Lerato Motaung

From: Lerato Motaung
Sent: 20 January 2012 01:04 PM
To: g.kekesi@bowman.co.za; Xolela Nokele; echamberlain@freeworldcoatings.com; Michael.Bosman@za.ey.com; Urs.Indermuhle@za.ey.com; j.meijer@bowman.co.za; c.azzarito@bowman.co.za; Leanie Mouton
Cc: Tebogo Mputle
Subject: RE: Kansai Paint Co., Ltd / Freeworld Coatings Limited - 53/AM/Jul11
Attachments: 20120120125250560.pdf

Dear Sirs

Please see attached reasons for decision in the above matter.

Regards

Regards

Lerato Motaung
Competition Tribunal South Africa
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-----Original Message-----
From: Tebogo Mputle
Sent: 23 November 2011 03:56 PM
To: g.kekesi@bowman.co.za; Xolela Nokele; echamberlain@freeworldcoatings.com; Michael.Bosman@za.ey.com; Urs.Indermuhle@za.ey.com; j.meijer@bowman.co.za; c.azzarito@bowman.co.za; Leanie Mouton
Cc: Alicia Hlafane; Lerato Motaung
Subject: Kansai Paint Co., Ltd / Freeworld Coatings Limited - 53/AM/Jul11

Dear All

Please see attached order in the above matter and kindly confirm receipt.

Regards

Tebogo Mputle
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south africa

COMPETITION TRIBUNAL OF SOUTH AFRICA

Case No:53/AM/JUL11

In the matter between:

KANSAI PAINT CO. LTD Acquiring Firm

And

FREEWORLD COATINGS LIMITED Target Firm

Panel	:	Norman Manoim (Presiding Member) Merle Holden(Tribunal Member) Medi Mokuena(Tribunal Member)
Heard on	:	22 November 2011
Order issued on	:	23 November 2011
Reasons issued on	:	20 January 2012

Reasons for Decision

Approval

[1] On 23 November 2011, the Competition Tribunal ("Tribunal") approved the large merger between Kansai Paint co. Ltd and Freeworld Coatings Limited subject to conditions. We explain below our reasons for this conclusion.

The Parties to the transaction

[2] The primary acquiring firm is Kansai Paint Co. Ltd ("Kansai"), a public company incorporated in Japan and listed on the Osaka and Tokyo stock

exchanges. Kansai is not controlled by any single shareholder; however, it controls a number of firms throughout the world.

[3] The primary target firm is Freeworld Coatings Limited ("Freeworld"), a public company listed on the Johannesburg Stock Exchange. Freeworld is not controlled by any single shareholder and it controls in excess of 29 subsidiaries throughout Africa and Australia. It is in a joint venture with E.I. DuPont Nemours and Company ("DuPont") in South Africa. DuPont, a German company has granted Freeworld a licence to manufacture OEMs coatings on its behalf.

[4] The transaction is a hostile takeover in terms of which Kansai made an offer to acquire the remaining issued share capital of Freeworld. After completion of the merger, Kansai will control Freeworld.

The Rationale

[5] Kansai submitted that it believes that Freeworld represents a highly attractive business as well as a strong platform for development and growth in Africa and as the majority of Freeworld's turnover relates to decorative coatings, Kansai's interest relates primarily to this aspect of the business.

The parties' activities

[6] Kansai is involved in the production and marketing of a wide range of coatings, in particular, automotive coatings; industrial coatings; decorative coatings; and marine and protective coatings. Automotive coatings are further divided into Original Equipment Manufacturer ("OEM")[1] and refinish automotive coatings[2]. It was submitted that in South Africa, Kansai does not supply any other coatings save for surface coat and base coat to Toyota through Duco, an independent distributor. Kansai does not have any manufacturing facilities in South Africa; as such all of the coatings it supplies in the country are manufactured in Japan and then imported by Duco.

[7] Freeworld is involved in the manufacture and distribution of decorative coatings and performance coatings under the following brands: Plascon,

[1]This type of coating is used for the coating of new vehicles. OEMs are further divided into electro-dipping coat; surface coat (primer); base coat; and clear coat.
[2]This type of coating is used for the supply of panelbeaters and body shops.

Polycell, Crown and Earthcote. Decorative coatings relate to paints used in painting houses and buildings primarily in the do-it-yourself and construction sector. The automotive business of Freeworld is conducted through Freeworld Automotive Coatings (Proprietary) Limited ("FAC"), Freeworld's wholly-owned subsidiary.

[8] Freeworld is not involved in the development of technology used in the automotive OEM coatings industry; however, through its joint venture with DuPont ("DFW"), it is active in the manufacture of OEM coatings using DuPont's licence. It also manufactures automotive refinish coatings using its own technology. The DFW is owned 49 per cent by FAC and 51 per cent by DuPont.

