also considered the effect of the merger in particular segments of these markets (with a focus on the B2E segment of the B&B market and the Food segment of the FCG market).
- Loss of potential competition in B&B, focusing on B2I and BE.

39. Underlying factors affecting existing rivalry in the relevant markets are the same in the UK as elsewhere in the EEA, and any effects of the merger at the EEA level would affect purchasers of coating products with plants in the UK.

40. Two factors were particularly relevant to our assessment:

- Metlac is a significant competitive force in the relevant markets (within the terms of paragraphs 5.4.5 and 5.4.12 of the CC's *Merger Assessment Guidelines*), as it

provides a significant competitive threat to other firms in the market by virtue of having a novel business model and a record of offering low prices.

- Second, a significant proportion of large and small customers which provided us with evidence indicated that they had significant concerns about the transaction. They have commented on the particular competitive force Metlac brings to the markets, which they see as being removed by the transaction and not able to be replicated by smaller suppliers or by a change in conduct on the part of the larger suppliers. While we have not had evidence from every customer, those customers from whom we have received evidence account for a significant proportion of metal packaging coatings demand both in the UK and in the EEA. When considering these customer concerns, we have placed most weight on the evidence provided regarding Metlac's low pricing strategy, where the evidence we received is consistent from both small and large customers, across both markets.

41. Our provisional view is that paragraph 5.45 is relevant here because against a backdrop of high market concentration, in our view Metlac has grown from being a small supplier to competing at a similar level to the three larger suppliers in the segments where it is active. This pattern of growth and expansion into the B&B market has not been replicated by other smaller suppliers which have been in the market for some time.

42. We have considered AkzoNobel's incentive to remove Metlac as a direct competitive constraint to it in the relevant markets. We received evidence that the parties compete in both B&B and FCG and that in the segments in which it competes, Metlac is an important constraint on AkzoNobel, via its low pricing, strong product quality and innovation and willingness to provide a wide range of products. We have also been provided with evidence showing that AkzoNobel competes strongly in the relevant markets, whilst Valspar and PPG do not appear to compete vigorously on

price. There is therefore an incentive on AkzoNobel to remove Metlac as a constraint on it and the result of this removal will give it a potential ability to raise prices.

43. We therefore consider it likely that AkzoNobel would change Metlac's pricing strategy and that customers would lose the benefits they currently enjoy from Metlac as a low priced supplier.

44. We have considered whether AkzoNobel would be likely to remove Metlac's innovative character from the market post-merger and are of the provisional view that it is unlikely that AkzoNobel would continue to offer Metlac's entire product range and, in relation to innovation, although there is no reason for AkzoNobel to seek to weaken Metlac's strengths in this area post-acquisition, its strengths in this area may be lost as a result of the merger process.

45. In relation to the B&B market, we considered that as a result of the removal of Metlac as a constraint in the B2E segment, AkzoNobel would be able to increase prices and that Valspar and PPG were unlikely to compete vigorously on price, on the basis of past behaviour, to counter this merger effect. Effects in the B&B market would be reinforced by the removal of Metlac as a potential entrant in the B2I and BE segments of the market.

46. In relation to the FCG market, we considered that AkzoNobel would also be able to increase prices and that Valspar and PPG were not likely to compete vigorously on price. As in B&B, it seems likely that the removal of Metlac as a constraint could result in increased prices. We also considered the extent to which removal of Metlac as a competitive force in the FCG market, particularly in the Food segment, where the merged entity will be nearly three times larger (whether by value or volume) than the next supplier in the segment, could be mitigated by expansion of smaller

suppliers. Whilst we found some evidence that smaller suppliers might be able to offer alternatives to Metlac products, at comparatively low prices, we did not receive evidence that they would be able, individually or collectively, to replicate Metlac's constraint across the market or that they had the ability or appetite to expand in a timely manner.

47. Metlac provided us with evidence that it was planning to enter two segments of the B&B market in which it did not currently operate: B2I and BE. We have therefore considered whether Metlac would be likely to enter those segments in the absence of the merger and whether such entry would lead to lower prices.

48. We have provisionally concluded that if Metlac were to enter the B2I and BE segments it would be likely to capture a significant market share. However, there are a number of factors over which we do not currently have sufficient clarity to be able to state that entry is sufficiently certain such that its removal would, on its own, create an SLC.

Market entry/expansion

49. We considered whether entry or expansion would be likely to occur in a timely and sufficient manner to counteract any effects of the proposed merger. We looked at the evidence of the history of entry and expansion being sponsored by customers and we considered whether customers could exert their buyer power in this manner in response to any unilateral effects. We provisionally concluded that entry or expansion into the B&B market was not likely to occur at a sufficient scale in a timely manner to constrain the merged entity.

50. We provisionally concluded that, whilst entry/expansion into some segments of the FCG market was likely, particularly with customer support, it was not clear that such

entry or expansion would occur at a sufficient level to constrain the merged entity, given past evidence on growth of smaller suppliers and qualification requirements.

Countervailing buyer power

51. We considered whether the four large customers in the B&B market had sufficient buyer power to counter any adverse effects of the merger. Customers currently rely on having Metlac as an option in their negotiations with B&B manufacturers and we think it is unlikely that the buyers would be sufficiently powerful to keep prices down following the disappearance of Metlac. The fact that a number of customers have found it necessary to sponsor new entry into the B&B segment indicates that they do not view only three suppliers as sufficient. Whilst we do think customer-sponsored entry is likely to occur, it is unlikely that it would be of a sufficient scale to replace the constraint Metlac currently places on the market in the near term.

52. We therefore do not think that buyer power is likely to be sufficient to counter any adverse effects arising from the merger.

53. In summary, we have provisionally concluded that the proposed merger would likely create unilateral effects in B&B and FCG markets. We found that Valspar, PPG and smaller suppliers would be unable to constrain the merged entity from raising prices. The merger would remove a potential entrant from the B2I and BE markets, which reinforces our provisional conclusion that the merger would result in unilateral effects in the B&B market. We found that new entry and expansion was unlikely to occur in a timely and sufficient manner to counteract the effects of the merger in either market and that countervailing buyer power was unlikely to be sufficient to counteract the effects of the merger in either market. We found that efficiencies were unlikely to provide sufficient customer benefits to counteract any adverse merger impacts.

Provisional conclusion

54. We have provisionally concluded that the proposed merger may be expected to result in a substantial lessening of competition in the markets for supply of metal packaging coatings for B&B and FCG, and this effect on competition in this market will also affect competition in the UK.