COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case No: 07/LM/Feb01

In the large merger between:

Chevron Corporation

and

Texaco Inc.

Reasons for the Competition Tribunal's Decision

APPROVAL

1. On 11 April 2001 the Competition Tribunal issued a merger clearance certificate approving the merger between Chevron Corporation and Texaco Inc. without conditions in terms of section 16(2)(a). The reasons for the approval of the merger appear below.

The parties

2. Both companies are two fully integrated oil companies incorporated in the US and carrying on business globally in the petroleum industry.

3. The primary acquiring firm is Chevron Corporation ("Chevron"), a fully integrated US oil company whose activities include exploration and production of mineral oil and gas, the operation of refineries, manufacture, supply and distribution of refined petroleum products , as well as the manufacture and supply of chemical products. It has a number of worldwide subsidiaries. However, for the purposes of this merger analysis, only those of its subsidiary firms conducting activities in South Africa in which it has a significant interest, will be alluded to.

4. The primary target firm is Texaco Inc. ("Texaco"), which, together with its wordwide affiliates, is active in the exploration and production of mineral oil and gas, the manufacture of fuels and lubricant products, the operation of trading, transportation and distribution facilities as well as the production of alternative forms of energy for power and manufacturing. Texaco also has extensive overseas subsidiaries. Its sole interest in the South African context for the purposes of this

analysis, is limited to its joint shareholding in Caltex Oil (Pty) Ltd, together with Chevron.

5. Neither Texaco nor Chevron themselves provide any services or sell any products within South Africa directly but do conduct activities in SA indirectly via three entities which they control:

   a. **Chevron Oronite Societe Anonyme (“ Chevron Oronite”)**
   This is a wholly owned subsidiary of Chevron Overseas Petroleum Inc, the ultimate shareholder being Chevron.

   b. **Chevron USA Inc.**
   TEMA, or the Technology Marketing branch, is a branch of Chevron .

   c. **Caltex Oil SA, (“Caltex”) owned by Caltex Corporation** in which Chevron and Texaco each indirectly hold a 50% shareholding, therefore Caltex is jointly owned and controlled by both Texaco and Chevron.

The merger transaction

6. This merger is in pursuance of a worldwide merger agreement concluded between Chevron and Texaco. The merger has been approved by the EU Commission but still awaits approval in the US from the appropriate antitrust authorities.

7. The merger is being effected via Keepep Inc, a merger subsidiary of Chevron. On the effective date, Keepep will merge into and with Texaco, terminating the separate existence of the merger subsidiary and leaving Texaco as the surviving company and a wholly owned subsidiary of Chevron. The merged entity will be renamed ChevronTexaco Corporation (“CTC”).

8. In terms of the merger agreement, each share of Texaco stock will be converted into the right to receive 0.77 of a share of Chevron common stock. Chevron shareholders will retain their shares in Chevron. Once the merger is effected, the shareholders of Texaco will own 39% of the shares in CTC while the shareholders of Chevron will hold 61%.

EVALUATING THE MERGER

The relevant market

9. Chevron and Texaco compete inter se in the refining and marketing of petroleum products worldwide but do not compete in this area within the South African oil industry. Caltex conducts these activities on its own account in South Africa and independently of its parent companies. Caltex’s oil refining and marketing

activities in SA will therefore remain unaffected by the merger. Caltex does however provide certain products to customers in South Africa, as and when required by its shareholders, Texaco and Chevron.

10. Insofar as the South African context is concerned, the Commission have identified four separate and distinct markets as follows:

    i. Lubricating Oil Additives
    ii. Catalysts
    iii. Sale of jet fuel
    iv. Sale of residual fuel and marine lubricants (marine products).

11. The Tribunal agrees with this categorization of the relevant markets. We will now proceed to examine each of these markets in turn.

Impact on competition

i. Lubricating Oil Additives

12. Chevron Oronite sells fuel and additive products in South Africa to finished oil manufacturers for blending with base oil into a finished lubricant product and then for on-sale to original equipment manufacturers.[1] Caltex is one such manufacturer who buys this product from Chevron Oronite and then sells the finished product to motor vehicle manufacturers.[2] Chevron Oronite competes with three other multinational additives companies, Lubrizol, Infineum and Ethyl, who will submit tenders, along with Chevron Oronite, to provide product. Therefore, additive customers could purchase from any of these alternative sources of supply, as well as from foreign companies.[3] In any event, neither Texaco nor its affiliates directly sell any products in SA that are interchangeable with Chevron Oronite's additives.

