

## Completed acquisition by Imerys Minerals Limited of the kaolin business of Goonvean Limited

The OFT's decision on reference under section 22(1) given on 3 April 2013. Full text of decision published 13 May 2013.

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**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.**

### THE PARTIES

1. **Imerys Minerals Limited (Imerys)** is a subsidiary of Imerys SA, a multinational group (listed on the Paris Stock Exchange), which is active in 47 countries across Asia, Africa, Europe, North America and South America. Through its subsidiaries, Imerys SA is engaged in the mining and processing of various industrial minerals which are used in the industrial and manufacturing sectors. In the UK, Imerys is active in the extraction and processing of industrial minerals, particularly kaolin (also referred to as china clay) and ball clay, primarily in the south west of England. Imerys extracts Kaolin at six quarries in Cornwall (Wheal Martyn, Karlake, Treviscoe, Melbur, Virginia and Wheal Remfry). In the year ending 31 December 2011, Imerys' UK kaolin business produced [ ] tonnes of kaolin and generated a turnover of £ [ ] million in the UK.
2. **Goonvean Limited (Goonvean)** was a subsidiary of Goonvean Holdings Limited (GHL) and is based in Cornwall. Goonvean is engaged in the extraction and processing of kaolin from five quarries (Prosper, Greensplat, Trelavour, Goonvean and Rostowrack), all of which are in Cornwall. Before the merger Goonvean also processed the waste from kaolin mining into secondary aggregates. In 2011, Goonvean generated turnover of £17.9 million.

### THE TRANSACTION

3. Imerys purchased the Kaolin business of Goonvean, including its five quarries located at Prosper, Greensplat, Trelavour, Goonvean and

Rostowrack. Goonvean's existing aggregate activities do not form part of the transaction and will continue to operate under a new company called Goonvean Aggregates Limited (GAL) and remain owned by GHL. Pre-merger, Goonvean produced secondary aggregates using secondary aggregate feedstock, that is, waste from kaolin mining. GAL will continue to produce secondary aggregates using secondary aggregate feedstock. As GAL is not part of the transaction and the kaolin pits are being sold, it follows that it will no longer have direct access to secondary aggregate feedstock and it has therefore entered into an agreement with Imerys for this. The secondary aggregate feedstock for these operations will be provided by Imerys under a long term commercial supply agreement with GAL.

4. The transaction completed on 1 November 2012 and was announced on 5 November 2012. The purchase price was £[ ] million. The transaction was notified to the OFT on 3 December 2012, the extended administrative deadline is 27 March 2013 and the statutory deadline is 8 April 2013.

## **JURISDICTION**

5. As a result of this transaction, the kaolin businesses of Imerys and Goonvean (together, **the parties**) have ceased to be distinct.
6. The turnover test set out in section 23 of the Enterprise Act 2002 (the Act) is not met. However, the merged parties overlap in the extraction, production and supply of kaolin in the UK. The merged parties submitted that their combined share of supply in kaolin for paper filler applications and in the supply of kaolin for tableware applications is [in excess of 50] per cent and therefore exceeds 25 per cent. As such, the share of supply test in section 23(3) of the Act is met.
7. The OFT therefore believes that it is, or may be the case, that a relevant merger situation has been created.

## **RELEVANT FRAME OF REFERENCE**

8. Both of the merged parties extract, process, and supply kaolin from their pits in Cornwall. Kaolin has a range of applications in industries as an input to production processes. The main end use applications for kaolin include

sanitaryware, tableware, paper filler and specialty applications. The parties submitted that the value of UK demand for kaolin has steadily declined over the last 10 years as manufacturing industries move overseas. The level of this decline has varied across the different applications: around 31 per cent in commodity performance minerals; 45 per cent in tableware; 54 per cent in paper filler; and 84 per cent in sanitaryware.

9. The extraction of kaolin also results in by-products of sand and stent (waste rock) which can be used as feedstock to produce secondary aggregates. The extraction and supply of kaolin and the supply of feedstock for secondary aggregates are considered in turn below.

## **KAOLIN**

### **Product market**

10. Kaolin (commonly referred to as China Clay) is a soft, earthy, usually white mineral, which remains chemically inert over a wide pH range and is formed over many millions of years by the hydrothermal decomposition of granite rocks. It is mined (by and large in open pits) and then crushed, milled, refined and purified (and sometimes subjected to thermal treatment ranging from drying to high temperature calcining) into a variety of grades. Pits are developed over time by following kaolin lenses or stopes, in order to extract suitable material.
11. The parties submitted that kaolin extracted from a mine may be used in a number of different applications, depending on its subsequent processing. Kaolin is used in a variety of different products, in a number of sectors. In paper filler it is used to alter the properties of wood fibre, adding opacity and brightness and reducing cost. In tableware and sanitaryware kaolin adds whiteness and contributes to mullite skeleton formation during firing. In specialty applications (namely, performance minerals for paints and coatings, adhesives, leather processing, insulation, plasterboard, tapes, sealants, biocides, rubber, explosives and textile coating) kaolin is used to add texture, or as a white pigment.
12. The parties overlapped in the supply of kaolin for paper filler, sanitaryware, tableware, and speciality applications. The parties assessed the transaction

for each application separately.<sup>1</sup> Third parties confirmed this approach, indicating that each application of kaolin identified above will require a different grade and quality of kaolin and thus kaolin for one application is not substitutable on the demand-side for kaolin for another application.

13. On the supply-side,<sup>2</sup> the OFT's investigation indicated that the primary factors governing the grade of kaolin and its ability to be used in different applications are the characteristics of the kaolin deposit itself, and that a producer would have limited ability to adapt the resultant qualities of the kaolin it produced. For example, a supplier indicated that it could not produce kaolin for certain uses because they did not have suitable kaolin deposits. Another indicated that it had limited expertise to produce certain types of kaolin and lacked the requisite production capability. While the OFT has been unable to confirm this is the case across all applications and for every supplier, the OFT considers that, based on the evidence available (including that from the parties), there is an insufficient basis to warrant widening the product scope to include multiple applications through supply-side substitution. As a result, the following applications or product categories have been considered separately:

- paper filler
- sanitaryware
- tableware and
- specialty applications.<sup>3</sup>

#### **Paper Filler**

14. Industrial minerals, such as kaolin, are used in paper manufacturing to alter the natural properties of wood fibres, so as to add certain desirable characteristics such as increased opacity and brightness, enhanced gloss

<sup>1</sup> With the exception of tableware and sanitaryware, which the parties argued should be considered together. This is considered in detail below.

<sup>2</sup> The OFT considers that markets are defined primarily on the basis of demand-side substitution. However, the OFT may aggregate several narrow markets into one broader one on the basis of supply-side substitution when production assets can be used to quickly shift supply between different products that are not demand-side substitutes, and the same firms compete to supply these different products and the conditions of competition between the firms are the same for each product. See *Mergers Assessment Guidelines*, A joint publication of the Competition Commission and the Office of Fair Trading, OFT1254, September 2010, paragraph 5.2.17.

<sup>3</sup> The exception to this is tableware and sanitaryware applications, which the OFT considers in detail below. See footnote 1.

and better printability. Industrial minerals are also around three to four times less expensive than wood pulp or recycled pulp. Increasing the mineral content will therefore lead to a reduction in production costs. Kaolin is used as a primary filler in supercalendered papers, which are used for newspapers, magazines, catalogues, supplement, inserts and advertising material. Kaolin may also be used as a filler in papers that have multiple coats.

15. The parties submitted that Magnesium Silicate (MS), Ground Calcium Carbonate (GCC) and Precipitated Calcium Carbonate (PCC) can be used as alternatives to kaolin in paper filling applications. In support of their position, the parties cited the 2006 European Commission (the **Commission**) decision in *Omya/Huber*,<sup>4</sup> in which it was observed that: the general trend from kaolin towards GCC and PCC as paper fillers seems to continue as paper manufacturers continue to move away from an acid-based method to an alkaline-based one.<sup>5</sup> However, the OFT notes that the Commission went on to say that the change from kaolin to GCC coincided with the conversion from acid to alkaline paper making and with the demand for brighter and bulkier paper. In a paper machine running an acid-based system, kaolin cannot be replaced by calcium carbonates; GCC and PCC cannot be used commercially in acid processes because of their natural reaction with acid. However, in alkaline paper manufacture kaolin may be substituted by GCC or PCC.
16. The OFT has therefore considered if the narrow candidate market of kaolin for paper filler can be widened through substitution on the demand-side.<sup>6</sup>
17. Based on the previous Commission cases,<sup>7</sup> the OFT understands that, for the acidic paper filling process, kaolin is the only option. Third parties in this segment indicated that they use acid, alkali and neutral lines, depending on customer demand and what type of paper they are producing. As such they use both GCC and kaolin in their plant. However, they indicated that they could not switch away from kaolin for their acid based paper production in response to a five per cent small but significant and non-transitory increase in price (SSNIP).<sup>8</sup> The OFT has been unable to

<sup>4</sup> Case M.3796

<sup>5</sup> Case M.3796, paragraph 35

<sup>6</sup> See *Merger Assessment Guidelines*, paragraphs 5.2.6 to 5.2.19.

<sup>7</sup> *Omya/Huber*, Case M.3796 paragraph 39, *Imetal/English China Clays*, Case M.1381.

<sup>8</sup> See *Mergers Assessment Guidelines*, paragraph 5.2.11.

confirm in detail the extent of demand for kaolin used in acidic-based paper filler applications relative to alkaline paper filler applications. While the OFT recognises that there may be sufficient demand-side constraints from alternatives to kaolin in relation to alkaline-based paper production, it has focused its assessment on acidic-based paper production where the evidence points to the parties overlapping and to limited substitution to other input products as an alternative to kaolin, and thus where the transaction is most likely to raise concerns in paper filler. The OFT has not found it necessary to conclude on the precise product scope in relation to acidic and alkaline based paper production.

18. Therefore, consistent with the previous Commission case in this area, the OFT considers kaolin for paper filler applications separately for the purposes of the competitive assessment.

#### **Sanitaryware and tableware**

19. Kaolin is used in white tableware, sanitaryware and for floor/wall tiles, where it adds whiteness and contributes to the mullite skeleton formation during ceramic firing. At high temperatures (above 1,200°C) calcination occurs, which transforms kaolin into a whiter inert material, chamotte, which is particularly suited to use in sanitaryware.

#### Alternatives to kaolin for sanitaryware and tableware applications

20. The parties submitted that there are a number of alternatives to kaolin, including: ball clays, talc, quartz and feldspar. The parties indicated that it is possible for ceramics manufacturers to vary the proportions of each mineral used in their production process, and that this might occur in response to a change in relative prices.
21. Customers who responded to the OFT's enquiries indicated that there is no technical or commercial alternative to kaolin in either application. These customers indicated that they would therefore have no option but to accept a SSNIP.
22. On this basis, the OFT considers that there is no substitute for kaolin for these two applications and has gone on to consider whether kaolin for tableware and kaolin for sanitaryware should be considered separately.

