SONOCO / WEIDENHAMMER MERGER INQUIRY

INITIAL SUBMISSION TO THE CMA AT PHASE 2

4 March 2015

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SONOCO / WEIDENHAMMER

INITIAL SUBMISSION TO THE CMA AT PHASE 2

1. INTRODUCTION AND EXECUTIVE SUMMARY

Introduction

1.1 On 31 October 2014 Sonoco Products Company ("**Sonoco**") acquired Weidenhammer Packaging Group GmbH ("**Weidenhammer**" and together with Sonoco, "the **Parties**") for €286million ("the merger"). Both Parties are suppliers of consumer packaging products, including composite cans. The merger has led to the aggregation of these businesses in the UK.

1.2 The Competition and Markets Authority ("**CMA**") has conducted a first phase review of the merger and issued its decision with respect thereto ("the **Decision**").[1] The Decision concluded that the merger had or may have resulted in a substantial lessening of competition ("**SLC**") and referred the merger for a Phase II investigation.[2] The principal reasons that the CMA reached this conclusion were:

(a) The counterfactual is the status quo.[3]

(b) The relevant frame of reference (the market definition) is for the production and supply of composite cans for food products in the UK.[4]

(i) The growth of flexible packaging and other alternative packaging formats was not sufficient to show substitution between packaging formats. Switching between formats has been low in recent years and there are switching costs.

(ii) Supply-side substitution between composite can production for food and non-food applications was not sufficiently easy to include the two in the same market.

(iii) The Parties only supplied a small quantity of composite cans overseas and transportation costs are high.

(c) The merged entity would have a market share of 85-95% of the relevant market as determined by the CMA.[5]

(d) The merging Parties are each other's closest competitors.[6] This was based on a review of internal documents, tenders and customer responses to CMA inquiries.

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[1] CMA "Completed acquisition by Sonoco Products Company of Weidenhammer Packaging Group GmbH" (ME/6485-14, 13 January 2015) ("the Decision").

[2] The Decision, para. 9.

[3] The Decision, para. 21.

[4] The Decision, para. 98.

[5] The Decision, para. 112.

The Decision, para. 129.

(e) Rival composite can suppliers for food applications (CBT and Visican) focus on small and medium-sized customers, have limited capacity and cannot meet the specifications of some customers.[7]

(f) Other packaging formats are not a significant threat to the merged entity.[8]

(g) There are high barriers to entry and no market entry within the last five years.[9]

(h) Although some customers may have buyer power, they would not protect smaller customers and so buyer power would not be sufficient to prevent an SLC. [10]

1.3 This submission explains why the Parties consider that those conclusions are not supported by the evidence.

The relevant counterfactual is one in which rationalisation will take place

1.4 The evidence shows that in the counterfactual neither the Sonoco nor the Weidenhammer composite can business in the UK would be financially viable without some form of rationalisation. Had the transaction not taken place, both firms are likely to have rationalised their UK business or one of those firms would have left the market entirely.

(a) The UK has excess capacity for composite cans and demand is falling. This ongoing trend has led to past consolidation and means further rationalisation is inevitable.

(b) The evidence shows that neither the composite can business of Sonoco nor Weidenhammer in the UK would be financially viable without some form of rationalisation.

(c) Sonoco views the merger as an opportunity to achieve cost-saving efficiencies that would materially improve profitability. Rationalisation will occur regardless of the counterfactual. However, the transaction will allow rationalisation to occur in an efficient and orderly manner.

1.5 Sonoco has already made submissions in respect of the failing firm defence.[11] [✂] Even if the failing firm defence was not met, the CMA ought to recognise that the counterfactual is not the status quo, but rather one in which the market will undergo significant rationalisation. Using the status quo as the counterfactual grossly exaggerates the impact of the merger.

Regardless of the counterfactual, the merged entity would find it unprofitable to raise prices

1.6 The market definition is too narrow. Rival packaging formats compete against composite cans because they can offer the same functionality and characteristics. In addition, as packaging is a

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7 The Decision, para. 158.

The Decision, para. 171.

