
Anticipated acquisition by Sibelco Minerals & Chemicals Limited of the minerals and materials business of Tarmac Central Limited

The OFT's decision on reference under section 33 of the Enterprise Act 2002 given on 14 August 2003

PARTIES

Sibelco Minerals & Chemicals Ltd, trading as WBB Minerals (WBB), is involved in the supply and processing of industrial minerals, silica sand, chemicals and plastic clays. It is part of SCR-Sibelco SA, a privately owned Belgian company, which processes and supplies a range of industrial minerals and is a leading supplier of silica sands on a worldwide basis. The minerals and materials business the subject of the merger ('the Business') is part of **Tarmac Central Ltd (Tarmac)** which is ultimately owned by the Anglo American group. The Business is involved in the processing and distribution of certain minerals and accounted for sales of [] (see note 1) in 2002. It operates from two sites at Kidsgrove (the Talke site) and at Fenton.

TRANSACTION

WBB is proposing to acquire the Business. The Business processes and distributes minerals including pigments and additives to the brick industry, specialist materials to engineering and aerospace sectors and minerals such as zircon, bauxite and perlite. There is no overlap between the parties in these areas which account for sales of [] (see note 1) of the Business. This assessment addresses only those areas where an overlap occurs.

This transaction was notified to the Office of Fair Trading (OFT) on 11 June 2003 and the 40 day administrative target expired on 6 August 2003.

JURISDICTION

The OFT believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation pursuant to sections 33(1)(a) and 23 of the Enterprise Act 2002 (the Act). As a result of this transaction WBB and the Business will cease to be distinct, in accordance with section 26 of the Act. The parties overlap in the supply of silica flour, dolomite, high purity silica sand and feldspar and the share of supply test in section 23 of the Act is met in each of these sectors.

RELEVANT MARKET

Product market

Silica Flour

Silica Flour is supplied mainly to fibre glass manufacturers and the ceramics and construction industry. UK sales are estimated at approximately [£2.5 to £3.5 million] (see note 2). The parties submit that Tarmac's Loch Aline silica flour (and a lower grade silica flour which Tarmac also produce) are not substitutes for WBB's silica flour due to their differing chemical properties (see note 3). Third parties, however, did not agree and suggested that they would consider switching between these products if the price of one or the other increased by 5-10 per cent.

On the demand side, customers had mixed views as to whether they could use other products in place of silica flour. There may be alternative products available to certain customers or others may be able to reformulate their batch mix to accommodate a change (although a customer indicated this could take around 12 months with no guarantee of success). For other customers, there was no alternative to using silica flour.

The OFT has considered the option of customers buying sand directly from suppliers and either contracting with a third party to mill it into flour or milling it in-house. Third party enquiries, however, suggest that for a 5-10 per cent price increase third party millers would generally not find it profitable to offer such a service and that customers would not have an incentive to mill in-house. It seems unlikely, therefore, that this could act as a competitive constraint on the merged firm.

The parties suggested that the third supplier in this sector, Stoddard, might be able to double its current output. However, even such an increase would have little effect on the merged parties' joint share of supply and would be insufficient to meet the needs of larger customers. It also does not appear that Hoben, who currently produce silica flour in-house but also buy flour from WBB, would be able to start supplying significant quantities to the open market if prices were to increase by 5-10 per cent. Hoben has therefore been excluded from the calculation of shares of supply and assessment of supplies to the open market.

Dolomite

Dolomite is a mineral that is used to supply the required amount of magnesia in the manufacture of glass. There are varying grades of dolomite, principally due to the levels of iron present. Spanish dolomite has very low iron content (around 0.025 per cent). This compares to UK dolomite whose iron content is higher by a factor of 10 at around 0.25 per cent. Presently, WBB supply Spanish and UK dolomite to the flat glass industry, Tarmac supply Spanish dolomite to flint (ie mainly bottle) glass producers. WBB contended that its Spanish dolomite was different to that supplied by the Business – since it contained an impurity (spinel) (see note 4) – and they were not, therefore, direct substitutes. Total sales of dolomite to the glass industry are in the region of [£4.5 to £5.5 million] (see note 2) and in significant decline.

