

Statement of Preliminary Issues

Ixom Operations Pty Limited / Oji Fibre Solutions (NZ) Limited

23 January 2019

Introduction

1. On 21 December 2018, the Commerce Commission registered an application (the Application) from Ixom Operations Pty Limited (Ixom) seeking clearance to acquire the manufacturing assets of a chemical manufacturing plant in Kawerau (the Tasman plant) from Oji Fibre Solutions (NZ) Limited (Oji) (the Proposed Acquisition).
2. Oji has used its Tasman plant to produce chemicals to bleach pulp produced at Oji's Tasman mill. However, Oji intends to cease production of bleached pulp at its Tasman mill and so no longer requires the co-located chemical plant, which it is selling to Ixom.
3. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.
4. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.¹
5. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **7 February 2019**.

The parties

5. Ixom is headquartered in Australia and has chemical manufacturing, supply and distribution operations in several countries around the world. In New Zealand, Ixom supplies chemicals to distributors, retailers and end users. It sources certain chemicals from Oji, and also imports and produces some chemicals itself.
6. Oji forms part of the Oji group, a major global supplier of pulp, paper and packaging. In New Zealand, Oji operates two pulp and paper plants, one in Kinleith, Tokoroa (the Kinleith mill) and the other in Kawerau, Bay of Plenty (the Tasman mill), and a

¹ 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.

mill for recycled product in Auckland. In addition, the Oji group operates a paper mill near Napier (Pan Pac). Oji has two chemical manufacturing plants, one each at its Kinleith and Tasman mills (the Kinleith plant and the Tasman plant, respectively). The chemicals produced at these plants are used in their mills and sold to customers.

Our framework

7. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.² As required by the Commerce Act 1986 (the Act), we assess mergers and acquisitions using the substantial lessening of competition test.
8. We determine whether an acquisition 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).³ This allows us to assess the degree by which the proposed acquisition might lessen competition.
9. If the lessening of competition as a result of the proposed acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:
 - 9.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;
 - 9.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and
 - 9.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser’s ability to exert substantial influence on negotiations.

Industry background

10. At this stage of our investigation, the chemicals relevant to the Proposed Acquisition are:⁴
 - 10.1 sodium hypochlorite (hypo);
 - 10.2 hydrochloric acid (HCl); and
 - 10.3 caustic soda (caustic).

² Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at www.comcom.govt.nz

³ *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

⁴ The Application at [1.2].

11. Oji currently manufactures each of these chemicals at its Tasman and Kinleith plants for supply to its own mills and the balance to third parties (including Ixom).
12. Ixom has a hypo plant in Timaru and sells most of its output to customers in the South Island.⁵

End uses

13. Oji uses hypo, HCl and caustic in its pulp and paper operations at its Kinleith and Tasman mills.
14. Aside from pulp and paper manufacturing, these chemicals are used for other purposes in New Zealand. For instance:⁶
 - 14.1 hypo is used for water treatment (drinking water and swimming pools) and for cleaning and disinfection processes.
 - 14.2 HCl is mainly used to manufacture poly aluminium chloride (PAC), which is used for coagulation in water treatment, metal treatment and paper making.
 - 14.3 caustic is mainly used for industrial cleaning, particularly in the food manufacturing industry.

Market definition

15. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed acquisition. 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 Act, as a matter of fact and commercial common sense.⁷
16. Ixom considers that it is appropriate to consider the effect of the Proposed Acquisition in the:⁸
 - 16.1 national market (or South Island and North Island markets) for the wholesale supply of hypo;
 - 16.2 national market for the wholesale supply of HCl; and,
 - 16.3 national market for the wholesale supply of caustic.
17. We will consider whether Ixom's proposed market definitions are appropriate. We will consider whether it is appropriate to define the relevant markets as single markets or if it is more appropriate to assess narrower markets based on such factors as concentration levels, formulation, the form the chemicals are supplied (eg, in bulk or different sized packaging), and end use.

⁵ The Application at [11.12].

⁶ The Application at [11.15].

⁷ Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

⁸ The Application at [19].

Without the acquisition

18. We will consider what the parties would do if the Proposed Acquisition did not go ahead.
19. In its Application, Ixom submitted that in the absence of the Proposed Acquisition:⁹
 - 19.1 Oji will close the Tasman plant from 31 March 2019; and
 - 19.2 Ixom will build a hypo plant in the North Island with Ixom re-locating its South Island plant to the North Island to meet demand while the new plant is being built.
20. We will seek further information to assess Ixom's submitted without-the-acquisition scenario, or whether there are other likely, more competitive, scenarios that could occur.

