ACE@15

Schwenk / Opterra - Merger between close competitors

15 November 2018

Bundeskartellamt

The views expressed are those of the presenter and do not necessarily reflect those of the Bundeskartellamt.

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Agenda

1. **What was the Schwenk / Opterra case about?**
   Key facts about the transaction & assessment

2. **Where do the parties' customers overlap?**
   Geographic market definition on the basis of actual shipments

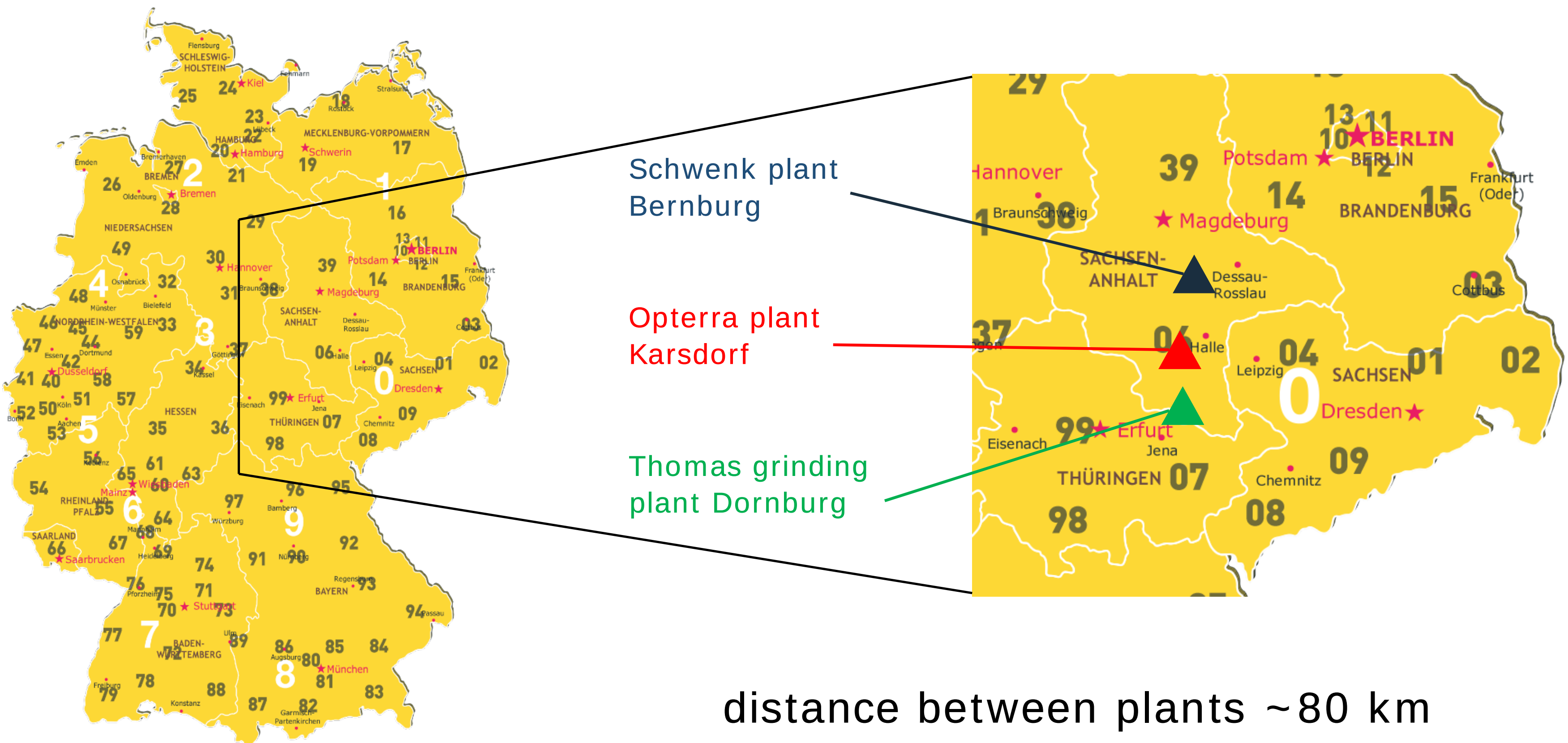
3. **Why not a "virtual cement producer" as remedy?**
   Innovative commitment proposal rejected as inappropriate

The Schwenk/Opterra case

- Filed in May 2017, commitments offered in Sep 2017, SO in Oct 2017, withdrawn in Nov 2017
- Target: **Opterra** operates large cement plant in Karsdorf (Saxony-Anhalt)

- Buyer: **Schwenk** operates large cement plant in Bernburg (Saxony-Anhalt)
- Schwenk vertically integrated downstream into ready-mix concrete, Opterra not