On the demand side, there appear to be a number of alternatives to Spanish dolomite if prices were to increase by 5-10 per cent. If dolomite with a higher iron content is used by flat glass manufacturers this would have to be compensated for by altering the batch mix. However, there is some degree of correlation between prices for Spanish and UK dolomite and Pilkington has recently switched from Spanish to UK dolomite for the manufacture of flat glass by using sand with a lower iron content. This suggests that, at least for certain flat glass customers, the price of UK dolomite may provide some competitive constraint on the price of Spanish dolomite. The price of Spanish dolomite is [] (see note 1) that of UK dolomite.

For flint glass manufacturers, UK dolomite may not be a direct substitute since its higher iron content makes it unsuitable. However, for flint glass it is possible to revise the batch mix to include cullet (recycled flint and flat glass) and so remove the need for dolomite altogether. A number of the major flint glass manufacturers have already made this change. One flint glass customer considered that Norwegian dolomite was an alternative to Spanish dolomite. However, potential suppliers of Norwegian dolomite have indicated that they would be unlikely to consider supplying to the UK glass industry unless demand and price increased significantly above expected levels.

On the supply side, Fordamin who currently import Spanish dolomite which is supplied to customers outside the glass industry, has informed the OFT that it would consider supplying this to flint glass manufacturers in the event of a 5-10 per cent price increase.

High purity silica sand

WBB imports [] (see note 1) tonnes of high purity silica sand from Belgium and France. The majority is supplied to the (see note 5) ceramics industry. Lead crystal glass manufacturers and industrial glass manufacturers also purchase small amounts ([] and [] (see note 1) tonnes respectively). Tarmac mines [] (see note 1) tonnes of high purity silica sand at its Loch Aline quarry in Scotland each year and this is marketed by both Tarmac Northern and Tarmac Central. Tarmac, through the Business processes (this comprises drying, magnetic separation, screening and bagging) [] (see note 1) tonnes of Loch Aline sand for supply to manufacturers of lead crystal glass while [] (see note 1) tonnes is shipped to Runcorn and supplied directly to high quality cosmetic glass and ceramics customers. A further [] (see note 1) tonnes of Loch Aline sand is milled at Tarmac's Talke plant to produce silica flour (see above). The transaction will only impact at the distribution level because Tarmac Northern will retain ownership of the Loch Aline quarry and will continue to supply customers direct with some [] (see note 1) tonnes of Loch Aline sand. If, post-merger, WBB were to raise prices by 5-10 per cent, customers might be able to switch to buying direct from Tarmac Northern. In addition, some customers indicated that they could also source from suppliers outside the UK e.g. US, China, Thailand. Total sales are £2-3 million per year.

WBB and Tarmac are the only two suppliers of high purity silica sand which has first been screened and magnetically separated for use by lead crystal glass manufacturers. The parties submit that, faced with a 5-10 per cent price increase, these customers could buy the sand from either WBB or Tarmac Northern and outsource screening and magnetic separation. Third parties did not think this was feasible due to the haulage costs involved.

On the supply side, there do not appear to be any firms that produce related products who, for a 5-10 per cent price increase, would start supplying high purity silica sand in the UK. There are no other UK deposits of this type of sand.

Feldspar

Feldspar is generally used as an additive in the batch mix for ceramics and glass as it causes the other materials in the mix to fuse together properly. North Cape Minerals (NCM), which is part of the Sibelco group, currently imports Norwegian feldspar into the UK which is then sold mainly to the ceramics and glass industry. Tarmac imports both Finnish feldspar from SP Minerals, a subsidiary of Sibelco, and Spanish feldspar from reserves independent of Sibelco. The parties submit that Spanish feldspar is not a substitute for Norwegian and Finnish feldspar due to its specific characteristics. A third distributor, PE Hines, currently obtains supplies from NCM. Sales of feldspar are estimated at £2.5 to £3 million per year and have been in decline over the past 20 years.

On the demand side, customers indicate that they would consider buying Norwegian, Italian, French, Finnish and Turkish feldspar if prices were to increase by 5-10 per cent.