## Separate markets for kaolin for sanitaryware and tableware applications

23. The parties submitted that the Commission has previously found a separate product market for kaolin sold for ceramics (including sanitaryware, tableware and tiles). In *Imetal/English China Clays* the Commission indicated that there was a greater degree of supply-side substitution between the tableware and sanitaryware kaolin than between other applications and, as such, they may be in the same market. However, the Commission did not conclude on this point as the parties did not overlap in ceramics.<sup>9</sup>
24. Third parties indicated that kaolins for sanitaryware and tableware applications are different, with each having specific properties and differences in relation to their whiteness, particle size and elasticity. As such, they indicated that demand side substitution between kaolin for use in these two applications of kaolin would not occur. Tableware in particular requires kaolin of a particular whiteness and brightness that sanitaryware grade kaolin does not possess.
25. In the absence of evidence in this case supporting demand-side substitution between kaolin for sanitaryware and tableware applications, the OFT has gone on to consider the extent to which the market may include both sanitaryware and tableware due to supply side substitution. As outlined above, the OFT may aggregate several narrow markets into one broader one on the basis of supply-side substitution when production assets give firms the ability and incentive quickly to shift supply between different products depending on demand for each, the same firms compete to supply these different products, and conditions of competition between the firms are the same for each product.<sup>10</sup>
26. On the supply side, suppliers of kaolin contacted as part of this investigation indicated that an impediment to production of kaolin for tableware applications is the quality of the kaolin deposits in pits. One supplier indicated that it would not be able to produce kaolin for tableware applications with the brightness and opacity required by customers. Therefore, based on the evidence available, the OFT considers that it does not automatically follow that a producer of one type of kaolin can readily

<sup>9</sup> See *Imetal/English China Clays*, paragraph 26.

<sup>10</sup> *Merger Assessment Guidelines*, paragraph 5.2.17

produce another. Furthermore, a customer indicated that Sibelco, a company extracting kaolin in Devon, does not have kaolin deposits of a sufficient quality to supply kaolin for tableware. [ ] As such, the OFT considers that the evidence does not suggest the product scope should be widened on the supply side to include both sanitaryware and tableware and has considered these separately for the purposes of undertaking the competitive assessment.

### **Specialty applications**

27. The parties overlap in relation to kaolin for use in certain speciality applications (namely paints and coatings, adhesives, leather processing, insulation, plasterboard, tapes, sealants, biocides, rubber, explosives and textile coating). Except in relation to some rubber applications, where kaolin adds texture, its primary use in specialist applications is as a white pigment. Of UK sales of around [ ] tonnes of kaolin for specialist applications in 2011, about:
- 20 per cent related to adhesives and sealants, where white pigments are used in the production of glue, paste, putty, and other sealants
  - 70 per cent related to paints and coatings, where white pigments are used to produce architectural coatings, industrial maintenance coatings, and road markings, and
  - 10 per cent related to rubber applications, where white pigments are used primarily in the production of cables, hoses, belts, and fabricated rubber products.
28. Other uses include the production of footwear, household products, floor tiles, and pharmaceutical products.

### **Alternatives for kaolin for speciality applications**

29. Although the Commission<sup>11</sup> has previously found a separate product market for kaolin for specialty applications, it lists a number of alternatives to kaolin, including: mica, diatomite, perlite, ball clay, GCC, bentonite, talc, quartz and cellulose thickeners. The parties indicated that it is possible

<sup>11</sup> *Imetal/English China Clays*, paragraph 18.

for paint and coatings manufacturers to vary the proportions of the other minerals used in their production process to enable the use of less kaolin and that this might occur in response to a change in price of kaolin.

30. However, customer responses in this segment, indicated that either: (a) there is no alternative to kaolin for use in speciality applications, so they could not switch away from it in response to a SSNIP; or (b) although partial substitution may be possible, they would have to reformulate their products to do this, which can take a significant amount of time. Further, third parties pointed to the alternative products contributing different characteristics to the formula that are not the same, or as effective, as those that kaolin brings to the products. As such, consistent with the previous Commission case,<sup>12</sup> the OFT considers kaolin for specialty applications separately for the purposes of the competitive assessment.

#### Premium and commodity grade kaolin

31. The parties submitted that there is a distinction between 'premium' and 'commodity' kaolin for specialty applications and that these should not be considered to form part of the same market. In particular, premium kaolin grades are characterised by ultrafine particle size (75 per cent of particles finer than two microns) and high brightness (greater than 84 ISO).
32. Imerys produces two grades of kaolin which are classed as premium, Speswhite and Supreme. They are used in:
- a) Speswhite: Adhesives, PU- Prepolymers, Polyvinyl acetate emulsions and derivatives (PVA), acrylics/acrylates, aminoplaste and phenoplastes (UF, MUF), silicones, sealants
  - b) Supreme: Paint, printing inks and lithographic inks.
33. Processing of these 'premium' grades, according to the parties, involves [ ]. In addition, these processes require costly infrastructure for storage and handling, which is reflected in an average ex-works bagged sale price of £[ ] for Speswhite and £[ ] for Supreme per tonne.<sup>13</sup> On the other hand, commodity kaolin grades, according to the parties, require less

<sup>12</sup> *Ibid.*

<sup>13</sup> Response to Issues paper paragraph 1.48

sophisticated processing and have lower brightness and average particle sizes, which results in a lower average selling price of £[ ] per tonne.

34. The parties argued that Goonvean's kaolin for specialty application is not comparable to these, stating that Goonvean's highest quality alternative, Opal Alpha, is coarser and less bright. They submitted that Goonvean does not (and cannot) produce any products which can be viewed as being premium commodity minerals. The parties argued that, as a result, in the absence of a competing product supplied by Goonvean, the parties do not overlap in the supply of so-called premium performance kaolin for specialty applications.
35. Customers, although recognising the terms 'commodity' and 'premium' performance minerals, could not point to a clear delineation between them. In relation to Speswhite, the OFT's market investigation did not fully support the parties' proposition. One [ ] customer in particular stated that it had switched from [ ] to another Imerys product that the parties categorise as a 'commodity' performance mineral, suggesting that there is some degree of substitution between 'premium' and 'commodity' performance minerals.
36. In relation to Supreme, the OFT notes that this is [ ].<sup>14</sup> The OFT did not receive any evidence of substitutes existing for the high value performance mineral, Supreme, either produced by Goonvean or any other manufacturers.
37. The OFT recognises that there may be differences between the quality and grade of kaolin extracted by the merged parties. However, the extent to which there is a clear distinction between premium and commodity kaolin is not supported compellingly by the evidence available to the OFT. While the evidence available to the OFT does not point to significant substitution between Supreme and other products, the evidence on Speswhite is less clear. As a result, the OFT has taken a cautious approach and has considered Speswhite alongside other performance minerals. In the absence of compelling evidence of sufficient substitution, the OFT also

<sup>14</sup> For instance the average UK selling price (per tonne) of what Imerys terms commodity performance minerals was £[ ] compared to £[ ] for Speswhite and £[ ] for Supreme.

considers high value minerals, namely Supreme, separately from other performance minerals.<sup>15</sup>

### **Conclusion on kaolin product market definition**

38. The OFT's market investigation pointed to a general lack of demand side substitution between kaolin and other types of minerals. Additionally, the OFT considered that, as the kaolin grade is at least partially dependent upon the quality of the extracted material, there is unlikely to be a sufficient degree of scope for supply side substitution. As such, and consistent with Commission precedent, the OFT has analysed the transaction in the supply of kaolin for paper filler applications, sanitaryware applications, tableware applications, and specialty minerals applications (commodity performance minerals and Speswhite) separately. The OFT considers Supreme separately.

### **Geographic market**

39. The parties submitted that the geographic scope is at least as wide as the European Economic Area (EEA-wide). In support of this, they pointed to the high levels of exports: the merged parties indicated that they each export around 90 per cent of their annual kaolin production.<sup>16</sup> Further, the parties submitted that it would not be prohibitively expensive for an overseas producer to import into the UK. There are significant imports of kaolin from outside the EEA (mainly Brazil) into Europe, according to the parties, and kaolin can be relatively easily and cheaply transported by being shipped dry and then made into a slurry by adding water. The OFT has taken into account these submissions on geographic scope in relation to each of the individual product markets identified above, namely paper fillers, sanitaryware applications, tableware and speciality applications (commodity performance minerals and Speswhite).

<sup>15</sup> The OFT considers the extent to which Goonvean may nevertheless be a potential supplier of a competing product to Supreme below.

<sup>16</sup> The parties submitted that the vast majority of their kaolin products are exported: in paper filler applications 99 per cent; in sanitaryware applications 96 per cent; in tableware applications 92 per cent; and in commodity performance minerals 80 per cent.

## Paper Fillers

40. The parties submitted that the geographic market for the supply of kaolin for use as paper filler is at least EEA-wide, based on the previous Commission decision that the geographic market in *Imetal/English China Clay* was EEA-wide. The parties submitted that there were significant imports into the EEA in 2011, amounting to around 139,000 tonnes, which represents 12 per cent of total EEA consumption. As such, the parties submitted that it is possible for kaolin to be transported into the UK in response to a five per cent SSNIP by UK suppliers.
  
41. In support of their argument, the parties submitted that they have two UK customers, which could be supplied by, for example, Explotaciones Cerámicas Españolas S.A (ECESA) a kaolin producer located in Spain, for an additional transport cost of £[ ] per tonne, based on transportation by sea freight. The parties submitted that their kaolin for paper filler applications has an average delivered price in the UK of £[ ] per tonne of which around £[ ] per tonne is transport costs, such that the additional £[ ] per tonne represents [between 0 and 10] per cent of the parties ex-works cost. The OFT did not received any evidence from third parties on the transportation costs specific to paper filler. However, the OFT received information on importation costs from third parties in relation to other types of kaolin. As discussed in detail below, these estimates were substantially higher than the parties' estimates. While the OFT acknowledges these do not relate to kaolin for paper filler customer, imported kaolin is likely to be transported in similar or identical ways across all applications, that is by road or ship in one of two formats - either dried or slurried. The OFT has not been provided with evidence to show that differential costs would not apply equally or similarly to kaolin for paper filler.
  
42. Further, one of Imerys' [ ] UK paper filler customers indicated that Cornish kaolin has certain properties which make it particularly suitable for their use and that Spanish kaolin is not a substitute. It stated that in response to a five per cent SSNIP by all UK producers it would consider buying outside of the UK, if it could a grade of equivalent quality at a competitive price. The OFT did not receive any compelling evidence from third parties that demonstrated that non-UK suppliers could supply kaolin of sufficient quality/grade, at a competitive price.