9 The Decision, para. 184.

10 The Decision, para. 208.

11 [✂]

derived demand, manufacturers are prepared to substitute between formats because they "compete" to offer profit opportunities. Customers are diverse, so they have different options. This should be taken into account when conducting the hypothetical monopolist test. Assessing whether each individual alternative packaging format is a substitute for composite cans will underestimate the loss of volumes that would result from a price increase by the merged entity. When considering the aggregate impact of a price increase, a hypothetical monopolist of composite cans for food applications is unlikely to be able to profitably raise prices.

1.7 As the market definition is too narrow, the market share figures overstate the position of the merged entity.

1.8 The conclusion that "the merging Parties are each other's closest competitors" does not recognise that the two Parties do not compete closely for a large proportion of their customers. Several large customers have secured long-term contracts that protect them from price increases during any reasonable time-frame. Many customers purchase products that only one of the Parties currently produce, meaning the merging Parties would not directly compete for those products in the counterfactual.

1.9 The customers that the merging Parties may have competed for have strong alternative options. The Decision raises concerns that some customers may not be able to switch away from the merged entity.[12] In order for customers to defeat a price increase, it does not require that all or even most customers can switch away. All that matters is enough customers that the price increase is imposed upon switch to make it unprofitable. What is required is that customers have sufficient outside options and those that are genuinely captive cannot be identified with sufficient accuracy. We find that those conditions are not satisfied.

(a) Large customers have considerable buyer power. The loss of any one of these customers would have a significant impact on the ability of the merged entity to achieve a reasonable profit. These customers are large fast moving consumer goods ("FMCG") suppliers and are sophisticated buyers. Among the many options available to the large customers are: the ability to sponsor market entry by a new competitor; the ability to switch to alternative packaging; and the ability to use overseas suppliers. The risk to the merged entity is that if the large customers took any of these options in response to a price increase by the merged entity, the sales will be lost indefinitely.

(b) Small customers have considerable options. As the Decision recognises, CBT and Visican are an option for these customers. It would only require a small number of customers to switch to those suppliers to make a price increase unprofitable for the merged entity. Small customers could also switch to other packaging formats or import from outside the UK. The orders of these customers are small and they sometimes use co-packers so it would be difficult for the merged entity to identify those that are captive to it.

1.10 To conclude, the evidence suggests that the merged entity would be unable to profitably increase prices.

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12 See for example, the Decision, para. 140.

Sonoco's conduct where it has no (or few) direct rivals shows that it would be unable to raise prices

1.11 Evidence shows that where Sonoco has no (or few) direct rivals for composite cans for food applications it is unable to raise prices.

(a) Sonoco produces a range of can specifications that its rivals do not. If Sonoco did not face other constraints, then we would expect it to be pricing higher for those "non-overlap" products. There is no evidence to suggest that Sonoco prices any differently for non-overlap products than overlap products.

(b) In the US, Sonoco has a share of supply of around [✂]% of composite cans for food applications. If Sonoco did not face other constraints, then we would expect it to be pricing higher in the US than the UK and be earning high profits. [✂].

1.12 The reason that Sonoco conducts its business in this way is because it is forced to. Regardless of whether it has a direct competitor for composite cans or not, it still faces significant constraints including: the threat of customers switching to other packaging suppliers; the threat of customers switching to cheaper packaging; and the threat of customers moving production off-shore

2. OVERVIEW OF THE CONSUMER PACKAGING AND COMPOSITE CAN INDUSTRY

2.1 The relevant businesses of Sonoco and Weidenhammer in the proposed merger operate in the consumer packaging industry. The global consumer packaging business is estimated to be worth USD760 billion.[13] This covers a range of packaging formats including (with proportion of total sales in brackets): paper (31%); rigid plastics (23.6%); flexible packaging (19.5%); metal (15.1%); glass (6.6%); and other (4.4%).[14] The fastest growing categories are rigid plastics (5.6% projected compound annual growth rate ("CAGR") between 2010 and 2014) and flexible packaging (3.5% CAGR between 2010 and 2014).[15] In comparison paper (2.8%), metal (1.9%) and glass (2.6%) have lower growth rates.

