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Statement of Preliminary Issues

Tronox Limited and National Titanium Dioxide Company Ltd

7 July 2017

Introduction

1. On 26 June 2017, the Commerce Commission registered an application (the Application) from Tronox Limited (Tronox) to purchase the titanium dioxide (TiO_2) pigment business of National Titanium Dioxide Company Ltd (Cristal) (the proposed merger).[1]

2. The Commission will give clearance if it is satisfied that the proposed merger will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed merger. We request that parties who wish to make a submission do so by **21 July 2017**.

The parties[3]

5. Tronox is a public limited company incorporated in Australia and is listed on the New York Stock Exchange. Tronox is an international chemical company active in mining, production and marketing of inorganic minerals and chemicals. It operates two vertically integrated businesses, namely TiO_2 pigment and Alkali Chemicals.

6. Cristal is an international chemical company incorporated in Saudi Arabia. Cristal operates five main business divisions: mining of TiO_2 feedstock and zircon; manufacture of TiO_2 pigment; production of titanium chemicals; production of ultrafine and speciality TiO_2 pigment; and research and development of titanium powder, alloys and related products. Cristal also owns and operates the "Arabian Chemical Centre" in Saudi Arabia, which is a chemical manufacturing plant. The five divisions and the Arabian Chemical Centre comprise the TiO_2 pigment business that Tronox is seeking to acquire.

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[1] A Public version of the application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

[2] The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

[3] The Application at [5-7].

7. Neither Tronox nor Cristal has manufacturing operations in New Zealand but instead supply TiO_2 pigment to customers in New Zealand from overseas plants, either direct to customers or via distributors.

Our framework

8. Our approach to analysing the competition effects of the proposed merger are based on the principles set out in our Merger and Acquisition Guidelines.[4] As required by the Commerce Act 1986, we assess mergers using the substantial lessening of competition test.

9. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[5]

10. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial sense.[6]

11. We compare the extent of competition in each relevant market both with and without the merger. This allows us to assess the degree by which the proposed merger might lessen competition. If the lessening of competition is likely to be substantial, we will not give clearance to the proposed merger. When making that assessment, we consider, among other matters:

    11.1 constraint from existing competitors – the extent to which current competitors compete and the degree they would expand their sales if prices increase;

    11.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    11.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Preliminary issues

12. The questions that we will be focusing on when assessing whether the proposed merger is likely to substantially lessen competition in the relevant markets are:

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4 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

5 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

6 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

12.1 would the merger reduce competition through eliminating the constraint that the two entities impose upon one another?

12.2 would the merged entity be able to engage in behaviour that forecloses rivals and renders them less able to compete?

Market definition

13. TiO_2 pigment is a chemical used in various applications to impart whiteness, brightness and opacity. According to the Applicant, the vast majority of TiO_2 pigment supplied into New Zealand is used in the coatings and plastic industries.[7]

14. The Applicant submits that Tronox and Cristal compete in a market that includes all types of TiO_2 pigment, regardless of production process, grade or application.[8] The Application argues that:

14.1 all applications in New Zealand for which the parties' sales overlap can use TiO_2 pigment produced through sulphate and chloride processes interchangeably;[9]

14.2 particular grades of TiO_2 pigment are interchangeable across different types of application;[10] and,

14.3 there is a high level of overlap between the grades of the merging parties and competitors, and multiple grades are normally suitable for the same application. Producers can easily switch production between different grades.[11]

15. Our investigation will test whether customers are able to switch between the types and grades of TiO_2 pigment as described above by the Applicant.

16. The Application considers that the geographic market for TiO_2 pigment is worldwide in scope.[12] We will test whether there are different conditions of competition in New Zealand, such that a narrower geographic market is appropriate.

Without the merger

17. The Application states that the relevant without-the-merger scenario is the status quo.[13]

Unilateral effects: would the merged entity be able to raise prices on its own?

7 The Application at [8.1].
8 The Application at [14.1].
9 The Application at [14.4].
10 The Application at [14.9].
11 The Application at [14.9].
12 The Application at [14.11].
13 The Application at [18.1].

18. Where two suppliers compete in the same market, a merger would remove a competitor that would otherwise act as a competitive constraint, potentially allowing the merged entity to raise prices or lessen quality.