43. In support of a narrower focus than the EEA, the parties' own internal documents<sup>17</sup> suggest that the market for UK kaolin for paper filler applications is the [ ], and that there are no alternative producers of kaolin located in these areas.
44. Based on the evidence available and on a cautious basis, the OFT has considered the supply of kaolin for paper filler at a UK level, whilst considering any identifiable competitive constraints that may exist from specific producers overseas where these are relevant.

#### **Tableware and Sanitaryware**

45. The parties have not made separate submissions on sanitaryware and tableware, so they will be discussed here together. The parties submitted that, although the Commission did not need to conclude, in *Imetal/English China Clay*<sup>18</sup> it suggested that the geographic market was either Western Europe or Western and Eastern Europe for the supply of kaolin for tableware and sanitaryware.
46. The parties estimated that the costs of transporting kaolin to Stoke-on-Trent (the region where the parties' sanitaryware and tableware customers tend to be located) would be similar to those for transporting kaolin to this area by producers based outside the UK, asserting that the cost differential would be fairly low.
47. A customer who buys kaolin for tableware indicated that it buys all of its kaolin from the UK and that transport costs are the main reason it would not source from further afield. Two customers who buy all of their kaolin for sanitaryware from the UK also indicated that it would not be cost effective for them to source from outside the UK because of transport costs.
48. The parties have provided invoices for purchases made by Goonvean from [ ]. They submitted that this is evidence that kaolin imports into the UK are cost efficient and viable.

<sup>17</sup> [ ]

<sup>18</sup> At paragraph 54.

49. Although the OFT did not receive evidence from third parties on the actual cost of deliveries from Cornwall, the evidence that it did receive raises sufficient doubt for the OFT to conclude, on a cautious basis, that the transport costs are likely to be sufficiently higher than the parties have estimated. In particular, one third party has provided invoices showing that transporting kaolin by road from Germany to Stoke-on-Trent costs £[ ] per tonne (ex VAT), in contrast to transportation of clay from North Devon costing £[ ] per tonne (ex VAT). The difference between the AKW and North Devon figures provided by the third party is £[ ], which compares with a range of tableware prices of £[ ]<sup>19</sup> to £[ ] per tonne.<sup>20</sup> Thus, the additional transport cost from AKW represents between an estimated 10 and 46 per cent of the current UK total price of tableware kaolin.
50. This third party indicated that this shipment of kaolin from AKW was brought in by barge, moored and then transported by road to Stoke on Trent as and when it was needed. It indicated that this was more expensive than its current arrangements, which involve bringing the kaolin in by road. This customer indicated that it only uses kaolin from suppliers in Germany due to its particular technical properties, which are not available in UK kaolin.
51. A kaolin producer based in mainland Europe also indicated that it faces a transport cost disadvantage of €30 per tonne, coupled with a current exchange rate disadvantage of around 10-12 per cent. This supplier indicated that it is not currently able to compete with Imerys and Goonvean and [ ]. This supplier indicated that a five per cent increase in price by the parties would not change its competitive position relative to UK suppliers.
52. The OFT has also been provided with evidence from a sanitaryware customer that transport costs from France are significantly higher than those from Cornwall. For this customer, transport from Cornwall costs around £[ ] per tonne, against transport from France which is around £[ ] per tonne. This is set against an average selling price in the UK of sanitaryware grades of kaolin of between £[ ]<sup>21</sup> and £[ ].<sup>22</sup>

<sup>19</sup> Goonvean mean selling price for Diamond DTC.

<sup>20</sup> Imerys mean selling price for Super Standard Porcelain.

<sup>21</sup> Goonvean mean selling price for Diamond Blend 270.

<sup>22</sup> Imerys mean selling price for Remblend.

53. Given customers of both tableware and sanitaryware kaolin have indicated that they would not switch away from UK producers, and provided evidence that purchasing from non-UK suppliers would result in a significant increase in transport costs, the OFT assess the supply of kaolin for both tableware and sanitaryware applications on the basis of supply in the UK.

### **Specialty applications**

54. The parties submitted, based on a previous European Commission decision<sup>23</sup>, that the geographic market for kaolin for specialty applications is larger than Europe and includes the US and Brazil.
55. The parties submitted that there are a number of EEA suppliers of kaolin for specialty applications, and that they would not face substantial additional transport costs in supplying into the UK. The parties estimated that Lasselsberger (based in the Czech Republic) would incur transport costs of approximately £[ ] a tonne and various German suppliers (such as Hoffman Minerals and Dorfner) would incur transport costs of approximately £[ ] a tonne. These transport costs should be judged, according to the parties, against the fact that Imerys itself incurs average transport costs of £[ ] per tonne in selling kaolin on a delivered basis to its UK customers, implying Czech Republic and German suppliers face incremental transport costs of approximately £[ ] per tonne and £[ ] per tonne, respectively.
56. The OFT has contacted a number of customers in this sector, with the majority indicating that commodity grades of kaolin cannot be feasibly imported into the UK due to high transport costs.
57. Some customer comments suggest there may be some degree of substitution to suppliers based outside of the UK in response to a SSNIP for high value premium products, such as Supreme, as transport costs comprise a much lower percentage of the purchase price. Indeed the OFT has received evidence that one customer is considering purchasing high value premium products from a supplier in the United States.

<sup>23</sup> Imetal/English China Clay, paragraph 51.

58. Taking the evidence in the round, the OFT has assessed the supply of lower value speciality application products, including Speswhite, at a UK level; the parties have referred to these products as commodity performance minerals. In contrast, the OFT considers the supply of higher value performance minerals, such as Supreme may be subject to constraints from outside the UK, although, in the absence of competition concerns in relation to Supreme it has not been necessary to conclude on this point.

### **Conclusion on kaolin geographic scope**

59. Based principally on the results of the OFT's market investigation, the OFT assesses each of the kaolin segments in which the parties overlap on a UK wide basis.

## **SECONDARY AGGREGATE FEEDSTOCK**

### **Product market**

60. The parties were both active in the production of secondary aggregate feedstock in Cornwall. Secondary aggregate feedstock, that is, sand and stent, which is a by-product of kaolin production, can be processed into secondary aggregates for use primarily in road building and cement making.
61. Sand and stent can either be processed into secondary aggregates,<sup>24</sup> or transported to a tip for long term storage. A kaolin producer therefore has the choice of selling waste material or paying to transport it and placing it in an above-surface tip for long term storage.
62. As secondary aggregate feedstock is a by-product of the mining process, the availability of alternatives will be dependent upon what other products are being mined in the area, including those extracted as primary aggregates. Primary aggregates are aggregates produced from materials extracted for the purpose of producing aggregates, rather than as a by-product of mining another product.

<sup>24</sup> Around 75 per cent of material will be suitable for processing into secondary aggregates, so around 25 per cent will always need to be tipped.

63. The OFT recognises that the supply of secondary aggregate feedstock may therefore be subject to indirect constraints from customers being able to switch to primary aggregates. However, the OFT and CC have previously looked at the secondary aggregate market in *Anglo American/Lafarge*,<sup>25</sup> with the CC concluding that primary and secondary aggregates are not in the same market, although there was some evidence of substitution from primary to secondary aggregates.
64. In this case, a customer told the OFT that in the event of a SSNIP affecting secondary aggregate feedstock, it would be forced to consider alternative means of supplying their customer base, which could include the opening of currently mothballed primary aggregate operations, and that this would be costly. However, this customer also highlighted current economic conditions, expressing concern that it would be unlikely to secure capital for such a significant investment.
65. On a cautious basis, the OFT has considered secondary aggregates separately for the purpose of its assessment although given that no competition concerns are raised in relation to the supply of secondary aggregated feedstock it has not needed to conclude on this issue.

### **Geographic market**

66. In *Anglo American/Lafarge* the Competition Commission found that the geographic market for secondary aggregates was local, due to high transport costs, and could be approximated by a 30 mile catchment area.
67. A third party has informed the OFT that in response to a SSNIP by a hypothetical monopolist of secondary aggregate feedstock in Cornwall, it would not be able to switch suppliers, as it stated that there is no viable alternative located outside Cornwall, primarily due to high transport costs. While the OFT is minded, based on the evidence available to it, to follow previous case precedent and assess the transaction on the basis of a 30-mile catchment area, the OFT has not found it necessary to conclude on this point and leaves the precise geographic scope open.

<sup>25</sup> Proposed joint ventured between Anglo American plc and Lafarge SA, OFT decision of 2 November 2011 and 'A report on the anticipated construction materials joint venture between Anglo American PLC and Lafarge S.A.' by the Competition Commission dated 1 May 2012.

## COMPETITIVE ASSESSMENT

### KAOLIN

#### Summary of shares of supply in the UK in 2011

	Paper Filler		Sanitaryware volume		Tableware volume		Specialty Applications	
	volume ('000 T)	Market share (%)	volume ('000 T)	Market share (%)	volume ('000 T)	Market share (%)	volume ('000 T)	Market share (%)
<b>Imerys</b>	[ ]	[85 to 95]	[ ]	[55 to 65]	[ ]	[45 to 55]	[ ]	[55 to 65]
<b>Goonvean</b>	[ ]	[0 to 10]	[ ]	[15 to 25]	[ ]	[20 to 30]	[ ]	[30 to 40]
<b>Combined</b>	[ ]	100	[ ]	[70 to 80]	[ ]	[75 to 85]	[ ]	[90 to 100]
<b>AKW Hoffman Minerals</b>					[ ]	[10 to 20]	[ ]	[below one]
<b>Sibelco</b>			[ ]	[20 to 30]			[ ]	[below 5]
<b>Others</b>					[ ]	[0 to 10]		

Note: The OFT Source: The parties' actual sales and Imerys' estimate of competitor sales, and Sibelco's actual sales in 2011.

68. Based on the parties' estimates of shares of supply, the merger creates a monopoly in the UK supply of kaolin for paper filler and tableware<sup>26</sup> and gives rise to a reduction in competing UK suppliers from three to two in the supply of kaolin for performance minerals.

#### Kaolin for use in Paper Filler

69. The parties were the only suppliers of kaolin for paper filler and as such the merger represents a merger to monopoly in kaolin for paper filler in the UK.<sup>27</sup> The merger therefore raises significant prima facie concerns in relation to kaolin for use in paper filler applications. Given the parties have made submissions that they do not compete strongly and that the merger

<sup>26</sup> [The OFT notes that AKW is present in the supply of tableware in the UK]

<sup>27</sup> On an EEA-wide basis, for paper the parties' combined share of supply is [40 to 50] per cent, with an increment of [0 to 10] per cent with other suppliers AKW ([20 to 30] per cent), Lasselsberger ([10 to 20] per cent), and Sibelco ([0 to 10] per cent).

does not significantly alter the position for customers, the OFT has proceeded to look at how closely the parties compete.