2.2 Sonoco believes that the UK packaging market is worth approximately USD20 billion. This value is based on assessing the Global market at USD760 billion with Europe consuming 30% of the Global market. If one applies the UK population over the population of Europe (64.1/742.5), it implies that the UK represents approximately 8.6% of the European market or roughly USD20 billion. When compared with the US Market at circa USD126 billion and the population differential this is directionally sound.

2.3 The manufacturers that buy these packaging formats often switch as they react to changing trends and the drive to win end consumers. Anyone who regularly visits the supermarket will know that food manufacturers packaging innovation is constant and on-going. For example ready-to-eat soups were previously only supplied in metal cans. These products are now available in alternative forms of packaging such as flexible pouches, rigid paper, and plastic tubs. Further examples are [✂], cocoa [✂] that were traditionally sold in the UK in composite cans, but are

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13 Figure is projected figure for 2014. See "Sonoco – CMA Summary_Supplementary Data – 15 Dec 2014", p. 3.

14 Figure is projected figure for 2014. See "Sonoco – CMA Summary_Supplementary Data – 15 Dec 2014", p. 4.

15 Figure is projected figure for 2014. See "Sonoco – CMA Summary_Supplementary Data – 15 Dec 2014", p. 4.

now sold in other packaging formats.[16] Due to a change in the demographic buying those products, the suppliers have switched to a different shape packaging [✂]. (Further examples of customers switching among different packaging formats are provided in later sections.)

2.4 The new packaging formats bring benefits to both suppliers and consumers. In many cases, the new packaging formats are cheaper than traditional formats. This offers the opportunity for manufacturers to earn greater margins on their products and offer their goods more cheaply to customers. The different types of packaging also allow manufacturers to present the product more attractively to customers. For example, unlike metal and composite cans, transparent plastic tubs and flexible packaging allow the customer to see the product before they buy. This generates new demand increasing sales of the products and raising customer profits.

2.5 Even though some products have special requirements (such as tamper-proof protection, oxygen-proof sealing, re-closability or inner-liner specifications), such requirements can generally be met by other forms of consumer packaging. This is illustrated by the vast number of products that are packed and sold in more than one form of consumer packaging:

- coffee (flexible packaging, plastic cans, metal cans, composite cans),
- powdered infant formula (composite cans, plastic cans, folding cartons, flexible packaging),
- tea (composite cans, folding cartons, flexible packaging, plastic cans, tin cans),
- salt (folding cartons, plastic cans, composite cans),
- icing sugar (composite cans, flexible packaging),
- crisps (composite cans, plastic cans, flexible packaging),
- cocoa powder (composite cans, plastic cans, flexible packaging),
- butter (rigid plastic containers, wrap-around paper),
- meat spread (rigid plastic containers, flexible packaging),
- confectionary (paper, flexible packaging, rigid plastic containers, composite cans),
- detergents (plastic bags, composite cans, rigid plastic containers, folding cartons),
- paint (plastic cans, metal cans),
- instant soups (composite cans, plastic cans, flexible packaging),
- hand rolling tobacco (flexible packaging, composite cans, plastic and metal cans)

2.6 The suppliers of all types of packaging must recognise the threat from other formats. All of their customers face rivals many of whom may offer a competing product in a different form of packaging format. The ability to offer a cheaper and more attractive product offers a critical advantage for manufacturers when competing against rivals to win supermarket shelf space. Suppliers face an on-going risk that customers will choose to focus their efforts on more profitable

[16] "Initial factual information requested from Sonoco and Weidenhammer (Annex C)", p. 26.

packaging formats or switch entirely to an alternative packaging format (in which case the customer may be lost indefinitely).

2.7 The customers of consumer packaging are large suppliers of FMCGs. They have large and sophisticated buyer teams which are deeply knowledgeable about the supplier of packaging. They have the ability to extract the best terms under threat of switching to a rival packaging format.