Geographic market

The parties submit that the relevant geographic market for these products is European because these minerals are high value products which can be transported economically over long distances. However, according to most customers, suppliers need to have a distribution presence in the UK. This is because it is uneconomic for customers to import directly from suppliers abroad as they often only purchase relatively small volumes.

Consequently, for the purposes of this assessment the appropriate frames of reference will be taken to be:

- The processing and distribution of silica flour in the UK;
- The distribution of UK and Spanish dolomite to glass manufacturers in the UK;
- The distribution of high purity silica sand in the UK; and
- The distribution of feldspar in the UK.

HORIZONTAL ISSUES

Silica flour

As a result of the transaction, the parties' combined share in the UK in volume terms will be [80 to 90 per cent], an increment of [40 to 50 per cent] (see note 2). In value terms it would be [80 to 90 per cent], an increment of [45 to 55 per cent] (see note 2). The remaining competitor is considerably smaller and unlikely to exercise any significant constraint. The potential for customers to purchase sand and have this toll milled appears to be both unlikely and uneconomic due to transport costs and the limited number of independent millers capable of doing this.

The parties submit that there has been a large decline in demand for silica flour, with three large UK customers no longer purchasing silica flour representing a decline of over [] (see note 1). This together with increased investment that will be required to meet more stringent health and safety requirements, means that new entry is unlikely.

The parties argue that, in the face of substantial declining demand, the transaction would allow WBB to reorganise its production facilities to enable it to offer alternative products. WBB's Oakamoor plant has 2 operating lines which it has confirmed are operating at [] (see note 1) of capacity utilisation (see note 6) which WBB contend is not economic. The transaction could restore the efficiency of the Oakamoor plant by increasing capacity utilisation through transferring silica flour production from Talke to Oakamoor. Freeing the Talke mill would then give WBB a third production line that could be used solely for white fillers and thereby allow WBB to offer alternative products to silica flour.

Dolomite

WBB and Tarmac are the only two suppliers of Spanish dolomite to the glass industry at present (WBB supplies to the flat glass sector and Tarmac supplies to flint glass manufacturers). Fordamin currently supplies Spanish dolomite of equivalent quality but to non-glass customers. Alternative supplies of Spanish dolomite may also be available as Tarmac does not own any quarries and only takes a small proportion of output on a non-exclusive basis. However, new entry at the distribution level seems unlikely in such a declining sector.

The transaction will strengthen WBB's position as the major supplier of Spanish and UK dolomite to the UK glass industry although an increment only arises in respect of Spanish dolomite. Dolomite accounts for about 7 per cent of the cost of the batch to manufacture glass. This may provide scope for the parties to increase prices without inducing glass manufacturers to switch as it only represents a small component of total costs.

That said, flint glass manufacturers such as Rockware and United Glass, who together account for 60 per cent of flint glass manufacture in the UK, have altered their batch mix to eliminate the need for dolomite. They have done this principally by using cullet to provide a number of materials required in the batch mix. While cullet is not a direct substitute for dolomite, any component used in the manufacture of glass can be introduced by using cullet. The majority of cullet arises from bottle bank collections and is sorted by specialist companies before recycling. Third parties considered that cullet was not always readily available.

The Competition Commission (CC) in its report on the merger between SCR-Sibelco SA and Fife Silica Sands Limited and Fife Resources Limited in 2001 (Cm5139) considered that the supply of suitable cullet was constrained because glass collected in bottle banks was coloured rather than clear, and that supply was unresponsive to price signals. In addition, for the manufacture of flint glass there could be contamination issues arising from the use of cullet that has been collected from outside the production plant. However, the evidence is that flint glass manufacturers have actually switched to cullet and the increase in the recycling targets in the EU Packaging Regulations can

be expected to expand supply. Greater availability of cullet, therefore, may further reduce the demand for Spanish dolomite, which has declined from 100,000 tonnes per annum 10 years ago to around 30,000 tonnes in 2002. Cullet may, therefore, provide a competitive constraint on the price of Spanish dolomite particularly for flint glass.

As far as flat glass is concerned, Pilkington which accounts for [] (see note 1) of flat glass manufacture, principally uses UK dolomite which Tarmac does not supply and uses only small amounts of Spanish dolomite supplied by WBB.