70. The parties stated that Goonvean only has [ ] for its paper filler kaolin in the UK and that the value of its purchases are low in comparison to the total size of UK sales, amounting to around £[ ] per annum.<sup>28</sup> They further argued that Imerys only has [ ] customers and that Goonvean would not be able to supply these. The parties argued that [ ] of these require their kaolin to be delivered in a slurried form which Goonvean does not currently have the ability to produce. They also submitted that Goonvean could not supply one of these customers on the ad hoc and irregular basis it requires. The [ ] of these customers has its [ ]. However, [ ].
71. The OFT received two third party responses in relation to kaolin for paper filler. Both third parties responding considered the parties to be competitors and confirmed that they did not consider there to be viable alternative suppliers from Europe or beyond. One third party noted that it benchmarked the parties against each other pre-merger. While it is not clear as to how price benchmarking has delivered better terms and conditions for this third party, the OFT considers this points to some degree of competitive interaction between the parties and awareness of their respective offerings. Set against this, the OFT notes that one third party indicated that Goonvean's [ ] may have limited its ability to switch to Goonvean.
72. The parties argued that strong competition will remain in the market as, they argued, several producers (for example, AKW, Lasselsberger and ECESA) are well placed to supply into the UK. As evidence of the constraint from overseas producers, the parties submitted that they have lost some non-UK customers to non-UK kaolin producers.
73. However, the OFT notes that no supplier based outside the UK currently supplies any kaolin for paper filler to the UK. Further, the OFT notes that customers – of kaolin for paper filler and across all other applications – have stated that the import of kaolin from mainland Europe would not be cost effective. The OFT considers the loss of non-UK customers is not probative of the extent to which UK customers may switch to non-UK suppliers and is therefore of limited evidential value.

<sup>28</sup> Total sales in the UK are around £300,000.

74. The parties also submitted that Sibelco, a UK based producer, is well-placed to supply UK customers. However, as with the suppliers based outside the UK, Sibelco currently does not supply kaolin for paper filler applications in the UK. Additionally, third parties have informed the OFT that Sibelco has not been able to produce kaolin that is suitable for UK customers, due to the higher abrasiveness and lack of brightness of its source material. The OFT also notes that [ ]. The OFT considers that, as a result, the extent to which Sibelco – [ ] – could constrain the parties from worsening their competitive offering post-merger is unclear. Should customers seek to source from Sibelco as an alternative when faced with, for example, a price rise from the parties, Sibelco would [ ].
75. The OFT acknowledges that Goonvean may not be as strong a competitor as Imerys in the supply of kaolin for paper filler applications given its limited facilities and sales. Nevertheless, the evidence, on balance, points to Imerys and Goonvean competing to some extent pre-merger, and representing the only feasible alternatives for UK customers, as no other suppliers actively compete to supply UK customers.

### **Conclusion**

76. For the reasons set out above, the OFT concludes that the merger will give rise to a significant concentration in the supply of kaolin for paper filler applications. Although the merger increment is small, customers have indicated that the parties compete and that they do not have any alternative suppliers post merger.

### **Kaolin for use in sanitaryware**

77. The parties and Sibelco are the main suppliers of kaolin for sanitaryware in the UK and as such the merger represents a reduction in competing suppliers in kaolin for sanitaryware applications in the UK. The parties have an estimated combined share of supply in the UK of [65 to 75] per cent with an increment [15 to 25] per cent. The only other significant competitor to the parties in the UK is Sibelco.<sup>29</sup> Sibelco competes in relation

<sup>29</sup> On an EEA-wide basis, the parties' combined share of supply would be around [25 to 35] per cent, with an increment of [0 to 10] per cent with other suppliers Lasselsberger ([20 to 30] per cent), AKW (10 to 20] per cent), and Soka ([0 to 10] per cent).

to the supply of kaolin for sanitaryware applications and holds around [20 to 30] per cent share of supply.

78. The parties supply kaolin for sanitaryware applications to only a limited number of UK customers. Both parties supply Ideal Standard which is Imerys' [ ] (Ideal Standard accounts for [ ] per cent of all UK demand).<sup>30</sup> In addition, Goonvean also supplies [ ].<sup>31</sup>
79. The parties have argued that any partial switching by Ideal Standard could therefore drastically shift market shares between suppliers and that Ideal Standard has used [ ].
80. The parties also argued that the [ ] price difference between the products they supply to sanitaryware customers<sup>32</sup> indicates the products cannot be substitutes and the products supplied by the parties are used for different purposes. In support of this, they further argue that different grades of kaolin for use in sanitaryware products may have different qualities. For example, the parties argued that Goonvean products have greater strength and plasticity and are relatively slow casting. Customers using Goonvean products tend to have less automated and more manual processes, whereas Imerys' kaolin supplied to [ ] has high natural strength or 'modulus of rupture'.
81. However, customers have indicated that they consider that the parties compete and that the parties' products are substitutable. The OFT notes that customers indicated that in the event of a price rise they would be unable to switch volumes to a supplier other than one of the parties. One indicated that it considered the parties to be close competitors. In the event that the parties increased prices they would consider changing production processes or staffing, but ultimately would have no option but to accept the increase. A customer also indicated that pre-merger it had an ongoing project to replace Imerys kaolin with Goonvean kaolin and considered the parties to be close competitors.

<sup>30</sup> Ideal Standard purchases [ ] tonnes of [ ] from Imerys for £[ ]. Ideal Standard purchases [ ] tonnes of [ ] for £[ ], and [ ] tonnes of [ ] for £[ ] from Goonvean.

<sup>31</sup> Goonvean supplies [ ] tonnes of kaolin to Ours Sanitaryware – [ ] of which were of [ ] at a delivered price of £[ ] per tonnes for £[ ]. Goonvean supplies [ ] tonnes of [ ] at an average delivered price of £[ ] per tonne for a total of £[ ].

<sup>32</sup> Diamond Swift has an average delivered price of £[ ] per tonne in 2012. NSC an average delivered price of £[ ] per tonne in 2012.

82. The parties submitted, [ ], that Sibelco has gained some volume from [ ] and had won orders from [ ]. However, [ ] stated that Sibelco's kaolin is not a close substitute to Imerys kaolin and that Sibelco's kaolin can be further substituted for Imerys kaolin only if a quantity of Goonvean kaolin is blended into the mix. Furthermore, third parties have indicated that clays produced in Devon lack the plasticity of Cornish clays, which is important to achieving high yield rates. As such, third parties have indicated that the parties are each other's closest competitors, with Sibelco representing a poor alternative.
83. Further, as noted above, [ ]. The OFT considers the fact that [ ] points to it being an ineffective competitive constraint to the merging parties. In the event of a price rise by the parties post-merger, customers seeking an alternative source of supply may not be able to source from Sibelco.
84. In relation to AKW sales in sanitaryware in the UK [ ]. Customers in sanitaryware have also indicated that there are only three potential suppliers to them, the parties and Sibelco, and did not point to AKW as an alternative. As a result, while the OFT recognises that AKW may have some limited sales for sanitaryware kaolin in the UK, it has been unable to confirm the parties submission on the extent of its supply into the UK and thus the strength of its competitive constraint on the parties. However, the OFT notes that even if it were the case that AKW had sales equivalent to the parties estimates, this would not be sufficient to allay concerns in the supply of kaolin for use in sanitaryware. In particular, the OFT notes that should this be the case the parties would still have a combined share of supply of around [65 to 75] per cent and the merger would bring together the two largest suppliers by volume of sales.

### **Conclusion**

85. The OFT considers the merger represents a significant concentration in the supply of kaolin for sanitaryware applications. In the absence of significant alternative and effective competing suppliers that would remain to supply UK customers, the OFT considers that the merger removes the principal competitive constraint on the parties and this indicates that unilateral effects may result from the merger.

## **Kaolin for use in tableware**

86. The merger represents a merger to monopoly<sup>33</sup> in the UK for tableware applications and as such raises significant prima facie competition concerns.<sup>34</sup>
87. [ ]<sup>35</sup> [ ]. [ ].
88. [ ].<sup>36</sup> Further, the parties submit that '[ ]'.<sup>37</sup>
89. [ ]. The parties provided internal documents that they suggest show a strategic decision to move away from sales to the tableware sector [ ], and some evidence of instances in which Goonvean rejected tableware business.
90. The parties submitted a Witness Statement from Goonveans' [ ], in order to support the proposition that Goonveans' strategy had been to cease supply of kaolin for tableware. [ ] explains at paragraph 1.19 that [ ]'.
91. The parties submitted that as a result, their strategy was not to actively compete for new tableware customers. The parties presented three Call Reports indicating that [ ].<sup>38</sup>
92. The OFT notes that Goonvean's action in this area has so far only involved [ ]. Goonvean explicitly stated that the change in strategy has not affected supply to existing customers, for which the OFT thus considers them to be active competitors to Imerys.<sup>39</sup> The OFT received no evidence demonstrating that, in the absence of the merger, supplies to existing customers would have ceased or reduced.
93. In support of them not being close competitors, the parties have argued that there has been no switching between the parties in the last three

<sup>33</sup> Some sales are made by AKW, in addition to the parties.

<sup>34</sup> For tableware applications on an EEA-wide basis, the parties' combined share of supply would be [40 to 50] per cent, with an increment of [five to 15] per cent with other suppliers AKW ([10 to 20] per cent), Sedleky Kaolin ([10 to 20] per cent), and Sibelco (0 to 10 per cent).

<sup>35</sup> [ ].

<sup>36</sup> Witness statement of [ ], paragraph 1.16, dated 6 February 2013.

<sup>37</sup> Witness statement of [ ], paragraph 1.17, dated 6 February 2013.

<sup>38</sup> Response to Issues Paper – Key documents, tab 14.

<sup>39</sup> [ ].

years, although the OFT notes that the switching process may take around 18 months, due to extensive trials and given the relatively low number of customers in this industry regular episodes of switching would not be expected. The parties also pointed to the price differential between their products. One example they give is supply to [ ] which purchases Imerys grades [ ] (£[ ] per tonne) and [ ] (£[ ] per tonne) and also purchases [ ] grade (£[ ] per tonne). The parties argued that if their products competed directly then customers would opt for cheaper products.