3. THE PARTIES AND THE TRANSACTION

Sonoco

3.1 Sonoco is a US corporation founded in Hartsville, South Carolina in 1899 by the Coker family. Sonoco is a manufacturer of industrial and consumer packaging products and a provider of packaging services, with approximately 334 locations in 33 countries.

3.2 Approximately 67% of Sonoco's global sales are generated in the United States, 16% in Europe, 6% in Canada and 11% in other regions. Sonoco operates in four business segments: (i) consumer packaging; (ii) paper and industrial converted products (e.g. recycled paperboard, chipboard); (iii) protective solutions (e.g. custom designed protectives, temperature-assurance); and (iv) display and packaging (e.g. point-of-purchase displays and custom packaging). Generally, Sonoco serves two broad end-use markets, namely the consumer and industrial segments. Consumer packaging sales in the UK make up less than [✂]% of Sonoco's worldwide turnover. Sonoco sells to [✂] customers in the UK from its plant in Lievin France. These sales amount to approximately [✂] in annual revenue. Sonoco also has some sales abroad from the UK to Canada and Italy.

3.3 Sonoco recently expanded in the UK through acquisitions. Sonoco acquired the rigid paper container business of Robinson Paperboard Packaging Ltd, from Robinson Packaging Plc ("Robinson") in 2011 [✂] (the Chesterfield Plant was subsequently acquired in July 2013 [✂]). [✂] Robinson now focuses on plastic packaging in the UK and Europe. As part of the acquisition, Sonoco acquired Robinson's rigid paper container plant located in Chesterfield. In April 2012 Sonoco acquired the assets of ABPS. Sonoco paid [✂] for ABPS's order book and rigid paper container production line, as well a [✂] contract with [✂] for sales of [✂] to [✂] per year. ABPS had a single rigid paper container production line and the business was losing circa [✂] per annum. APBS only had a small production line but allowed Sonoco to compete to supply new products such as DIY and other promotional businesses.

Weidenhammer

3.4 Weidenhammer is a German corporation founded in Hockenheim, Germany. Weidenhammer manufactures and sells composite cans, composite drums and rigid plastic containers to the consumer goods and food industry. Weidenhammer was run and owned by the Weidenhammer family from 1955 up until the acquisition by Sonoco in October 2014.

3.5 Weidenhammer's sales in the UK make up less than [✂]% of Weidenhammer's worldwide turnover. Weidenhammer's sole UK plant (Bradford) is located in proximity to Sonoco's plants in Chesterfield (63 km beeline) and Manchester (40 km beeline). A [✂] proportion ([✂]%) of the

products manufactured in Weidenhammer's UK plant are sold abroad in [✂]. There are also a small amount of sales into the UK from Weidenhammer's continental plants.

3.6 Weidenhammer entered the UK market for composite cans in 2007/2008 by buying the Bradford plant from Chesapeake [✂]. Chesapeake sought to exit supply of composite cans in the UK. [✂].

3.7 Weidenhammer entered the UK plastics market by purchasing a plastic injection moulder (L&D Mouldings) in July 2011. Shortly after, in November 2011, Weidenhammer opened its new site in Bradford in order to facilitate the move into rigid plastic containers using in-mould label production. Although Weidenhammer's focus on the plastics market was a change for the Weidenhammer UK business (that occurred in the last five years), it is not relevant to the product market of the two companies currently under review by the CMA.

3.8 The turnover of Weidenhammer worldwide for 2013 was [✂] (approximately [✂]) of which [✂] was in the EU and [✂] was generated in the UK with [✂] for the UK composite cans for food market.

The transaction

3.9 The two separate companies, both running businesses in the consumer packaging market, have been aware of each other for the past thirty years. More than 20 years ago (before the current senior management were appointed), Sonoco had discussed with Weidenhammer the possibility of buying its business; these discussions did not result in any successful negotiations.

3.10 More recently, in early 2014, Sonoco was approached by [✂] of Weidenhammer. [✂] asked Sonoco if they would be interested in buying the Weidenhammer business, which includes ten plants based in Europe, five of which are in Germany, a plant in Russia, a plant in Chile and a joint venture in the US.

