

Anticipated acquisition by Clariant of certain assets of Kilfrost

Summary of provisional findings

Notified: 19 May 2016

1. On 17 February 2016, the Competition and Markets Authority (CMA), in exercise of its duty under section 33(1) of the Enterprise Act 2002 (the Act), referred the anticipated acquisition by Clariant AG (Clariant)¹ of the European aircraft de-/anti-icing fluid (ADF) business, the rail de-/anti-icing fluid business and associated assets (the Target Business) from Kilfrost Group Public Limited Company (Kilfrost) (altogether the Merger) for further investigation and report by a group of CMA panel members (Group). Throughout this report, where relevant, we refer to Clariant and Kilfrost collectively as the Parties.
2. Clariant is a Swiss-based global specialty chemicals company with a turnover of CHF 5.8 billion (£3.9 billion) in financial year ending 31 December 2015. Clariant supplies the aviation sector with a number of products, including ADF and runway de-icing products. It began selling ADF in the UK in 2012 when it won two large supply contracts.
3. Kilfrost is a family owned UK-based supplier of ADF and rail de-icing fluids. Its turnover in the 18 months to 31 March 2015 was £75 million. Kilfrost's headquarters and main manufacturing facility are in Haltwhistle near Newcastle upon Tyne, from which it serves customers, mainly in the UK and the European Economic Area (EEA). Prior to August 2015, it also operated in North America and Asia.
4. There are three types of ADF that are used in the UK (and the EEA): Type I, Type II and Type IV.² Type I is used only for de-icing aircraft (the removal of frost, ice, slush or snow), while Types II and IV can be used for both de-icing and anti-icing (the protection against the formation of frost or ice and accumulation of slush or snow), as they contain thickeners to increase their viscosity. Before they can be sold commercially, ADF products and the

¹ Through its subsidiaries, Clariant International AG, Clariant Produkte GmbH (Deutschland) and Clariant Production UK Limited.

² Type III is used in Canada and Russia but not in the EEA, because it uses mono-ethylene glycol.

facilities in which they are manufactured need to be certified in accordance with SAE International's standards.

5. Aside from Clariant and Kilfrost, one other supplier sells ADF in the UK: Belgium-based Proviron. A French company, ABAX, also supplied in the UK until the end of the winter season 2013/14. Other suppliers in the EEA are LNT Solutions Limited (LNT Solutions) and ADDCON Europe GmbH (ADDCON).
6. The sale of Kilfrost's business involved a formal bidding process that took place in summer 2015, at the end of which Clariant agreed to purchase customer contracts, some intellectual property (IP) rights and limited operating assets (but not the factory or employees) relating to the ADF and railway de-icing operations of Kilfrost. The acquisition was implemented as a staggered transaction, with the first phase consisting in the North American and Asian operations and completing in August 2015. The second phase was for the European operations and resulted in an Asset Purchase Agreement being signed in Autumn 2015. Only the second phase (the Merger) was subject to regulatory approvals. We are satisfied that this Merger, if completed, will create a relevant merger situation.
7. In order to identify the relevant market within which to examine the competitive effects of the Merger, we first defined the product market before examining issues relating to geographic market definition:
 - (a) The assessment of the relevant product market starts with the products of the merging parties: both Clariant and Kilfrost supply ADF of Type I, II, and IV to customers in the UK. There are however no overlaps between the Parties in relation to rail de-icing and having made some preliminary enquiries, we focused our investigation on the other elements of the Target Business, ie the supply of ADF of Type I, II, and IV.
 - (b) We sought evidence from customers about the substitutability of different types of ADF and found that ADF products are largely complementary. However, we also found that although there are some exceptions, customers tend to buy all the types of ADF they require from the same supplier. Although two of the suppliers currently supply only Type I ADF in the EEA, they are in the process of obtaining certifications for Types II and IV. The other suppliers with sales in the EEA are able to offer the three relevant types of ADF to customers. In addition, we were informed by suppliers that although the tanks in which ADF products are made are dedicated to a given type of ADF, they can be easily and quickly re-allocated to the production of another type, although they would typically do this at the beginning of a winter season. We therefore provisionally

conclude that the relevant product market comprises all types of ADF that are certified for use in the EEA.