94. In relation to the parties' respective product offerings for kaolin for tableware applications, customers indicated that they viewed the parties as close competitors. For instance, third parties have indicated that Diamond Star was specifically developed by Goonvean to compete with Imerys Super Standard Porcelain. Taking the above evidence into account the OFT considers that the parties are each others' closest competitor in the supply of kaolin for tableware applications. This therefore raises prima facie competition concerns.
95. Set against this, the parties submitted that they would face strong competition from UK and non-UK suppliers.<sup>40</sup> Specifically, in the UK, they submitted that Sibelco markets tableware grades on its website and is capable of supplying it and they also pointed to overseas suppliers such as AKW.
96. The OFT's investigation indicated that Sibelco does not supply tableware grades in the UK, [ ]. This is [ ]. This was confirmed by third parties.
97. In relation to AKW, the parties submitted that it supplies it tableware grade to Furlong Mills in the UK and its [ ]. However, it is unlikely to pose a strong competitive constraint on the parties [ ]. In addition, a third party also indicated that AKW OKA grade is extremely bright so is used to add whiteness, but has poor plasticity and casting properties, so can only be used in small percentages in tableware applications and only when blended with Cornish clay.
98. While the OFT recognises that there may be the possibility for a limited degree of partial substitution by customers away from the parties products to AKW OKA, the extent to which such limited scope for substitution

<sup>40</sup> Response to the Issues Paper, paragraphs 6.27 to 6.28.

would be sufficient to constraint the parties post-merger is unclear and appears unlikely.

## **Conclusion**

99. The OFT considers the merger represents a significant concentration in the supply of kaolin for tableware applications. There is evidence from third parties that the parties are competing closely with each other. In the absence of significant alternative competing suppliers that would remain to supply UK customers, the OFT considers that the merger removes the principal competitive constraint on the parties and indicates that unilateral effects may result from the merger.

### **Kaolin for use in specialty applications (CPM and Speswhite)**

100. The parties have a combined share of supply of [90 and 100] per cent with an increment of [30 to 40] per cent<sup>41</sup> for CPM and Speswhite applications taken together. The only other companies Imerys lists as active in this sector in the UK are Hoffman Minerals and Sibelco, although they each supply [0 to 10] per cent of total UK supply. The OFT considers the parties' shares of supply in the UK to be significant and considers that they raise significant prima facie competition concerns.

101. Sibelco is the only other UK-based producer of CPM kaolins. It does not produce any products which the parties categorise as PPM such as Speswhite.<sup>42</sup> Sibelco produces a number of products: kaolin 50, Puraflo S, CC31, Puraflow CC, and Puraflo WB which can be categorised as CPM.

102. The parties submitted that Sibelco is a strong constraint to the parties in the supply of CPM. The OFT's market investigation indicates that Sibelco's presence in CPM and specialty applications is limited with their total sales in CPM representing about [below 10] per cent of supply by value [ ].

103. In the absence of significant competing suppliers to UK customers, the OFT considers the merger removes the principal and only effective competitive

<sup>41</sup> On an EEA-wide basis, the parties' combined share of supply would be [35 to 45] per cent, with an increment of [10 to 20] per cent with other suppliers Lasselsberger ([five to 15] per cent), Hoffman Minerals ([five to 15] per cent), and AKW ([0 to 10] per cent).

<sup>42</sup>[ ].

constraint to each of the parties, pointing to a likelihood of unilateral effects.

104. Despite this initial assessment, the parties have made submissions to the OFT asserting that the parties do not compete strongly. The OFT has therefore assessed the extent and closeness of competition between the parties.

105. The parties submitted that they are not close competitors because:

(a) Goonvean lacks the [ ] to produce PPM products. They have not been able to supply Imerys customers. For example, the parties submitted Goonvean would not be able to supply [ ] with CPM grades for paints as it cannot meet their [ ].<sup>43</sup>

(b) The parties each produce products for customers which the other cannot produce an alternative to for technical/quality reasons. For example, the parties submitted that [ ] rejected Imerys' grades for use in [ ] due to [ ].<sup>44</sup>

106. However, three customers stated that the parties competed. One of these customers considered that although Goonvean is smaller it was active, and had sought new customers in this area. This was in part supported by evidence that Goonvean had participated in new product trials for a global paint manufacturer. Goonvean's web-site indicates that it has developed a suite of CPM products which are used in similar applications to those of Imerys.<sup>45</sup> As such, on a cautious basis, the OFT considers that the parties compete in the supply of CPM and Speswhite taken together.

## **Conclusion**

107. The OFT considers the merger represents a significant concentration in the supply of kaolin for specialty (CPM and Speswhite) applications. The evidence available to the OFT does point to the parties competing. In the absence of significant alternative competing suppliers that would remain to supply UK customers, the OFT considers that the merger removes the

<sup>43</sup> Response to Issues Paper, paragraph 7.45(a).

<sup>44</sup> Response to Issues Paper, paragraph 7.46(a).

<sup>45</sup> [www.goonvean.com/products/extenders.html](http://www.goonvean.com/products/extenders.html)

principal competitive constraint on the parties and indicates that unilateral effects may result from the merger.

### **Potential competition in the supply of Supreme**

108. The OFT has considered whether Goonvean is a potential competitor to Imerys in so-called 'premium' performance minerals, specifically whether it could produce a product in direct competition with Supreme. The OFT notes that one of the rationales for the merger was for Imerys' to [ ]. Although Goonvean has not presently invested in the necessary technology, it is clear that [ ].<sup>46</sup> The OFT understand that the principal investment required by Goonvean would be [ ].

109. In addition, the OFT has been informed by a customer that it had entered into a trial with Goonvean designed to find an alternative product [ ], suggesting the possibility that, although Goonvean does not presently appear to produce a product which is in direct competition to Supreme, it may do so in the future or have the intention of doing so in future.<sup>47</sup>

110. However, this customer also indicated that it was trialling four other suppliers alongside Goonvean and that Goonvean had performed poorly in initial tests.

111. The OFT notes there may have been a possibility that Goonvean would have entered in competition against Imerys' Supreme product, absent the merger. However, the extent to which this would have occurred is far from clear, based on the evidence available to the OFT. Given the conclusions in relation to other product categories, the OFT has not found it necessary to conclude on the extent to which Goonvean may have represented a potential competitor to Imerys for its Supreme product.

### **Conclusion on competitive assessment across all kaolin applications**

112. Given the significant concentration in supply resulting from the merger, the closeness of substitution between the kaolin supplied by each of the merged parties, and the absence of material competitive constraints to the parties post-merger, the OFT believes that, in the absence of evidence to

<sup>46</sup> [ ].

<sup>47</sup> Goonvean stated to the OFT that it could not consider supplying this customer as it could not [ ].

the contrary, the merger may be expected to give rise to unilateral effects in the supply of kaolin for tableware, sanitaryware, paper filler and specialty applications in the UK.

## **BARRIERS TO ENTRY AND EXPANSION**

113. When assessing whether entry or expansion might prevent a SLC, the OFT considers whether it would be timely, likely and sufficient.<sup>48</sup>

114. Kaolin is a naturally occurring product which has been mined in Cornwall for over 200 years. One of the rationales for the transaction is to acquire high quality kaolin deposits for use in tableware which have not been identified elsewhere. Kaolin deposits appear to be finite and as a result the OFT does not have evidence to indicate entry or expansion into the UK by an existing producer of tableware grade kaolin or indeed any of the product categories concerned. Specifically, the OFT has no evidence to indicate that there are any sites in the UK which might be suitable for a new kaolin extraction plant.

115. Although evidence supports only limited existing actual competition from other suppliers, the OFT has also considered the extent to which other suppliers may begin supply in or to the UK, entering or expanding against the parties. The OFT does not have evidence to indicate entry or expansion into the UK by an existing producer of kaolin would be timely, likely, or sufficient. Specifically, the OFT does not have any evidence to indicate that there are any sites in the UK which might be suitable for a new kaolin extraction plant.

116. The OFT does not consider that an existing supplier located outside of the UK would have the ability, or the incentive to supply into the UK, given the differences in quality of Cornish kaolin identified by customers and the costs of transporting to the UK, also highlighted by third parties, and likely to render imports more costly.

117. For example, one kaolin producer based in mainland Europe indicated that the cost of importing kaolin into the UK given the relatively small quantities demanded here would not be economically viable given the transport costs which would be involved in shipping small quantities at a time.

<sup>48</sup> See *Merger Assessment Guidelines*, paragraph 5.8.3.

118. Nevertheless, despite these general arguments suggesting the prospect of entry is limited, the OFT has gone on to consider the parties arguments in relation to each category.

### **Paper filler applications**

119. The parties argued that Sibelco, which is present in the UK but has no current UK paper filler supply, are well placed to commence supplies in the UK and that they would increase spare capacity by around [ ] tonnes in the coming months – which is equivalent to [ ] times UK demand – [ ]<sup>49</sup> The OFT investigation revealed that although [ ].

120. In any case [ ] that UK customers found the qualities of their kaolin for paper filler unsuitable for their intended uses so it would be unlikely that any capacity would be focused on supply into the [ ].

121. [ ].

122. The OFT therefore considers that that new entry or expansion in this market is unlikely.

### **Sanitaryware applications**

123. The parties have argued<sup>50</sup> that Sibelco could compete to supply [ ] and already has a formulation called JAWS (Just Add Water) which is made in the UK using ball clay and kaolin and can be used to produce sanitaryware. They submit that as a result of this and given they will be losing a large paper filler customer, they would have excess capacity to devote to gaining additional UK customers.

124. As outlined above, [ ] since third parties have indicated that it is a poor substitute for the parties.

125. As already discussed above, transport costs from mainland Europe are significant, [ ]. Therefore, the OFT does not believe that entry by a mainland European supplier is likely, and note that the parties have

<sup>49</sup> As reported in The Financial Times on 17 January 2013 'UPM plans to reduce 580,000 tonnes of graphic paper production in Europe'.

<sup>50</sup> Response to the Issues Paper paragraph 5.55

provided no evidence to suggest that a mainland EU supplier is intending to expand into the UK.

126. The OFT therefore concludes that that new entry or expansion in this market is unlikely.

#### **Tableware applications**

127. The parties submitted that Sibelco is a strong competitor and that it has the necessary reserves to begin producing tableware grades to compete with the parties' products, SSP and Diamond Star. The parties further submit that AKW already supplies UK customers and would have the ability and the incentive to increase its UK sales.

128. [ ] The parties submitted that the character of deposits in terms of kaolin yield, whiteness, brightness flow and mineral composition (for example, content of iron, potassium, feldspar, mica, potash and quartz) will vary both between pits and within an individual pit. This means that varying grades and qualities exist as between Imery's and Goonvean's pits as well as within each of the pits. This would support the proposition that the parties, and by implication, Sibelco's kaolin for tableware may not have the qualities required by customers in the UK.

129. In relation to expansion or entry by AKW or a mainland European producer, given the cost of importation and the resultant increase in delivered costs which will be associated with this, (which have already been discussed as part of the discussion on geographic market above), it is doubtful whether the incentive exists for a producer from continental Europe or indeed further afield to import into the UK. The relatively small deliveries required by individual customers on a regular basis would further compound this issue. Coupled with this is the point that several customers [ ], which is that the kaolin produced by the parties has certain qualities which mainland European kaolins do not possess and so, even if they could be imported at a competitive cost, the products are not considered to be substitutable by customers. In the context of falling UK demand as manufacturing generally move overseas – [ ] it is difficult to see a strong incentive for expansion into the UK.