3.11 Two Sonoco representatives, [✂], met with and the advisor of Weidenhammer on 24 February 2014 in New York to discuss acquiring the Weidenhammer business. These informal discussions were not documented by way of formal minutes. Discussions continued through March 2014 and a negotiation session was held in April 2014 (where the framework of bid and ask came together). There are no formal minutes documenting this negotiation session.

3.12 A non-binding letter of intent was signed on 28 April 2014. Due diligence began in May 2014 and a Management Presentation was presented to the Sonoco Management on 19 May 2014 by select Weidenhammer managers. Due diligence was limited as Sonoco was a competitor in the market and Weidenhammer wanted to alleviate the risk of sharing confidential data without the surety of closing the deal.

3.13 The acquisition was completed on 31 October 2014 and the businesses are being integrated (outside of the UK) as permitted by the derogations of the initial enforcement order dated 5 November 2014. Sonoco purchased the entire share capital of Weidenhammer for €286 million (approximately £224 million). The acquisition included all of the Weidenhammer's European businesses. Bradford was not offered separately from the rest of the European businesses.

4. RATIONALE FOR THE TRANSACTION

[✂] RATIONALE FOR THE TRANSACTION

4.1 Sonoco has previously provided the CMA with the two predominant reasons for the acquisition:

4.2 First, to enable Sonoco to enter the German market. Sonoco's presence in the German market was limited to paper and industrial converted products and Sonoco previously had no German presence in consumer packaging. Almost half of Weidenhammer's sales (approximately €118.6m out of €248.8m worldwide) are in Germany and the transaction was strategic for Sonoco to enter this market.

5. MARKET DEFINITION

Introduction and summary

5.1 The Decision uses as a frame of reference the production and supply of composite cans for food products in the UK.[17] Sonoco and Weidenhammer are both active in the consumer packaging market in the UK. In the view of the Parties, the consumer packaging market comprises a number of packaging products that constitute a single packaging market. The standard test to identify a relevant market is where there is a set of products with respect to which a hypothetical monopolist could profitably impose a small, yet significant, increase in price. The Parties submit that such an increase in price would not be possible for composite cans for food products in the UK.

5.2 Composite cans compete with other packaging formats. This is not only because different formats can offer the same characteristics and functionality but because other packaging formats offer at least as good profitability opportunities for manufacturers. Customers of composite cans are diverse. Although not all customers may be willing to switch to a particular packaging format, all customers could switch to at least one other format (and typically many formats). This is evidenced by: the fact that almost all products are offered in several formats (see paragraph 2.5 above); customers normally invite tenders from a wide range of packaging suppliers; and there are many examples of customers switching between packaging types. As switching occurs often and without warning, it is not possible to be able to predict which customers would or not switch in response to a price increase.

5.3 On the supply-side, producers of composite cans for non-food applications could quickly and easily adapt their production processes to compete to supply composite cans for food applications.

5.4 For these reasons the relevant market to be considered with respect to the merger should at least include all paper and board packaging and, arguably, all types of consumer packaging.

Competition between different packaging formats

5.5 Sonoco and Weidenhammer are both active in the consumer packaging market in the UK. In the view of the Parties, the consumer packaging market comprises a number of packaging products that constitute a single packaging market. The packaging forms that the Parties include in the

[17] The Decision, para. 10

UK packaging market include flexible packaging, paper and board packaging, plastic containers (rigid plastics) and metal packaging.

5.6 These products compete against each other in different ways.

5.7 First, although some alternative packaging formats appear different, they all can generally offer the same characteristics and functionality. Special requirements of the packed consumer products such as tamper-proof protection, oxygen-proof sealing, re-closability or inner-liner specifications can be met by most forms and materials of consumer packaging. A customer that requires packaging that meets those technical specifications has a choice of many formats. Customers also have choices where the packaging format is chosen for presentation or marketing purposes. For example, a customer that wishes the packaging to be transparent (so the customer can see the product) could choose flexible plastic pouches, plastic tubs or glass jars. A customer that wants a packaging type that has a premium look could choose between glass jars or composite cans. As different types of packaging serve both functional and marketing needs, it makes the various formats highly substitutable for manufacturers and end consumers.