ii. Catalysts

13. TEMA, a branch of Chevron U.S.A. Inc., sells catalyst pellets which basically aid in the process of refining of crude oil to finished petroleum products. TEMA sells catalysts in the USA to National Petroleum Refineries of South Africa (Pty) Ltd ("NATREF") which then imports the product into South Africa. Competitors of

1 Additives are chemical substances added to petroleum products to impart or improve certain properties. Bulk additives are a feedstock in the manufacturing process of lubricating oil.
2 The finished product is used as a lubricant in diesel and petrol engines.
3 The parties also state that Chevron's control of Chevron Oronite does not mean that Chevron or its subsidiaries will purchase exclusively from Chevron Oronite, necessarily, but may do so from a competitor, if their prices happen to be cheaper.

TEMA include ExxonMobil Research and Engineering and Criterion Catalyst Company. According to the merging parties, neither Texaco nor any of its subsidiaries sell this product or any substitutes thereof in South Africa.

14. Accordingly, there is no product overlap in the first two markets between the activities of the merging parties and those they conduct via their subsidiaries in South Africa.

iii. Sale of Jet Fuel

15. Texaco and Chevron, through their subsidiaries, market and sell jet fuel to foreign airlines worldwide. An international bid process ensures Texaco and Chevron can bid for air contracts along with other major commercial jet fuel competitors. Contracts are awarded on an airport-by-airport basis and once awarded, a contract is concluded between either Texaco or Chevron and the particular foreign airline.

16. Jet fuel is a largely homogenous commodity, subject to stringent quality specifications by international authorities. Accordingly, purchases of jet fuel are always based on price. Airlines are therefore likely to shift suppliers in response to better prices.

17. Local oil companies do not sell jet fuel directly to foreign airlines but would supply them with jet fuel when foreign airlines are due to call at a South African airport. In such circumstances, their international office will contact their local subsidiaries in SA and advise them of a particular airline's fuel requirements. In this way, Caltex is notified by Chevron or Texaco, as the case may be, of their respective clients' requirements for jet fuel. This is then physically delivered at either Johannesburg or Cape Town international airports. Caltex then invoices either Chevron or Texaco for physical supply of product, akin to an "intra-group sale". The transaction occurs outside South Africa. Chevron and Texaco themselves do not have the facilities to physically deliver the product.

18. Caltex sells jet fuel to one major customer, South African Airways ("SAA") on its own account in competition with other oil companies, such as BP, Shell and Total. The absence of local facilities ensures Chevron and Texaco do not compete in the South African market and they do not sell jet fuel to SAA or any other South African customers. Therefore the merger will have no effect on Caltex's sale of jet fuel to SAA. [4]

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4 This was confirmed by a major local airline. Local oil companies do not sell jet fuel directly to foreign airlines but would make jet fuel available via their international office contacting their local subsidiaries in SA and advising them of fuel requirements.

19. Accordingly, there are no competition concerns in this market. Jet fuel is merely made available in SA via Caltex to foreign airlines but the essential transaction occurs outside South African borders. The merging entities have no infrastructure or facilities in South Africa therefore do not compete for the supply of jet fuel in the South African market to local customers.

20. The Tribunal endorses the Commission's view that no competition concerns are raised in respect of markets (i) to (iii). We now turn to the fourth market where the Commission identified a product overlap and where some concerns were raised by customers.

iv. Sale of Marine Products

21. This market comprises marine fuel (residual fuel) and marine lubricants. Residual fuel is a by-product of refined crude oil and used as a marine fuel and an industrial fuel. [5]

22. By means of a tender process, supply agreements are concluded between a marine lubricants supplier and a particular shipping line for the supply of that vessel's worldwide network requirements.

23. Chevron and Texaco market these products worldwide via FAMM, (Fuel and Marine Marketing LLC) a joint venture set up by them to sell marine products to shipping lines in over 100 countries.

24. The commission identified some product overlap here since Caltex sells marine products in its own name to local marketers, who on-sell it to the end-customer, the foreign vessels, which are also FAMM customers.

25. When a vessel is due to call at a South African port, FAMM notifies Caltex who will arrange for the product to be delivered to the vessel. Invoicing and payment is effected outside SA by FAMM itself. Accordingly, Caltex sells these products on its own account to FAMM who on-sells it to major shipping lines who happen to be docking at SA ports.