130. The OFT therefore concludes that that new entry or expansion in this market is unlikely.

## Specialty applications

131. Imerys submitted that Sibelco is a constraint on the parties given that it is active in CPM. However, [ ].
132. The OFT has not been able to verify whether or not Sibelco has reserves of high quality grade kaolin which would enable it to expand into CPM. However, the OFT notes that, regardless of any reserves, [ ].
133. The OFT therefore concludes that that new entry or expansion in this market is unlikely.

## BUYER POWER

134. Customers may be able to use their negotiating strength to limit the ability of a merged firm to raise prices. Such countervailing buyer power may make competition concerns less likely to arise.<sup>51</sup> The parties have made submissions on buyer power in relation to each of the applications, which are considered below. However, the OFT makes a number of general points on the extent of countervailing buyer power in this case that apply across each of the applications.
135. First, the OFT considers that a customer's negotiating strength will be stronger if it can easily switch its demand away from a supplier, particularly if there are several alternative suppliers to which the customer can credibly switch or the customer has the ability to sponsor new entry. In this case, the OFT considers that customers have limited ability to switch away from a supplier due to the very limited number – and in some cases the absence – of alternative suppliers. Further, the OFT notes that the evidence points to the merger having a material effect on the availability of feasible alternatives for customers, reducing this from two to one for some applications and from three to two in others. The OFT considers that the limited availability of alternatives for customers, and the effect of the merger in limiting this further, restricts the scope for countervailing buyer power in this case.

<sup>51</sup> See *Merger Assessment Guidelines*, Section 5.9

136. Second, where suppliers engage in bilateral negotiations, as in this case, the relative bargaining strength of suppliers and customers is determined by their mutual dependency. In this context, the OFT notes that the merging parties export the vast majority of their extracted kaolin and so do not appear to be especially dependent on UK customers for their business and profitability. In contrast, the evidence available to the OFT points to UK customers being almost entirely dependent for their kaolin on two or three UK suppliers. As a result, the OFT considers that prima facie UK customers are far more dependent on the merging parties than the merging parties are on UK customers and this may tend to limit the scope for countervailing buyer power in this case.
137. Finally, the parties have argued that where a customer is pan-European or active across a range of products, these customers can use this to constrain the parties activities in the supply of kaolin and/or in the UK. The OFT acknowledges that such 'punishment' can feasibly occur. However, the OFT is sceptical of the extent to which such punishment may occur in practice without supporting evidence. Further, the OFT does not consider that such buyer power – even if it were to exist for a single large supplier – would necessarily extend to smaller customers.
138. In light of the above, the OFT considers it unlikely that countervailing buyer power would be sufficient to mitigate any competitive harm arising from the merger. Nevertheless, given the parties' submissions on buyer power in relation to each of the applications, the OFT has considered these in detail below.

### **Paper filler applications**

139. The parties submitted that the decline in demand for paper filler kaolin in the UK has led to increased price competition as kaolin producers seek additional volumes to cover significant fixed costs associated with kaolin extraction.
140. Further, customers such as [ ] procure on a Pan-European basis and UK supply accounts for a small proportion of this. The parties argued that large customers such as this would have the ability to punish Imerys post-merger if it attempted to impose an unreasonable price rise by reducing orders of kaolin for use outside of Europe or purchases of other minerals in other countries.

141. However, as outlined above, the OFT considers that a customer's negotiating strength will be stronger if it can easily switch its demand away from the supplier, particularly if there are several alternative suppliers to which the customer can credibly switch or the customer has the ability to sponsor new entry. In this case, customers who responded to the OFT indicated that they did not have alternative suppliers from which to source kaolin, relying solely on the parties, nor did customers perceive themselves as having any degree of buyer power.

142. In light of the above, and given the merger will result in the removal of the strongest outside option available to customers, the OFT does not consider the evidence suggests that buyer power may be sufficient to mitigate any competitive harm arising from the merger.

#### **Sanitaryware applications**

143. The parties have submitted that as Ideal Standard sources from [ ] and represents [ ] per cent of UK sales it holds a degree of buyer power.

144. Customers in the sanitaryware market have indicated that there are only three potential suppliers to them and that Imerys and Goonvean are each other's closest competitors. Thus as a result of the merger, there will only be one potential switching option for third parties. As already discussed, Sibelco may not represent a credible switching option as its clays are mixed with those of the parties. As such, to the extent that countervailing buyer did exist prior to the merger, the merger weakens it significantly.

#### **Tableware applications**

145. Imerys submitted that customers had buyer power in this market. Imerys argued that, [ ], buy a number of products from Imerys in addition to kaolin. Imerys claims that in the event of Imerys attempting to increase prices, [ ] would be able to punish Imerys by reducing purchases of other products. The OFT has been unable to confirm with [ ] the extent to which they may have used such a strategy in the past or could do so in the future. In the absence of supporting evidence from the parties on this point, it is difficult for the OFT to place any weight on the parties claims. In particular, the OFT notes that Imerys is currently the chosen supplier in these other products that [ ] source. Thus, if it were to reduce its purchases of other materials in response to a price rise, it would have to

purchase these from a second choice supplier, potentially at a higher price, suggesting that this may be an ineffective punishment strategy.<sup>52</sup>

146. The merger represents a merger to monopoly in this market,<sup>53</sup> as such, customers will have no ability to switch to an alternative supplier, currently present in the market. As discussed in barriers to entry and expansion, the OFT does not believe that entry from supplier based in mainland Europe is realistic. Hence, the any countervailing buyer power which did exist before the merger will be removed by the merger, as customers will be unable to switch.
147. Given that customers have indicated they do not have a choice of supplier other than the parties and this alternative option has been removed by the merger, the OFT considers that it is unlikely any customers have significant buyer power.

#### **Specialty applications**

148. The parties submitted that many of their customers procure on a multi-product and/or pan-European basis. These customers would be able to 'punish' any attempt by the merged entity to raise UK kaolin prices above the competitive level by reducing other, more profitable purchases of other minerals or of kaolin in other countries. The parties submitted that multinational customers such as [ ] who buy numerous products from the parties across Europe are good examples of this. However, there is no evidence of this occurring and customers maintain that they are unable to get supplies elsewhere.

#### **Conclusion on the supply of kaolin**

149. Given the evidence points to the parties competing and the absence of or limited alternative suppliers – and the absence of mitigating factors – the OFT believes that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

<sup>52</sup> The OFT notes that this may result in a price rise for all products, rather than just for kaolin.

<sup>53</sup> [The OFT notes that AKW is also a supplier of kaolin into the UK].

## SECONDARY AGGREGATE FEEDSTOCK

150. The parties are the only producers of secondary aggregate feedstock in Cornwall.
151. Imerys supplies secondary aggregates feedstock to Brooklands and Aggregate Industries (AI) under [ ]. The amount produced far exceeds demand and the majority is tipped. Imerys does not process secondary aggregates itself either pre-merger or post-merger (unlike Goonvean who did pre-merger). Prior to the transaction Goonvean processed its own kaolin waste into secondary aggregates and did not supply any third party.<sup>54</sup> As such, Imerys submitted that, as the transaction does not include the part of Goonvean which deals in secondary aggregate feedstock, and Goonvean was not an actual competitor to Imerys before the transaction as it only self-supplied, competition in secondary aggregate feedstock will be unaffected by the transaction.
152. The OFT notes that there were three companies active in the processing of secondary aggregate feedstock in Cornwall pre-merger (Aggregate Industries (AI), Brooklands, and Goonvean). [ ].
153. Goonvean's secondary aggregates business currently has on-site secondary aggregate processing facilities at the Prosper, Greensplat and Rostowrack pits, and processes materials from the Trelavour and Goonvean pits at Rostowrack. All potential secondary aggregate feedstock from Goonvean pits was either processed by Goonvean or tipped.
154. As part of the transaction, Imerys has contracted to supply some secondary aggregate feedstock to GAL (which was not part of the transaction) under a long term supply agreement. Under the terms of this agreement Imerys is obliged to supply [ ].
155. The OFT has examined the extent to which:
- a) A customer active in the processing of secondary aggregate feedstock would have been able to source from Imerys and could potentially have sourced from Goonvean.

<sup>54</sup> Post-merger Imerys has entered into an [ ] supply agreement to supply GAL with the secondary aggregate feedstock that it requires.

b) The extent to which the concentration of the underlying supply of kaolin waste to the secondary aggregates supply chain to a single supplier, Imerys post-merger will affect customers of processed secondary aggregates. Pre-merger, Goonvean supplied processed secondary aggregate feedstock to [ ] through a long-term agreement and Imerys supplied feedstock to AI and Brooklands through a long-term agreement. Post-merger, all underlying supply will be from Imerys to both GAL under a long-term supply agreement and to other customers (including AI and Brooklands [ ]).

156. In relation to the potential entry of Goonvean into the supply to third parties of secondary aggregate feedstock, the parties submitted evidence to show that Goonvean processed all its secondary aggregate feedstock in-house and that it had excess capacity to process even more secondary aggregate feedstock should it have been available. Given it had the ability and capacity to process all (and indeed) more secondary aggregate feedstock, it appears to the OFT credible that its supply of secondary aggregate feedstock was unavailable for purchase, and as a consequence it was not an actual or potential competitor in this market.

157. In relation to the concentration of the underlying supply, although GAL has entered into a long term supply agreement with Imerys' as part of the merger, the OFT does not consider that this will materially affect the supply of secondary aggregate feedstock given that its volumes were never available on the merchant market, given its exclusive agreement with [ ] in any case, although given that no concerns are raised the OFT has not needed to conclude on this issue.

158. Imerys has indicated that current production of waste material in Cornwall far outstrips the demand from the secondary aggregate market. In total, Imerys submits that post merger they produce around [ ] million tonnes of waste material suitable for processing into secondary aggregates, against a total current demand for secondary aggregate feedstock of around [ ] million tonnes. The excess material must be transported to a tip, at a cost of around [ ] pence per tonne, stored at a tip<sup>55</sup> and then the tip must be

<sup>55</sup> Imerys indicated that it had to incur costs in excess of £[ ] over a period of six years before it could commence tipping at Scarewater.

remediated at some point in the future.<sup>56</sup> It also indicated that it had stockpiled enough to meet current demand for more than the next 10 years. As a result, Imerys submits that it would have no incentive to increase price post merger, as it would reduce demand for secondary aggregates, so increasing storage costs.