5.8 Second, different packaging formats compete with composite cans because they offer at least as good profitability opportunities to manufacturers. Manufacturers purchase composite cans and other types of packaging in order to fill with their products and these are then supplied to downstream retailers. Manufacturers earn profits from the difference between the cost of producing the good (including the cost of packaging) and the price at which they sell products to retailers (such as supermarkets). Manufacturers will be prepared to switch between two types of packaging that allow them to achieve the same level of profitability. This means so long as there are customers that will be prepared to buy in different formats (which do not need to be the same customers), manufacturers will find different packaging as substitutable. Different packaging formats are therefore highly substitutable for manufacturers.

Low switching costs leads to price elastic customers

5.9 The Parties believe that the costs of switching the material or form of consumer packaging for a manufacturer is generally low as long as the switch is from rigid to rigid, such as a switch from composite can to rigid plastic or tin. The Parties believe that – contrary to the views expressed in the Decision – the customer's production lines can, in most cases, easily and at low cost be adjusted to a new rigid packaging form. New machinery or extensive staff-training is not necessary. A switch from rigid to flexible would be more expensive than a rigid-to-rigid switch, but since flexible bags are already cheaper than rigid cans, a price increase for composite cans and the consequential larger cost advantage gained from a switch to flexible packaging can justify an investment by a customer in a new packaging line.

5.10 The cost of switching could be minimised by choosing a switching time that the product was due to be altered anyway. During the year, customers will make changes to the production run, for example, where there is a change in the ingredient list or a redesign of the label. The customer will already incur costs to make those adjustments and so could use one of those occasions to switch to another packaging format. In addition, it is common industry practice for consumer packaging suppliers to incentivise customers to switch packaging formats by bearing some or all of any switching costs through low cost equipment leases and cash incentives.

5.11 The above assumes that the customer does not already offer the product in alternative packaging. If instead the product is offered in a range of formats (which most products already are) then the customer is able to swiftly switch between packaging formats. The customer could achieve that by focusing its promotional efforts on one packaging format rather than another. In this way, customers can almost costlessly switch between packaging formats in reaction to changes in relative price. This can occur for example because consumer packaging is subject to different raw material costs and seasonal variation. As the changes in costs flow through to the price of packaging, it leads to switching behaviour among fillers. For example, the costs of producing tin cans (and therefore the cost to customers) vary considerably depending on the raw material price. In the past, both Weidenhammer and Sonoco have experienced customers switching from tin to composite cans when an increase of metal prices was perceptible as a consequence of strong global steel markets, and *vice versa* when steel prices fell (See example in 5.12(e)).

Evidence of switching

5.12 The ability of customers to switch between packaging formats is evidenced by the many examples of switching.

(a) Recently, [✂] business converted its volume from Sonoco composite cans to self-manufacture single wrap paperboard cans for products [✂]. This packaging is produced by [✂] and its co-packer [✂] who have invested in machinery together. This sort of conversion is quite easy for the customer to make and ensures that customers maintain adequate pricing leverage.

(b) Customer switches between different forms of consumer packaging including: baked beans that shifted from metal cans to plastic jars and thermoformed tubs, and also soups that no longer are offered solely in metal cans, but also in stand up sachets.

(c) Another example is in the powdered beverage segment. Traditionally, Sonoco supplied composite cans for products such as [✂] and cocoa. Recently, there has been a push to attract a younger demographic to consume these products and this trend has led to the introduction of new, differently shaped packaging. [✂].

(d) New packaging is generally well accepted by customers in the consumer goods industry and may serve as a marketing tool (e.g. in re-launches) or differentiator (e.g. for new product entries). There has been switching between tin and composite cans for coffee [✂]. Additionally, when the cost of tin increased, other food producers [✂] converted to less expensive composite cans but reverted back to tin when raw material prices dropped.

(e) Switching has also occurred between composite cans and flexibles. The growth of coffee being sold in flexible packaging (such as refills and premium, barista-style coffee) has impacted the demand for composite tubes. Different packaging formats are interchangeable as coffee is sold in flexible packaging, plastic cans, metal cans and composite cans (as well as glass jars).