Background

[9] On 21 January 2011, the merging parties notified the Competition Commission of their merger in terms of section 13A of the Competition Act 89 of 1998 ("the Act"), as an intermediate merger.

[10] On 18 April 2011, the Commission approved the merger subject to a number of conditions, including a condition that required the merging parties to divest of Freeworld's entire automotive coatings business.

[11] On 11 July 2011, Kansai filed a request for consideration in terms of section 16(1)(a) of the Act alleging that the Commission's findings were incorrect and therefore, requested that the Tribunal approve the merger without the divestiture condition. The merging parties submitted that the Commission had erred in finding that there was an overlap between the activities of the merging parties by aggregating different levels of the supply chain that had inflated their combined market share.

[12] Initially the Commission opposed the consideration request and defended its condition. The Department of Trade and Industry (DTI) applied for and was granted intervention rights in these proceedings. Shortly thereafter, the DTI notified the Tribunal that it would not proceed with its intervention as the Commission was going to sufficiently represent its concerns in the matter.

[13] The Commission, on 4 November 2011, filed a set of revised conditions in terms of which the divestiture condition was withdrawn and replaced with an obligation to manufacture locally. We understand this revision followed negotiations with the merging parties. Annexure A contains the revised conditions and the order made by the Tribunal on 23 November 2011

The Relevant Market and the Impact on competition

[14] As Kansai is not involved in the decorative coatings market, the merger analysis focussed solely on automotive coatings. The products supplied by the automotive coatings firms are e-coat, surface coat, base coat and clear coat. Although all four of these coatings are required in order to coat a vehicle, each coating on a particular vehicle does not need to come from one supplier as the buyers may wish to spread their business across suppliers.

[15] The structure of the market as analysed by the parties is a useful tool to understand the roles of the major players at various stages of the supply chain. At the top of the chain for OEM automotive coatings (for new vehicles) are the technology suppliers namely DuPont, Kansai, PPG, BASF and Hemmelrath. All of them are multinationals who engage with the OEMs all around the world under a very strict regime of accreditation and closely knit commercial relations.

[16] Production of coatings can occur in three ways. Using their technology, the coating firms can manufacture in their home countries for their own markets and also export to other markets; invest in foreign markets for local production; enter into alliances globally with each other for manufacture and have franchising or joint venture arrangements with local firms where their technology is combined with local manufacture.

[17] At the second tier of the South African supply chain there is only one local manufacturer of the physical product. Freeworld manufactures some products in its own right under license from DuPont and other products that are not substitutes, as part of a joint venture with DuPont. Freeworld manufactures e-coat, solvent-borne surface coat, solvent borne base coats and limited quantities of clear coat under the licensing arrangement with DuPont using imported raw materials. DFW, the joint venture between DuPont and

Freeworld, which is controlled by DuPont, manufactures water-borne surface coats and water –borne base coats with DuPont technology.

[18] Kansai on the other hand, a Japanese based multinational, operates in South Africa by importing the physical product from Japan through Duco, a local distributor, who takes ownership of the product and distributes to the OEMs, more notably Toyota and Nissan.

[19] Kansai is also in a joint venture with PPG a major multinational manufacturer of automotive coatings under a Master Global Alliance Agreement. This agreement gives Kansai access to multinational OEMs other than Japanese but is not applied to any OEMs manufacturing in South Africa.

[20] The South African market is also supplied by imports. Most of the clear coat which is based on DuPont technology and some of their water-borne base coat is imported. In addition, all of the OEM automotive coatings supplied by Kansai (imported by Duco), PPG, BASF and Hemmelrath are imported. A conservative estimate of the extent of imports by value amounts to 40 per cent of the domestic market.[3]

[21] Finally at the bottom of the chain of supply lie the distributors who either import or source domestically to supply the OEMs. Two South African distributors, Duco and Chemetall are not involved in the manufacture or generation of the technology. Duco distributes all Kansai coatings that are imported from Japan and certain PPG coatings. Chemetall solely distributes Hemmelrath products. DFW is both a distributor and manufacturer distributing imports from DuPont, local production from DFW itself and Freeworld local production.

[22] BASF and PPG have in-house distribution facilities for their imports sourced from production abroad.

[23] The customer base for the automotive coatings supply chain is the seven major multinational OEMs. In order of production market share they are Toyota (27.3 per cent); Volkswagen (25.9 per cent); Mercedes Benz (11.7 per

[3]Econex Report, Kansai/Freeworld – An Economic Analysis, Stellenbosch, 11 November 2011

cent); BMW (10.6 per cent); Nissan (7.6 per cent); Ford (7.3 per cent); General Motors (6.4 per cent); and Others (3.2 per cent).