159. Imerys' long term supply agreements with AI and Brooklands will be [ ]. Imerys submitted that this will enable them to open up supply to other purchasers of secondary aggregate feedstock as these agreements had been on an exclusive basis. AI and Brooklands requirements were relatively modest in relation to the total volumes of secondary aggregate feedstock being produced had exacerbated the stockpiling issues identified and the associated costs. [ ] expressed the view that the end of these agreements would open up opportunities for it to expand its businesses which were not previously available.

160. Imerys has also indicated that Wolf Minerals issued a definitive feasibility study in May 2011 in connection with developing a tungsten and tin mine in Devon, and have obtained planning permission for mining until 2021. Two third parties have also indicated that Wolf Minerals may start mining and producing tungsten by early 2015. As a by-product of tungsten mining secondary aggregate feedstock is produced which can be used to produce secondary aggregates.

161. [ ]. Third parties have confirmed that secondary aggregate feedstock may be produced as a by-product of the mining activities.

### **Conclusion on Horizontal Effects – secondary aggregate feedstock**

162. The OFT has examined the extent to which the merger may give rise to the loss of a potential competitor to Imerys in the supply of secondary aggregate feedstock and the extent to which the concentration of underlying kaolin waste supply into the secondary aggregate supply chain may restrict competition downstream. However, given its assessment in relation to the supply of kaolin, the OFT has not found it necessary to conclude on the extent of competition lost in the secondary aggregates supply chain.

<sup>56</sup> Imerys indicated that remediation costs were over £[ ] for Imerys' Hensbarrow tip.

## **THIRD PARTY VIEWS**

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

## **ASSESSMENT**

164. The parties overlap in the supply of kaolin for paper filler, sanitaryware, tableware and performance minerals in the UK.

### **Paper filler**

165. The merging parties are the only firms supplying kaolin for paper filler applications to UK customers. While the parties argued the market is wider because the majority of product is exported, evidence from third parties indicates that it is more appropriate to consider the main geographic area in which the parties compete as being the UK. Third parties indicated that there are no products which can be substituted for kaolin.

166. Sibelco currently exports kaolin for paper filler applications but does not [ ]. The transportation costs and relatively low demand for most UK customers suggest imports are not cost-effective. The merger therefore represents a reduction in competing suppliers from two to one, being between the only two parties that are currently active in supplying to UK customers. The merger would therefore create a merger to monopoly and a realistic prospect of a substantial lessening of competition.

### **Sanitaryware**

167. The parties overlap in the production and supply of kaolin for use in sanitaryware in the UK. Evidence pointed to there being no alternative to kaolin for customers. The parties argued the geographic market was wider because the majority of product is exported, however, evidence from third parties indicates that it is more appropriate to consider the main geographic area in which the parties compete as being the UK.

168. Imerys currently holds around [55 to 65] per cent share of supply in kaolin for sanitaryware applications in the UK with an increment of around [15 to 25] per cent of supply in the UK. Third parties indicated that the high transportation costs and relatively low demand for most UK customers

make imports not cost effective and that as a result AKW which the parties submitted have sales of sanitaryware kaolin in the UK are not a strong competitive constraint to the parties.

169. Sibelco is the only other significant supplier in the UK with a share of supply of around [20 to 30] per cent. There are in total only three customers for kaolin for tableware in the UK with Ideal Standard accounting for around [ ] per cent of total demand. It is for this reason that the parties argued that market shares could be radically shifted if Ideal Standard were to shift some of their demand to Sibelco. However, [ ]. The OFT believes the transaction creates a realistic prospect of a substantial lessening of competition in the supply of kaolin for sanitaryware applications in the UK.

### **Tableware**

170. The parties overlap in the supply of kaolin for tableware applications in the UK. While the parties argued the market is wider because the majority of product is exported, evidence from third parties indicates that it is more appropriate to consider the main geographic area in which the parties compete as being the UK. The parties will hold [75 to 85] per cent of this market which raises prima facie concerns for the OFT and so is a merger to monopoly.<sup>57</sup>

171. Customers told the OFT that there were no substitutes for kaolin for tableware applications and that they would be reluctant to use kaolin from overseas as it did not have the necessary quality. In any case, the transportation costs and relatively low demand for most UK customers are likely to render imports uneconomical. The parties submitted that that they would not have been close competitors in the future as [ ]. The OFT's concerns are not mitigated to any degree by this claim as the evidence presented by the parties indicates a continuation to supply all existing customers at existing volumes which would not lead to any change in the competitive landscape for a number of years. Therefore the OFT considers that customer choice will be eliminated by the transaction and therefore believes that the merger will lead to a realistic prospect of a substantial lessening of competition.

<sup>57</sup> [The OFT notes that AKW is also active in this market].

## **Specialty Applications**

172. The parties overlap in the supply of kaolin for specialty applications. The parties submitted that 'CPM' and 'PCM' form separate markets, although the OFT found some evidence of substitution between products categorised as both CPM and PPM by the parties. On a cautious basis, the OFT therefore considered CPM and Speswhite together for the purposes of its competitive analysis. The OFT did not have evidence to show that Supreme was a substitute for any of the other products within speciality applications and has therefore not included this in its market definition.
173. The parties argued the market is wider than the UK because the majority of product is exported, however, evidence from third parties indicates that it is more appropriate to consider the main geographic area in which the parties compete as being the UK.
174. The parties have a combined share of supply of [90 to 100] per cent with an increment created by the merger of [30 to 40] per cent. Sibelco is marginally active in lower value grades [ ]. The OFT found, on the evidence available, that Sibelco does not pose a sufficiently strong constraint on the merged entity [ ].
175. The OFT therefore believes that the merger may be expected to result in a substantial lessening of competition in the supply of kaolin for specialty applications (CPM and Speswhite).

## **Conclusion**

176. Consequently, in relation to kaolin for paper filler, sanitaryware, tableware and specialty applications, 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.
177. 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**

178. The OFT's duty to refer under section 33(1) is subject to the application of certain discretionary exceptions, including the markets of insufficient importance, or de minimis, exception under section 33(2)(a) and the undertakings in lieu exception under section 73(2) of the Act.

179. The OFT has found a realistic prospect of an SLC in relation to the supply of kaolin for paper filler, sanitaryware, tableware, and commodity performance minerals applications. The OFT's duty to refer in this case is therefore met. The OFT may decide not to refer a merger to the Competition Commission (CC) if it believes that the market to which the duty to refer applies is not of sufficient importance to justify a reference. In deciding whether or not to apply the de minimis exception, the OFT will exercise its discretion, taking account of the facts of each individual case and its circumstances and having regard to its guidance and decisional practice in the area.

### **Markets of insufficient importance ('de minimis')**

#### **Availability of undertakings in lieu**

180. The OFT believes that it would be proportionate to refer a problematic merger (that is, not to apply the de minimis exception) where the OFT considers that it is 'in principle' clearly open to the party or parties to offer a clear-cut undertaking in lieu of reference. This is because the recurring benefits of avoiding consumer harm by means of undertakings in lieu in a given case, and all future like cases, outweighs the one-off costs of a reference.<sup>58</sup>

181. Cases that the OFT considers are in principle suitable for resolution by undertakings in lieu are typically those where the part of the transaction that raises concerns can be divested to an independent third party purchaser.<sup>59</sup> The OFT's Exceptions Guidance also stresses that '[t]he OFT will take a conservative approach to assessing whether undertakings in lieu

<sup>58</sup> Exceptions to the Duty to refer and undertakings in lieu of reference guidance, December 2010, paragraph 2.2.

<sup>59</sup> Exceptions to the Duty to refer and undertakings in lieu of reference guidance, December 2010, paragraph 2.24.

are in principle available. To the extent that there is any doubt as to whether undertakings in lieu would meet the 'clear-cut' standard, it will not be included in the 'in principle' assessment. In other words, it must be clear that the competition concerns in the case in question are obviously such as to make the case a candidate for resolution by undertakings in lieu.<sup>60</sup>

182. The OFT also considers that, as a merger involves a structural change, a structural solution will normally be the most appropriate remedy, in the event of the reference test being met. As outlined in its Guidance, the OFT is more likely to accept structural undertakings as undertakings in lieu than behavioural undertakings because they address the change to the market structure that gives rise to the competition concerns.

183. In this case, the OFT considers that there are genuine doubts as to whether the SLC identified could be resolved by a clear-cut undertaking in lieu.

184. As set out above, the OFT has identified competition concerns in relation to the supply of kaolin for paper filler, sanitaryware, tableware and speciality applications. The OFT is conscious, through third party testing, that the main determinant of the competitive strength of a supplier appears to be the underlying kaolin deposits. Any divestment short of providing access to the underlying kaolin deposits would therefore appear to be insufficiently clear cut.

185. As such, a structural remedy would need to involve divestment of one or more pits. The OFT considers, however, based on the evidence available, including the submissions from the parties, that there are doubts as to whether the pits can be clearly separated and sold to an effective purchaser, in particular, one that is able to operate at a scale efficient enough to enable them to compete effectively.

186. The OFT also considers whether any plausible undertaking in lieu would be proportionate either on the basis that it is tantamount to unwinding of the transaction or it is not a proportionate response to the harm identified. Given the extent of the pits which would need to be divested in order for a supplier to potentially reach an efficient scale and given the majority of

<sup>60</sup> Exceptions to the Duty to refer and undertakings in lieu of reference guidance, December 2010, paragraph 2.27.

kaolin is exported and this is not where the SLC has been identified, the OFT considers that a carve-out of the whole of Goonvean would disproportionate to the harm to UK customers. The OFT does not include what would amount to a prohibition of the merger when considering whether an 'in principle' undertaking in lieu is available.

187. Overall, the OFT does not consider there is an 'in principle' clear-cut undertaking in lieu available given the importance of the underlying kaolin deposits for a supplier. The OFT also considers that any divestment of pits would require divestment of all of Goonvean's pits and as such would be disproportionate to the nature and extent of harm which has been identified in its SLC analysis. In the absence of any identifiable clear-cut undertakings in lieu an analysis of the application of the de minimis exception is considered below.

#### **Application of the markets of insufficient importance exception to this case**

188. The parties argued that the OFT should apply the de minimis exception to the duty to refer<sup>61</sup> on the basis that the total annual revenue from the parties activities in kaolin production is below £10 million.

189. The OFT considers that the market(s) concerned will generally be of sufficient importance to justify a reference where the annual value of these markets in the UK is more than £10 million. Where the value of a market(s) is less than £3 million, the OFT would expect to refer a merger only where there are exceptional factors and where the customer harm was particularly significant. Where the annual value is between £3 million and £10 million, the OFT will consider whether the expected customer harm resulting from the merger is materially greater than the average public cost of a reference.<sup>62</sup>

190. In this case the parties provided figures for the total value of the markets for the supply of kaolin for paper filler, sanitaryware, tableware and 'commodity' performance minerals (including Speswhite) of just over £6 million. Given the value of the market is between £3 million and £10 million the OFT has analysed whether a reference is justified, as set out in its Exceptions Guidance.