Preliminary issues

21. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in the relevant markets by assessing whether horizontal unilateral effects, vertical effects or coordinated effects might result. The questions that we will be focusing on are:
 - 21.1 unilateral effects: would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?
 - 21.2 vertical effects: would the Proposed Acquisition increase Ixom's ability and/or incentive to engage in behaviour that forecloses rival suppliers and renders them less competitive?
 - 21.3 coordinated effects: would the Proposed Acquisition change the conditions in the relevant markets so that the firms in the market could coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market?

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

22. Where two suppliers compete in the same market, a merger of the two may remove a competitive constraint, potentially allowing the merged entity to raise prices or lessen quality.
23. Ixom and Oji both produce hypo in New Zealand. Ixom submitted that the Proposed Acquisition would not be likely to substantially lessen competition in the hypo market because of:¹⁰

⁹ The Application at [18.1].

¹⁰ The Application at [25-29].

- 23.1 the availability of imports at reasonable cost for hypo suitable for use in agricultural cleaning;
 - 23.2 the continued availability of hypo from Oji's Kinleith plant;
 - 23.3 the ability for a new operator to build a hypo manufacturing plant; and
 - 23.4 the ability of hypo customers to use chlorine, or on-site hypo generation or UV treatment technology as substitutes for hypo for water treatment.
24. Oji produces caustic in New Zealand, while Ixom imports caustic. If these sources of caustic are alternatives for customers, then the acquisition by Ixom of Oji's Tasman plant could remove a competitive constraint. Ixom submitted that the Proposed Acquisition would not be likely to substantially lessen competition in the affected market for several reasons:¹¹
- 24.1 the merger will cause only a small increase in Ixom's market share;
 - 24.2 should Ixom ever seek to sell caustic from the Tasman plant to the rest of the market, it will face competition from other importers; and
 - 24.3 there is unlikely to be any change in the competitive situation between the with and without the acquisition scenarios.
25. We will assess whether the evidence supports the claims made by Ixom in respect of hypo and caustic.
26. A merger could also reduce competition if one of the merging firms was a potential or emerging competitor. Oji produces HCl. Ixom neither produces nor imports HCl. As part of our assessment, we will consider whether Ixom imposes a constraint on Oji due to the threat it could expand its business to start supplying those products. In such a case, the merger may preserve any market power the incumbent firm may hold.

Would the merged entity be able to foreclose rivals?

27. A merger between suppliers can result in a substantial lessening in competition due to vertical effects.

Vertical effects

28. A vertical merger is a merger between firms operating at different levels of a supply chain (for example, a wholesaler and a retailer). Vertical mergers can increase a merged entity's ability and/or incentive to foreclose its rivals, including by raising the costs of rivals or by changing the conditions of entry to make it harder to enter or expand.
29. The Proposed Acquisition will increase the vertical integration between the manufacturing and wholesale supply functional levels of the affected markets. Oji

¹¹ The Application at [20.30].

currently supplies hypo and HCl to Ixom and other distributors and customers.¹² Ixom competes with some of those distributors to supply to downstream customers. The Proposed Acquisition may therefore result in Ixom being both a supplier and competitor of buyers of these chemicals.

30. Ixom has submitted that the Proposed Acquisition would not give Ixom the ability and/or the incentive to foreclose competitors from each of the affected markets because:¹³
- 30.1 the high operating and fixed costs at the Tasman chemical manufacturing plant would act as a strong disincentive to Ixom foreclosing competitors in each of these markets as any attempt to do so means Ixom would risk not being able to cover its fixed costs;
 - 30.2 the availability of hypo and HCl from Oji's Kinleith plant;
 - 30.3 the constraint from imports of HCl and hypo (for some uses);
 - 30.4 the potential for a rival to build a competing hypo plant; and
 - 30.5 the ability of water treatment customers of hypo to substitute other products.

Coordinated effects: would the proposed acquisition make coordination more likely?

31. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining rivals to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across the market. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all the firms in the market to be acting in a coordinated way.
32. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

Next steps in our investigation

33. The Commission is currently scheduled to make a decision on whether or not to give clearance to the proposed acquisition by **12 March 2019**. However, this date may change as our investigation progresses.¹⁴ In particular, if we need to test and consider further the issues identified above, the decision date is likely to extend.

¹² Oji produces caustic at its two plants. According to the Application, Oji uses all this production for its own use and does not sell caustic at the wholesale level of the caustic market. This makes it less likely that vertical issues might arise from the merger.

¹³ The Application at [21].

¹⁴ The Commission maintains a case register on our website at <https://comcom.govt.nz/case-register> where we update any changes to our deadlines and provide relevant documents.

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

Making a submission

35. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference Ixom/Oji in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **7 February 2019**.
36. 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.
37. 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 in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