19. Tronox and Cristal are current competitors in the supply of TiO_2 pigment to customers in New Zealand. The Applicant, however, submits that it will face competition from a large number of other competitors that also supply (or could supply) customers in New Zealand. These include international players such as Chemours, Huntsman, Lomon Billions and Kronos.[14] The Applicant submits that large customers have significant negotiating leverage and, for the most part, Cristal and Tronox are not the closest competitors for those customers.[15]

20. The Applicant submits that there are low barriers to entry and expansion in the New Zealand market:[16]

    20.1 rivals do not require a local sales team in New Zealand, and can supply to customers either directly or through a distributor;

    20.2 TiO_2 pigment is easily transported and transport costs are low; and,

    20.3 fixed costs are high so producers are highly incentivised to supply TiO_2 pigment in order to lower average costs.

21. The Applicant submits that customers are able to exercise countervailing power.

    21.1 Some customers source from multiple suppliers simultaneously and so can easily switch between suppliers.[17] Customers will normally have several suppliers for whom they have tested the suitability of TiO_2 (referred to in the Application as a “qualified supplier”), which they can switch to.

    21.2 Most customers are large and sophisticated.[18] Large multi-national customers are able to leverage global buying capacity when negotiating price.

    21.3 Smaller customers can source from large international suppliers or from distributors in New Zealand.[19]

22. Our investigation will test:

    22.1 the relevant market, including whether TiO_2 produced using the sulphate and chloride processes are in the same market;

    22.2 the closeness of competition between the merging parties;

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14 The Application at [19.4].
15 The Application at [19.4(d)].
16 The Application at 28-29.
17 The Application at [19.7].
18 The Application at [21.1].
19 The Application at [19.26].

22.3 whether other suppliers of TiO_2 (including manufacturers of TiO_2 and distributors) offer products that are good alternatives to New Zealand customers of the products that the merging parties offer;

22.4 how easily rival suppliers could increase supply to New Zealand; and

22.5 whether customers could impose any countervailing power.

23. We note that the needs of each TiO_2 pigment customer may differ depending on its manufacturing process or the preferences of its customer. Small TiO_2 pigment customers may have different options to large TiO_2 pigment customers. This means the ability of each TiO_2 pigment customer to switch to alternative suppliers may differ. We will consider whether any customers have a strong reliance on the TiO_2 pigment that the merging parties supply, and whether the merged entity would be able to target such customers for price increases.

Coordinated effects: would the merged entity be able to coordinate with rivals to raise prices?

24. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[20]

25. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the merger would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable. Some factors we will consider are:

25.1 whether the characteristics of the product or service makes coordination likely, for example when:

25.1.1 the products are homogenous;

25.1.2 there is little innovation and stable demand;

25.1.3 firms can easily observe each other’s prices; and

25.1.4 there is repeated interaction;

25.2 whether the merger will leave any markets with only a few rivals or eliminate a vigorous competitor;

25.3 whether the firms in the market are similar (for example, in size and cost structure) such that they will have similar incentives to coordinate;

[20] Commerce Commission, *Mergers and acquisitions guidelines* (July 2013) at [3.84].

25.4 whether interactions between suppliers enhance the potential for coordination; and

25.5 whether the threat of entry or the countervailing power of customers or suppliers would disrupt any attempts to coordinate.

Would the merged entity be able to foreclose rivals?

26. The proposed merger raises potential vertical effects. A vertical merger is a merger between firms operating at different levels of a supply chain (eg. a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability and/or incentive to foreclose its rivals, including by refusing to deal with competitors completely (total foreclosure), or by raising prices it charges competitors (partial foreclosure).

27. The merger between Tronox and Cristal will lead to aggregation at different levels of the supply chain, including the mining of feedstocks and the manufacture and production of TiO_2 pigment and derivatives. The Applicant submits that the merger will lead to an increase in the feedstock and TiO_2 pigment produced, and so will not have anticompetitive effects.[21]

28. We will consider whether the merger will create the ability and incentive to foreclose either upstream or downstream rivals. In considering whether it could be profitable for the merged entity to foreclose rivals due to vertical effects, we will consider:

28.1 whether the merger would increase the merged entity's ability and/or incentive to foreclose competitors; and

28.2 whether that conduct is likely to have the effect of substantially lessening competition in a relevant market.

Next steps in our investigation

29. The Commission is currently scheduled to make a decision on whether or not to give clearance to the merger by **Monday 21 August 2017.** However, this date may change as our investigation progresses.[22] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

30. As part of our investigation, we will be identifying and contacting parties we consider will be able to help us assess the preliminary issues identified above.

Making a submission

31. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Tronox/Cristal" in the subject line of your email, or by mail to

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21 The Application at [22.1].

22 The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.

The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **21 July 2017**.

32. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

33. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA. For example, if disclosure would unreasonably prejudice the supplier or subject of the information. In assessing the confidentiality of information contained in submissions for the purposes of publication on our website, we intend to apply an approach that is consistent with the OIA.