The Schwenk/Opterra case



distance between plants ~80 km

The Schwenk/Opterra case

- No. 1 and No. 2 in the relevant market for grey cement in "central Germany" (*details later*)

- stable market positions

Supplier	Market share
Opterra	40-45%
Schwenk	20-25%
Combined	**60-65%**
Cemex	<10%
Thomas	<10%
Dyckerhoff	<10%
LafargeHolcim	<10%

- Combined capacity 4x that of closest competitor Thomas

- Opterra most active supplier especially vis-à-vis ready-mix concrete producers (most important customer group; ~60% share of sales)

The Schwenk/Opterra case

- SIEC because of both unilateral and coordinated effects
- Unilateral effects
  - elimination of a close competitor in terms of plant location, quality and price
  - target particularly active competitor vis-à-vis ready-mix concrete producers
  - effective capacity utilisation of competitors ~95%
  - capacity expansion by existing competitors and market entries unlikely
- Coordinated effects
  - cement markets susceptible to (tacit) collusion
  - reduction in number of relevant suppliers, alignment of capacity utilisation
  - increase in symmetry esp. due to vertical integration into ready-mix concrete (by Schwenk in contrast to Opterra pre-merger)

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Demand oriented, data-driven geographic market definition

- Basic idea of GMD: identification of those areas where customers are directly affected by a horizontal merger
- standard method: regional/local markets are typically defined by drawing circles around production plants or stores
  - e.g. COM in Holcim/Cemex 2014 (M.7009) or HeidelbergCement/Schwenk/ Cemex Croatia 2017 (M.7878)
- rather crude approach with several shortcomings, inter alia
  - Many customers unaffected (affected) by the merger may (not) be included in the market
  - Not clear where to center circles (plant of the target or the buyer?)
  - Market shares are often very sensitive to changes in radius

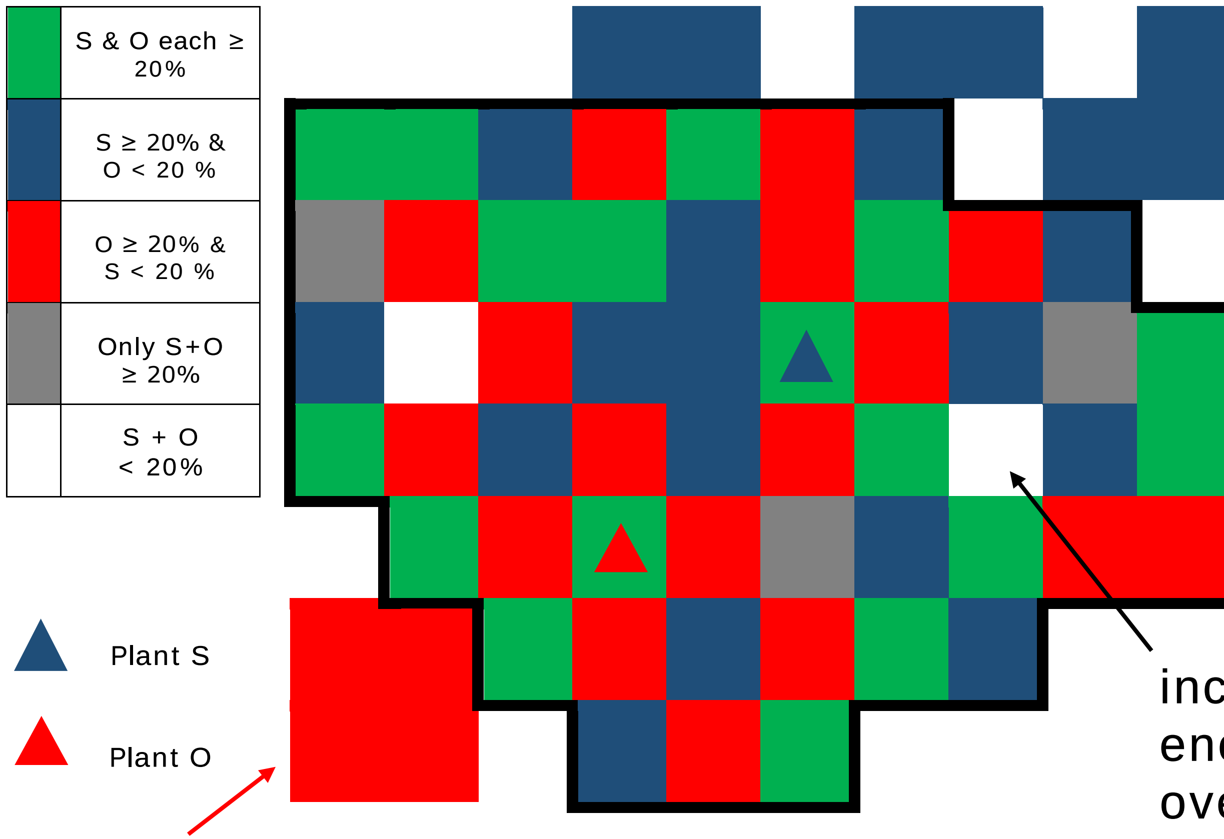
Demand oriented, data-driven geographic market definition