<sup>61</sup> Exceptions to the Duty to refer and undertakings in lieu of reference guidance, December 2010, OFT1122.

<sup>62</sup> The average figure is currently around £400,000.

191. In considering whether the expected customer harm resulting from the merger is materially greater than the average public cost of a Competition Commission reference, the OFT will base its assessment on a number of factors. These factors are set out in detail in its Exceptions Guidance<sup>63</sup> and were applied in favour of exercise of the discretion in a number of previous cases<sup>64</sup> and against the exercise of the discretion.<sup>65</sup> These factors are:

- market size
- strength of the OFT's concern (that is, its judgment as to the probability of the SLC)
- magnitude of competition lost by the merger, and
- durability of the merger's impact.

192. In addition to the above factors the OFT believes it is also appropriate for it take into account the wider implications of the decision it takes to exercise its discretion on de minimis for the treatment of future cases. The OFT will be less likely to apply its discretion on de minimis where it believes that that the merger is one of a potentially large number of similar mergers that could be replicated across the sector in question (replicability).

193. The OFT has considered each of the factors above in determining whether to exercise its discretion in this case.

194. **Market size** – The OFT considers that the proposed acquisition creates a realistic prospect of a substantial lessening of competition in the markets for kaolin for use in paper filler, tableware, paper filler and specialty applications in the UK. The total turnover associated with this market is around £6 million.

195. In this case, the parties argued that the total value of the market could be reduced to below £3 million based on the general decline in demand for

<sup>63</sup> Exceptions to the Duty to refer and undertakings in lieu of reference guidance, December 2010, paragraphs 2.28 to 2.43

<sup>64</sup> *Completed acquisition by Midland General Omnibus Limited of the commercial bus services of Felix bus services Limited*, OFT, 30 May 2012; *Completed acquisition by Arriva Midlands North Limited of the business and assets of Liyell Limited trading as Midland*, OFT, 21 January 2013; and *Anticipated acquisition by Orbital Marketing Services Group Ltd of Ocean Park Limited*, OFT, 14 November 2008.

<sup>65</sup> *Completed acquisition by Nufarm Limited of AH Marks Holdings Limited*, OFT, 29 August 2008.

kaolin in the UK<sup>66</sup> and the exclusion of certain customers that would be unaffected by the merger due to either the absence of active competition by the parties for these customers or the presence of certain customers with countervailing buyer power.

196. The OFT considers that, when considering market size for the purposes of applying *de minimis*, it takes account of factors which may indicate that the market size may significantly change in the foreseeable future.<sup>67</sup> The OFT considers that the extent to which the market will continue to decline in this case, as argued by the parties, is uncertain. In particular, the OFT notes that one customer of the parties submitted that it will significantly expand in the UK, bringing production back from overseas. The OFT must be cautious in taking account of wider macroeconomic conditions and drawing distinctions between structural and cyclical industrial change in its application of the *de minimis* exception.

197. In relation to the exclusion of particular customers, the OFT has in the past disregarded revenues from unaffected customers where it has been completely clear and supported by compelling evidence that these customers would be unaffected by the transaction, both because these were not a focus of the OFT's concern<sup>68</sup> or because there was a clear evidence supporting those customers having countervailing buyer power.<sup>69</sup>

198. In this case, the OFT has been unable to confirm the extent to which there is active competition between the parties for each of those customers that

<sup>66</sup> For example, the market for kaolin for use in paper filler is declining with sales falling around 84 per cent since 2003/4; the market for kaolin for use in sanitaryware is declining and sales have fallen an estimated 45 per cent since 2003/4; and sales of performance minerals have been in steady decline since 2003/4 and falling by an estimated 35 per cent within this time period.

<sup>67</sup> See *Exceptions to the Duty to refer and undertakings in lieu of reference guidance*, December 2010, paragraph 2.30 and *Anticipated acquisition by Spectris plc of Lochard Ltd*, OFT, 29 January 2009, paragraphs 120 to 126.

<sup>68</sup> See, for example, *Completed acquisition by National Express Group plc of the Intercity East Coast Rail franchise*, 10 January 2008, where the theory of harm focused on the effect on coach services and not on rail services so for the purposes of exercising its discretion in relation to road/rail overlaps rail revenue on the overlap flows could be excluded for purposes of its cost/benefit *de minimis* assessment.

<sup>69</sup> *Anticipated acquisition by Orbital Marketing Services Group Ltd of Ocean Park Ltd*, OFT, December 2008 and *Anticipated acquisition by FMC corporation of the alginates business of ISP holdings (U.K.) Limited*, OFT, August 2008.

the parties have highlighted as those they are not actively competing against each other for. However, the OFT notes that, a number of these submitted that they did consider the parties to be close competitors. The OFT therefore considers that the evidence, in contrast to previous cases, does not suggest these customers would be necessarily unaffected by the merger.

199. Further, the OFT notes that in this case the OFT has not been able to point to the presence of countervailing buyer for any customer, instead evidence tends to point against the presence of countervailing buyer power for the reasons outlined above and so the OFT does not have the evidence, in contrast to previous cases, to suggest that certain customers would be protected from any competitive harm arising from the merger and should be excluded from the calculation of the appropriate market size for application of de minimis.

200. In summary, the OFT has given the parties' arguments on the market size careful consideration but believes that these are not compellingly supported by the evidence available. The OFT thus considers there to be sufficient uncertainty around these arguments such that it is unable to confidently point to factors reducing the market size to a degree that points to a clear application of the de minimis exception in this case. The OFT notes further that, even in the event that these customers are removed from the calculation or that declines in market size are taken into account – neither of which is compelling supported by the evidence available – this would not necessarily reduce the market size sufficiently to lead the OFT to be able to conclude, with a sufficient degree of certainty, that the de minimis exception could clearly be applied to this case, particularly given the other factors considered below.<sup>70</sup>

201. The result of this is that the total size of the 'affected' market is estimated to be above £3 million for de minimis purposes. This means that whilst the de minimis exception is potentially applicable, the size of the affected markets is significant.

<sup>70</sup> For example, the OFT considers that, notwithstanding its conclusion that [ ] should be removed from the market when calculating the market size, the decision whether or not to refer the merger based on the de minimis discretion would not differ even if they were excluded.

202. **Strength of the OFT's concerns** – The OFT will take into account the strength of its belief that the merger will have an anti-competitive effect when deciding whether to exercise the 'de minimis' exception. As a result, the strength of the OFT's belief that harm will result from the merger, although not in itself conclusive, tends to point away from the exercise of the de minimis exception to a substantial degree in this case. This is because of the parties' high market shares – [ ] – and the reduced choice for customers who say they are unable to obtain supplies from outside of the UK.
203. **Magnitude of competition lost by the merger** – The merger causes a reduction in the number of suppliers of kaolin for paper filler and sanitaryware from [three to two], and in tableware and specialty applications from three to two. Customers have indicated that either no substitutes exist or if they do exist they would not be cost effective to import. The majority share (at least [60 to 70] per cent) in each of the markets identified will be controlled by the parties as a result of the merger.
204. These factors suggest that the magnitude of competition lost as a result of the proposed merger is more likely to be at the high range and therefore weighs against exercising of the de minimis discretion.
205. **Durability of the merger's impact** – No new kaolin deposits have been identified in the UK and so the OFT considers the prospect of entry to be minimal. The only other UK based supplier has indicated that it cannot expand into tableware or CPM as it is constrained by the quality of its deposits and the incentive/ability to invest in the infrastructure needed to do so. Therefore, the duration of any harm arising from this merger may be evident for a number of years and is considered high risk.
206. **Transaction rationale and the value of deterrence** – Given that there are no further known kaolin deposits in the UK, it is unlikely that this merger is replicable, and as result there would be little deterrence effect.

**Conclusion on the application of the markets of insufficient importance exception**

207. Overall, the OFT considers that the evidence points towards the impact of the merger being relatively high. In particular, the size of the market

remains relatively high in de minimis terms, the scale of any anti-competitive effects arising from the merger is likely to be high as it will lead to either customers having no or limited choice. In addition, there is a lack of constraints from demand side substitutes suggested by third parties. The duration of any harm is considered to be of a long term nature. The OFT therefore has decided not to exercise its discretion not to refer this transaction to the Competition Commission on the grounds of the de minimis exception.

## **UNDERTAKINGS IN LIEU OF REFERENCE**

208. The parties offered undertakings in lieu in the form of the transfer to a purchaser of all existing UK customer contracts in relation to applications in which an SLC is identified (paper filler, sanitaryware, tableware and/or commodity performance minerals), together with all relevant product formulations, manuals and confidential information, intellectual property rights for the UK (by way of assignment or irrevocable exclusive licence, other than trademarks and brand names given the scope for confusion in export markets). Imerys would also provide any essential technical assistance and other support to the purchaser (pursuant to a transitional services agreement or, if necessary, by transferring appropriate staff) to enable them to prepare grades that are acceptable to Goonvean's UK customers. If required by the purchaser Imerys would transfer certain items of processing equipment that are surplus to Imerys' requirements following previous internal reorganisations, together with items that are likely to be surplus to requirements following integration of the Goonvean and Imerys kaolin businesses.

209. The OFT considers that, in the absence of long-term access to the underlying kaolin deposits, such undertakings in lieu do not remedy in a clear cut way the substantial lessening of competition concerns created by the merger and identified above. In particular, significant doubts have been raised by third parties of the extent to which access to recipe formulations and know-how would enable a supplier to compete effectively. It is unclear that a purchaser of the 'recipes' could use its own source kaolin to produce identical products to Goonvean.

210. Third party market testing with competitors indicated that the transfer of know-how, in the form of recipe formulations for certain kaolin products,

would not provide any advantage to those competitors in seeking to enter and supply UK or other customers. Third parties noted that such recipes can be relatively easily obtained through laboratory testing and that the underlying source kaolin is the primary dictator of the final product. Similarly, it is not clear that the transfer of customer contracts offers any benefit to a purchaser who cannot fulfill those contracts without long-term access to the required underlying kaolin deposits demanded by the customer.

## **DECISION**

This merger will therefore be referred to the Competition Commission under section 22(1) of the Act.

## **Endnotes**

1. The table at paragraph 68 contained certain inaccuracies which have been corrected above.
2. In relation to paragraph 80, it was the parties' submission that [ ].
3. In relation to footnote 67, by way of clarification the OFT did not reach a conclusion on whether or not sales to [ ] should have been excluded or not. It was the OFTs view that there would have been no material difference to the outcome of the de minimis calculation whether or not they were included or excluded.
4. Paragraph 91 relates to Goonveans' strategy.