High purity silica sand

The transaction will not alter the number of firms active in the supply of high purity silica sand; rather it alters their shares of supply as Tarmac is only selling part of its distribution business (operated through Tarmac Central) to WBB. Post merger, WBB will have a share of supply in distribution in the UK (by volume) of [40 to 50 per cent], an increment of [20 to 30 per cent] (see note 2). Post merger, WBB will become a distributor for Tarmac sand mined from the Loch Aline quarry together with WBB's own sand imported from Belgium. Tarmac Northern will retain ownership of the Loch Aline quarry and continue to supply customers direct. As noted above, customers will still be able to source sand direct from Tarmac Northern and this may continue to act as a constraint on the merged business.

Potential concerns arise in respect of a small sector of high purity silica sand, comprising [] (see note 1) tonnes of high purity silica sand which has been screened and magnetically separated for supply and use by lead crystal manufacturers. Post merger, WBB would be the only supplier of this sand in the UK. However, this is a sector of the industry that is in significant decline; UK sales are valued at only some £400,000 per year. WBB contend that the potential further decline in the downstream market – as UK manufacturers relocate abroad - may act as a competitive constraint post-merger. Some customers had concerns about the reduction in the number of suppliers whereas others recognised the need for rationalisation in a declining industry.

Feldspar

All three distributors in the UK currently source some or all of their requirements from Sibelco companies. The merger itself will result in a reduction in the number of distributors from three to two. Post merger, the parties will distribute [60 to 70 per cent] (see note 2) of feldspar sold in the UK. The reduction in the number of distributors means that choice is necessarily reduced for customers. However, the remaining alternative, PE Hines, would have the ability to switch to sourcing feldspar from alternative supplies which exist elsewhere in Europe.

BARRIERS TO ENTRY

The parties submit that the distribution business for these products is very low-tech and barriers to entry are low. There do not appear to be any irrecoverable capital costs associated with storage and distribution as the facilities used (warehouses, transport) are rented or hired on a short-term basis. Staff and equipment requirements also appear limited and could feasibly be arranged on a short term or as-needed basis.

However, the OFT has not been supplied with any quantitative information on the scale of entry costs relative to the size of the market or expected turnover and profits.

For silica flour, a new entrant would need to set up its own grinding mill (which was estimated by a third party as costing in the region of £1.3 million). This is largely a sunk cost due to the specialized nature of the mill. In addition, forthcoming health and safety regulations relating to the level of permissible dust emissions will increase the costs of entry. The parties estimate that upgrading an existing silica flour plant will cost between [] and [] (see note 1).

The parties have also put to us that it would be feasible for a large customer to undertake import and distribution itself, provided that the quantities involved justified the necessary time, cost and effort. Third parties, however, doubted that customers would have the incentive or necessary storage facilities to do this.

BUYER POWER

Prices appear to be negotiated with each customer and there is, therefore, scope for the parties to price discriminate. The parties submit that they have a list price which is used as a guide for agreeing a price. Discounts are often given to customers based on the volume purchased and their credit worthiness. Major customers tended to have long term rolling contracts of between 3 and 5 years. The parties have suggested that glass companies are sophisticated buyers with detailed knowledge of prices across Europe, who could retaliate to price increases by changing batch mix, threatening to relocate or threatening to switch all purchases away from WBB if prices increased. A number of third parties however raised doubts about the latter course of action and it is also unlikely that a 5 to 10 per cent increase in the price of dolomite alone will prompt relocation.

A few customers, for example, lead crystal glass manufacturers who purchase high purity silica sand that has been screened and magnetically separated, thought that the decline in its downstream market would act as a competitive constraint on the parties. But others believed that the merger would remove what little buyer power they did possess and lead to an increase in prices.

VERTICAL ISSUES

The transaction does not appear to raise any vertical issues.

THIRD PARTY VIEWS

As has been noted above, third parties expressed mixed views about the competitive effects of the proposed transaction. Some were unconcerned as the raw material in question did not represent a large proportion of the cost of the final product so an increase in price could be passed on to their customers or covered by their existing margins. Others were concerned because the reduction in choice of supplier would lead to increased prices and they did not consider that they had any countervailing buyer power.