- Preferable approach: identification of overlap between parties on the basis of actual trade flows or customer flows
- Method is based on und fully conforms with established product market definition principles
  - focus on demand-side substitution
  - focus on actual overlap between merger parties

Identification of horizontal overlap – stepwise practical implementation

- Collection of data for all physical shipments from all cement producers in Germany per production plant (2014 to 2016)
- Calculation of share of total demand served by merging parties´ plants ("share of supply") per 5-digit postal code area
- Display in a map with postal code areas coloured according to merger parties´ share of supply ➔ threshold of 20%
  - reached by both merging parties individually, either of them alone or only both of them together.
- Cumulative criteria to define relevant geographic market
  - high density & intermixture of areas where the merger parties´ common share of supply is ≥ 20%
  - inclusion of enclosed 5-digit postal code areas with lower share of supply

Identification of horizontal overlap - illustrative example



not included because O is not a rele-vant source of supply

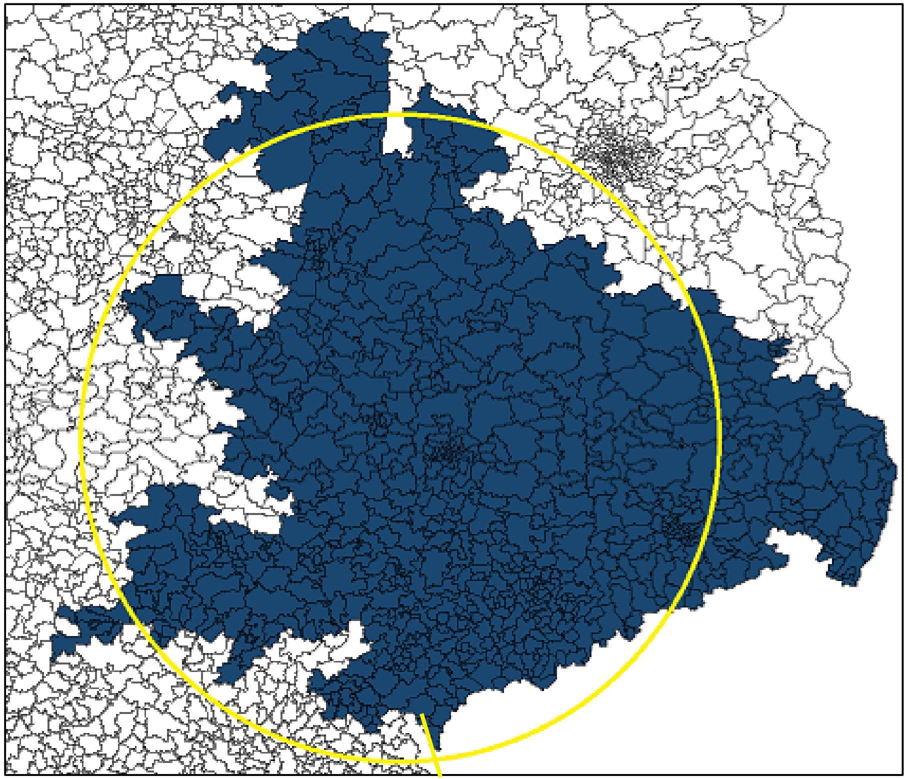
included because enclosed by overlap areas

not included because S is not a relevant source of supply

Resulting market area „Mitteldeutschland“ („Central Germany“)

- Geographic market encompasses (almost all) 5-digit postal code areas where <u>both</u> merger parties are a relevant source of supply for costumers

- Deliveries into the area included in market volume (from cement plants situated outside the market / outside Germany)



yellow line: exemplary 150 km-radius around target plant Karsdorf

Elzinga/Hogarty-style plausibility checks

- Resulting geographic market exhibits a share of self supply of >65% and a share of production consumed internally of >70%
- Neighbouring areas (loosely defined) also show high shares of self supply and low shares of imports from „Mitteldeutschland“

Neighbouring area	Share of self supply	Imports from „Mitteldeutschland“
„Berlin/Brandenburg“ (North East)	>65%	<20%
„Ost-/Mittelniedersachsen“ (West)	>65%	<10%
„Südosthessen/Nordfranken“ (South West)	>50%	<10%
„Ostbayern“ (South)	>55%	<10%