- (c) In order to define the geographic market, we considered three factors: the characteristics of ADF products, including the types of products that can be used in different geographies; customer requirements and supply-side issues, including the extent to which local operations are necessary; and at what distance suppliers can profitably sell their products. We provisionally conclude that there are no clear boundaries to the geographic market, but that it is unlikely to be wider than the EEA, while there are also local aspects of competition resulting from a combination of each customer's specific requirements and each supplier's ability to meet those requirements which indicate that the geographic market may be narrower than the EEA.
8. We therefore provisionally conclude that the relevant market in which to assess the competitive effects of the Merger is the market for ADF products in the EEA, recognising that there are local variations in the competitive constraints faced by the Parties in different parts of the EEA, which are taken into account within the assessment of the competitive effects of the Merger, as they relate to UK customers.
9. Before turning to our analysis of the competitive effects of the Merger, we considered what would have happened to Kilfrost in the absence of the Merger (the counterfactual). To reach a view, we examined three possible scenarios: whether Kilfrost would have continued to operate independently; whether it would have been acquired (either in whole or in part) by an alternative purchaser; and whether it would have exited the market. In order to make this assessment, we obtained evidence from the Parties, the advisers to Kilfrost and the potential purchasers that had made indicative offers. Based on this evidence, we provisionally conclude that the most likely counterfactual to the sale of Kilfrost to Clariant would have been its acquisition by an alternative purchaser which would have continued to supply ADF within Europe including the UK. We have therefore analysed the competitive effects of the Merger against the pre-merger conditions of competition.
10. We next turned to the assessment of the effects of the Merger on competition. We first examined the nature of competition before the Merger, and in particular the requirements that customers have in relation to ADF, the nature of contractual arrangements, competitive processes and switching issues.
11. We provisionally conclude that the two key dimensions of competition are price and security of supply. In addition, to be credible, the supplier must also have a product that meets the required quality standards (ie internationally

recognised certifications and approvals). In terms of processes, customers either simply renew their contracts with their current supplier following a renegotiation, or seek alternative quotes, either formally or informally. Even though demand for ADF is relatively inelastic and customers' willingness to pay is high, prices are constrained through a number of mechanisms, including:

- (a) Where they have credible options, customers seek to obtain better prices through negotiations, either informally or through formal tenders, and we have seen evidence that this has resulted in lower prices.
- (b) In particular we have seen evidence that customers have been able to achieve better prices by playing off Clariant and Kilfrost.
- (c) Some customers have taken steps to increase the options they have available (for example, by dual sourcing) although customers have a limited ability to use such strategies.

12. Against this background, we considered whether, following the Merger, Clariant would have the ability and incentive to increase the price of ADF (or to submit less attractive bids) or otherwise worsen other elements of its offering (including security of supply), compared with its and Kilfrost's pre-Merger offerings. As part of this assessment, we obtained evidence on the competitive positions of the Parties and other ADF suppliers with operations in the EEA. We also sought the views of customers on the overall offerings of suppliers, including the Parties, and examined in more detail evidence relating to the product range and quality (including innovation), cost management and supply chain management of these suppliers. Our main provisional findings are that:

- (a) Clariant and Kilfrost are the two largest suppliers of ADF, not only in the UK where their share of supply exceeds 90%, but also in the EEA, and perhaps globally. In the EEA, the Parties' share of supply is well in excess of 80% and between them they hold most of the large customer contracts (including in the UK).
- (b) The Parties regard each other as close competitors and we have seen extensive evidence of intense competition between them, at least for large contracts both in the UK and the EEA. When the Parties compete, it is across all aspects of their offering.
- (c) The combination of long-term track records in the supply of ADF and extensive and well-established logistics infrastructures, which demonstrates their ability to meet security of supply requirements,

together with their large customer bases give both Kilfrost and Clariant significant competitive advantages over competitors.

- (d) The offerings of ADF suppliers are differentiated and consist of a number of elements that comprise the ADF product itself, price and other contract terms, additional services and non-price elements. Other ADF suppliers are viewed by customers in the UK as less credible than the Parties across all aspects of their offerings. They also have significantly more limited geographic footprints, and have not (yet) been able to establish a large customer base or logistical infrastructure, or to prove their ability to deliver ADF reliably in difficult weather conditions.
13. Finally, we considered whether it was likely that timely and sufficient entry or expansion by other suppliers might prevent a substantial lessening of competition (SLC). In the light of the significant barriers to entry we identified (in particular: evidence of a good track record of delivery under any weather conditions; the risks and costs of putting in place an appropriate infrastructure before winning sizeable contracts; and the risks and costs of holding large stocks of product) and the lack of credibility of suppliers other than Kilfrost and Clariant in the UK, we provisionally conclude that expansion by any of the existing suppliers (ie Proviron, ABAX, LNT Solutions and ADDCON) would be unlikely to occur at sufficient scale or within a short enough timescale to mitigate the effects of the loss of Clariant's closest competitor in the supply of ADF to UK customers.
14. In view of the above, we provisionally conclude that the proposed acquisition of certain assets of Kilfrost by Clariant may be expected to result in an SLC in the market for the supply of ADF in the UK. We expect that following the Merger, Clariant would have an incentive to increase prices and/or worsen non-price aspects of its offering (including security of supply). We consider that there is a particular risk of price increases given that the price sensitivity of customers is relatively low.