ASSESSMENT

This proposed acquisition qualifies for investigation under the share of supply test in the Act in relation to the supply of silica flour, dolomite, high purity silica sand and feldspar.

For dolomite, the constraints offered by changing the batch mix, using cullet, and the existence of an additional supplier of Spanish dolomite in the UK would appear sufficient to address any competition concerns arising from this transaction in this sector. Similarly for feldspar, the existence of another distributor and the possibility of that distributor obtaining supplies elsewhere in Europe appear to be a sufficient constraint. For high purity silica sand the fact that customers will still be able to source sand direct from Tarmac Northern may be expected to act as a constraint on the merged business. For supplies of specialist high purity sand to lead crystal manufacturers, we note the fact that this sector is in decline and that the prospect of further decline may act as a constraint. While the merger appears to reduce competition within this sector and give rise to a substantial lessening of competition the scale of such effects (given that sand supplied to lead crystal manufacturers is valued at approximately £400,000 per year) would not appear to justify reference pursuant to section 33(2)(a) of the Act.

In silica flour the parties will have a combined share in the manufacture and supply of [80 to 90 per cent] (see note 2) in volume terms in the UK. They are the two largest and closest competitors, each having production capacity significantly larger than other UK suppliers of silica flour. The remaining competitor appears unlikely to be able to exercise a constraint on the merged firm. Alternatives in terms of toll milling appear both unlikely and uneconomic and new entry also appears unlikely due to the decline in demand in the industry combined with increased health and safety requirements. The OFT therefore believes that there is a significant prospect that this merger may be expected to result in a substantial lessening of competition in the supply of silica flour in the UK.

The parties have argued that structural change is inevitable as a result of decline in demand and enhanced health and safety requirements which will require further investment to upgrade mills to reduce dust emissions. The OFT has considered these arguments, but believes on balance that there is a significant prospect that this merger may be expected to result in a substantial lessening of competition in the supply of silica flour in the UK. Such matters would appear to be best addressed during a further investigation of the proposed merger by the CC.

UNDERTAKINGS IN LIEU OF REFERENCE

The OFT therefore considers that it is under a duty to make a reference under section 33(1) of the Act. Pursuant to section 73(2) of the Act, the OFT may, instead of making such a reference, accept undertakings for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which may be expected to result from it. In considering whether to accept such undertakings, the OFT is, in particular, to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and adverse effects resulting from it pursuant to section 73(3) of the Act.

Having reached a reference conclusion, the OFT has considered whether there might be undertakings in lieu of reference which would address the concerns outlined above. An undertaking by WBB not to acquire Tarmac's silica flour business would address those concerns and allow the remainder of the transaction to proceed. However, we have been informed by WBB that such an undertaking would not be forthcoming. WBB regards the silica flour business as an essential part of the merger. WBB has, however, indicated that it would be prepared to consider other alternative behavioural remedies in particular a price cap. However, the lack of any obvious benchmark against which to limit prices and the fact that WBB will shortly need to make a considerable investment - to meet new health and safety regulations - might suggest that devising a price cap that would adequately replicate the loss of competition arising from the merger would be difficult. Moreover, while any cap might limit prices it would not address concerns relating to the aspects of non-price competition, such as quality and service, the incentives for which might also be reduced by the merger. On balance, therefore, and in the absence of a divestment undertaking, the OFT does not consider that the competition concerns identified in this case can be resolved by means of undertakings without the need for further investigation of the proposed merger by the CC. The OFT does not consider that behavioural undertakings, in particular a price cap, are sufficiently clear cut or capable of ready implementation in this case.

DECISION

This merger will therefore **be referred** to the CC under section 33(1) of the Act in relation to the supply of silica flour in the UK.

Notes

1. Text deleted at the request of the parties
2. Actual figures replaced by a range at the request of the parties
3. WBB contends that since it does not supply any equivalent grade of silica flour to that milled from Loch Aline sand, the supply of lower grade silica flour by each of the parties is the principal issue
4. The parties have asked OFT to make clear that it is the Spanish dolomite supplied by WBB that does not contain spinel
5. The parties state that the majority of high purity silica sand is supplied to the glass and ceramics industries
6. WBB states it is the silica flour operating lines at the plant which do not run at full capacity