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Commitment proposal by Schwenk

- No structural remedy / divestiture was offered
  - the merger parties were not prepared to divest a complete cement plant and
  - the relevant plants were deemed to be indivisible at least in economic terms
- Schwenk offered a “cement plant slice” instead
  - long-term contractual obligation to supply an annual amount of up to 500 kt (kilo tonnes) grey cement produced in Karsdorf to an independent buyer (“plant slice”)
  - together with a customer base with an annual offtake of 450 kt grey cement in the relevant market “Mitteldeutschland” (mainly customers of the Karsdorf plant, transfer conditional on consent of the respective customers)
  - non-compete obligation by Schwenk for 2 years
  - exclusive responsibility for operating the plant to remain with Schwenk including procurement, production control and investment decisions

Commitment proposal by Schwenk

- Fixed and variable payments by the buyer
  - a fixed amount up-front to compensate for past investments & annual contribution to the fixed costs according to the share of the plant slice
  - The actual quantity of cement delivered to be paid for based on a price model roughly equal to the amount of actual variable production costs
  - contribution pro rata to costs for necessary investments in order to fulfil legal requirements and a one-time option to participate in other investments (and benefit from resulting cost reductions)
- No specific buyer proposed by parties
  - buyer to be independent from merger parties with no significant market position to date; effective use of plant slice to be expected
  - buyer to be approved by Bundeskartellamt

Market test

- Proposal warranted closer examination ➔ market test
  - cement producers and customers (including those with a potential interest to buy the plant slice)
- A number of companies expressed interest in principle
- Almost all the questioned customers considered the “plant slice” remedy inappropriate to compensate for the negative impact on competition
- Many of the companies, among them potential acquirers, also pointed out the considerable risks of the contractual arrangement
  - above all regarding the possibilities to terminate the contract (extraordinary dismissal => return of slice to Schwenk), plant operation and investment

Assessment

- The acquirer of the “plant slice” was meant to become a "virtual cement producer“ with roughly the level of pre-merger sales of Schwenk in the relevant market
- Innovative type of remedy in German merger control
  - not accepted by Bundeskartellamt in a merger case so far
  - similar commitment proposal (sale of power generation capacity) rejected in one case but for different reason (sale had already been negotiated independent of the merger; case *B8-84/03 – E.ON/Hansestadt Lübeck*)
  - similar commitments accepted by COM but for different markets e.g. in cases *M.2530 Südzucker/Saint Louis Sucre* (“virtual sugar plant”) and *M.7018 E-Plus/Telefonica* (“MVNO package”)
- No example from ordinary course of business for a „plant slice“ in the cement industry (unlike e.g. in power generation)

Assessment

- General requirements for the acceptance of commitments:
  - A remedy has to be suitable and necessary to completely remedy the competitive harm identified in the Bundeskartellamt's investigation in a timely manner (*Guidance on Remedies in Merger Control*, para 14)
  - Clear preference for structural remedies (*Guidance*, paras 23 et seq.)
  - Suitable acquirer
  - Non-structural remedies possible under special circumstances but remedies must not aim at subjecting the parties' market conduct to continued control (Section 40(3) sentence 2 GWB)
- Case-by-case assessment of effectiveness

⇒ Q: Can the proposed "virtual cement producer" remedy compensate for the loss of competition due to the elimination of Opterra on a lasting basis and as effectively as a divestiture remedy would?

Assessment

- Proposed commitment finally rejected as inappropriate
  - in view especially of the serious concerns expressed during the market test
- Buyer of the “plant slice” not expected by the Bundeskartellamt to be a long-term effective competitor because of limited ability
  - Schwenk can influence actual production costs to be paid
  - very limited possibilities for buyer to differentiate from Schwenk because of common product portfolio and location & shared production costs
  - detailed knowledge by Schwenk of customer base and price structure of buyer due to transfer of customer base and common production site
  - fixed maximum capacity of „plant slice“, possibility of extraordinary dismissal
  - Schwenk can compensate for reduced capacity at Karsdorf plant with spare capacity at nearby Bernburg plant (and also expansion capacity at Karsdorf)
- ... and incentives ➔potential coordination between buyer and Schwenk

Public documents

- Case summary “Withdrawal of notification of planned acquisition of OPTERRA Zement GmbH by SCHWENK KG” from 12 January 2018, available at https://www.bundeskartellamt.de/EN.

- Sektoruntersuchung Zement und Transportbeton, Abschlussbericht gemäß § 32e GWB - Juli 2017, available at https://www.bundeskartellamt.de (in German only).

- Guidance on Remedies in Merger Control, May 2017, available at https://www.bundeskartellamt.de/EN.

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Cement merger: Schwenk/Opterra

The Bundeskartellamt perspective

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