26. Where marine fuels are required on a spot basis[6] *along the shipping vessel's particular trading route, the international vessels will contact Caltex (as well as Shell, BP, etc) via local marketers or agents, notifying them of their fuel requirements. The agents will obtain quotes from all suppliers of marine fuel*

5 Industrial fuel is a land sale fuel used for industrial purposes. It falls out of the analysis since neither party is active in this market within South Africa. Lubricants are primarily used to lubricate marine diesel engines as well as for some on-shore applications.
6 A once-off purchase of product for immediate delivery.

(including Shell, BP and Caltex) and those who can provide the most cost competitive supply of fuel will provide fuel to these vessels on a spot basis, once the particular vessel docks at the appropriate local port along its route.[7]

27. Accordingly, FAMM supplies marine products on a worldwide basis through pre-arranged, long-term contracts. In South Africa, it might transact through Caltex who will arrange for supply to FAMM's customers locally. However, vessels may prefer to dock at specific ports and obtain their marine product supplies on a spot basis from local suppliers such as Caltex, Shell or BP via local agents or marketers.

28. In respect of marine products, even though Caltex does supply foreign vessels to a limited extent, it does not compete on the same scale as FAMM, which supplies marine products directly to foreign vessels on a worldwide basis. The Tribunal is therefore of the view that there are no major competition effects in this market and the merger will not alter the status quo.

29. Insofar as marine product contracts are awarded on a worldwide basis, the geographical market is global. Where foreign vessels transact with local agents directly, by purchasing fuel on a spot basis, customers still have the ability to source from a global pool of supply should any individual port not meet their requirements or should that supplier's fuel be too expensive.

Barriers to Entry

30. The parties advise that in relation to the sale of residual fuels, any new entrant would require capital to purchase marine fuels from the refineries to be able to sell to their customers. Even with additional storage and transportation costs, this would not present significant impediments provided custom can be secured. No tariffs or regulations apply. Similarly in respect of the sale of marine lubricants, the parties report that the finished blended product could be easily imported by a new entrant with minimal duties applicable, alternatively market entry would involve purchasing base oils and additives and blending them together. Barriers to entry are accordingly low.

Countervailing Power

31. There is a significant degree of countervailing power present in the marine products market. The shipping vessels are able to use their vast international networks to optimally source marine lubricants and fuels along their trading routes all over the world.

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7 Customer concerns in this regard are dealt with under vertical integration.

Nature and Extent of Vertical Integration

32. By virtue of the fact that Caltex and Chevron Oronite are controlled by the shareholders of the merging companies and make product available by supplying to their customers within South Africa, there is a potential for vertical integration issues to arise. In the additives market, the fact that Chevron Oronite competes with many other multinational additives companies, has already been dealt with.

33. In the marine products market, two local customers of Caltex raised the concern that since Caltex supplies residual fuel mainly at its Cape Town port from its Cape Town refinery, Caltex could raise prices or decide to supply FAMM only and not the local marketers, effectively cutting off supply at the CT port.

34. The parties allayed these concerns by stating that local marketers could in the event of any vertical foreclosure effects or other attempts by the merging parties to exploit their market power, just as easily source product from any of the other oil companies present in SA such as Shell, BP, or Engen. The parties state that marketers are not precluded in the above case from sourcing fuel from these other oil companies, who could merely ship fuel from their refineries to the Cape Town harbour, alternatively obtain product from the Caltex refinery by means of an exchange of product. (agreement whereby Caltex agrees with say, Shell, that Shell will supply product at Caltex's refinery without physical delivery having to take place).

35. In any event, these and other vertical threats such as price collusion are present to the same extent as ever before. Caltex has been jointly controlled by Chevron and Texaco for some time and the merger does not change the status quo or conditions of competition in the market. There is furthermore a sufficient degree of competition in all the product markets already to offset any vertical integration concerns. There are therefore unlikely to be any new vertical considerations arising as a result of this merger.

Conclusion

Neither Texaco nor Chevron directly conduct any activities in South Africa. Those activities conducted by subsidiaries of the merging parties in each of the four markets described above within South Africa do not raise competitive concerns for the reasons expressed. The joint control exercised by the merging parties over Caltex will not be altered by the acquisition of the target firm, instead the status quo will remain unaltered. Low barriers to entry into the marine products market and a large degree of countervailing power by shipping vessels would in any event check any abuse of market power by the merged entity through Caltex. The Tribunal therefore endorses the Commission's view that this merger will not result in the substantial lessening or prevention of competition in any market.

<u>24 April 2001</u>

D.H.Lewis **Date**

Concurring: N. Manoim, P. Maponya