[24] Nissan and General Motors source all four coatings from DFW. The other OEMs use several suppliers often preferring to have more than one supplier for each coating.

[25] The choice of supplier is governed by a bidding process which has the prerequisite of accreditation of both the product and production facility by the particular OEM in order to enter the process.

[26] The analysis of the relevant market has however led to differences of opinion between the experts as to the relevant product market and the geographic market. The experts for the Commission (Econex) and the parties (RBB) do agree that refinish and decorative coatings are different markets. As Kansai is not active in either of these markets the merger will have no effect on market shares.

[27] In automotive coatings however, Econex defines one aggregated vertical market for coatings by integrating vertically down the supply chain. RBB on the other hand suggest that there are three vertically different markets at each level of the supply chain, namely the supply of technology, manufacture, and distribution.[4]

[28] The geographic market is also defined differently by the experts. Econex defines a national market for automotive coatings while RBB suggests that it is global. Econex when analysing the data however then comes to the conclusion that the national market is so constrained by global considerations that despite having large domestic market shares the parties will be unable to exercise any market power.

[29] Initial analysis by the Commission appeared to have found a 30 per cent differential between the domestic price of coatings and import parity pricing by the automotive coating firms.[5] This differential suggested that were the merged firm to exercise market power it would be able to raise prices up to

[4]RBB Economics, The Merger of Freeworld and Kansai, September, 2011.
[5]We will return to the impact of the hostile merger on the provision of such data to the Commission.

import parity. Upon the request by the merging parties for a reconsideration of the merger on the grounds of market definition new data were obtained by Econex. These data were more disaggregated and showed that the difference between domestic and imported prices was no more than 5 to 10 per cent.

[30] RBB suggested that the continuing difference between import parity and domestic prices can be attributed to the countervailing power that the OEMs exercise in their dealings with the automotive coatings firms. This countervailing power is reflected in the OEM's power to keep prices below market determined rates

[31] In the view of the Tribunal, pricing so close to import parity is also indicative of the impact of globalisation on the market however defined. Whether one defines the market as national subject to global constraints or a global market, it amounts to the same definition in terms of the exercise of market power. Furthermore, the potential for collusion between automotive coatings producers is severely diminished by the disciplining threat of imports and the considerable countervailing power exercised by the OEMs.

[32] The above analysis shows that the divestiture of Freeworld's entire automotive coatings business is no longer necessary and accordingly was correctly excluded from the conditions when the Commission and the merging parties re-negotiated them. (See Annexure A)

[33] When the conditions were re-negotiated the Commission and the merging inserted certain behavioural conditions which were not part of the previous order. These conditions provide for the following: disincentivising Kansai from raising toll manufacturing fees charged by Freeworld by making re-negotiated fees subject to Commission oversight (2.2); inhibiting possible co-ordinated conduct between Kansai and DuPont by curtailing information flows between the firms; inhibiting co-ordination between Kansai and PPG if the Master Global Alliance Agreement between Kansai and PPG is extended to include South Africa by requiring the parties to inform the Commission if it is.

[34] We do not need to consider the adequacy of these conditions as they were agreed to by the parties. To the extent information flows are a possible concern we believe they are adequately addressed by the conditions.

.The Public Interest

[35] Paragraphs 3, 4 and 5 of the conditions address public interest concerns that were agreed to by the merging parties and the Commission during the Commission's initial process. As these conditions were not the subject of the consideration, we need not consider them but they are retained in the order.

CONCLUSION

[36] We failed to find any substantive anticompetitive effects to the merger that could not be addressed by the revised agreed to conditions and that the dire condition of a divestiture initially required of the merging parties was found to be unwarranted. In addition, conditions relating to merger related public interest concerns such as employment, the development of local manufacturing with concomitant research and development were agreed between the Commission and the merging parties and were not the subject of these consideration proceedings.

[37] Nevertheless, as a result of this finding we were concerned whether incorrect information had been provided to the Commission that had led to their recommendation of a divestiture in the first instance. We were informed by the Commission that an internal process is underway to determine the veracity of the original information. It is an offence under the Act for any person to knowingly provide false information to the Commission.[6] If the Commission has reason to believe that this has occurred, it should not hesitate to report the matter to the appropriate authorities.

MERLE HOLDEN	20 January 2012 **DATE**

Norman Manoim and Medi Mokuena

[6] Section 73(d)

Tribunal Researcher:	Tebogo Hlafane
For the merging parties:	Bowman Gilfillan Attorneys
For the Commission:	Xolela Nokele