5.13 The Decision has identified that for "some" products, composite cans are the only or most suitable packaging format.[18] However, what matters is not whether "some" customers would not be prepared to switch but whether there are enough marginal customers that would switch. The claim that customers would not be prepared to consider other packaging formats seems inconsistent with what we observe: customers offer their products in a wide range of formats (see Annex B for example); and there are many examples of customers switching. The danger for the suppliers of all types of packaging is that it is hard to identify which customers would or would not switch. The risk of raising prices to a customer is that, if they are wrong, the customer would be lost to composite cans indefinitely.

Supply side substitution

5.14 Suppliers of composite cans for food applications would face the threat of suppliers of composite cans for non-food applications switching to the production of composite cans for food if prices rose. There is no material difference between the cans that are supplied for food and non-food applications. The CMA has raised concerns that producers of composite cans for non-food applications would face costs to make the factory suitable for food applications.[19] However, as manufacturers of composite for non-food applications often already supply supermarkets, Sonoco believes that many of those manufacturers would already have similar hygiene standards to Sonoco.[20] Therefore any costs to meet food hygiene standards are likely to be minimal. There would be few additional costs that a non-food manufacturer would occur in order to supply for food applications.

Closest substitutes

5.15 The Parties consider that a hypothetical monopolist of composite cans would not be able to profitably raise prices due to the switching that would occur. Customers are diverse and the alternatives they switch to will differ. However, what matters is the total aggregation of switching that occurs, not whether an individual product is a good substitute for all customers. Given the substitution available, the Parties believe that it would be appropriate to define the relevant market as including all types of consumer packaging.

5.16 In the event that the CMA does not accept a market for all relevant consumer packaging materials, then Sonoco would submit that for the purpose of the share of supply test, the products to consider are: i) paper and board packaging, and (ii) rigid plastics.

5.17 Paper and board packaging would include both spirally wound composite cans and single wrap cans. This definition would include rivals that produce composite cans [✂] who produce cans for home care products, household chemicals, pet care, food, and specialty cans for the alcoholic beverage market. [✂] who derives a large portion of revenues from barrier food packaging also serves many of the same markets as Sonoco and Weidenhammer like powdered infant formula.

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18 The Decision, para. 66.

19 The Decision, para. 86.

20 [✂]

In the 2013 consolidated financial statement [✂] leadership lists Weidenhammer as a competitor.[21]

5.18 The definition would also include companies [✂] that produce single wrap cans to serve many of the same markets that the Parties do. The Decision argues that the companies do not currently supply products for food service in the UK.[22] However, the relevant question is whether they could supply the food industry quickly and low cost. The Parties believe they could.

5.19 While [✂] primary business in Europe is in foodservice packaging, according to the company website, they are also "a leading producer of formed paper containers for retail food supplying many leading FMCG brands." Both [✂] and [✂] are able to supply equipment to their customers to form their single wrap packages on site thereby giving them a freight advantage to traditional composite can manufacturers which must ship their products to customers in the round form. [✂] is also adding barrier packaging to its traditional single wrap portfolio to compete in markets traditionally served by the composite can. The [✂] website touts [✂] "innovative material and barrier technologies (which) provide great food protection and extended shelf life." A recent article on the website FoodProductionDaily.com detailed how [✂] has teamed up with [✂] to launch a range of 200ml pots in the UK which are lined with an aluminium barrier layer to keep snacks fresh.[23] [✂] pots are being used for [✂] two snacks: the [✂] and the [✂]. The [✂] is twist on the traditional crisp, containing chickpeas, wholegrain spelt and yellow split peas. The [✂] is a savoury nut, lightly roasted pea and seed cluster. A few photos of these packages are embedded below.

[✂]

Geographic market

5.20 The evidence suggests that customers could economically import packaging from an overseas supplier.

5.21 The CMA notes that transport costs are around [✂]% of the price of the goods.[24] However, the relevant test is the cost of transport for export sales compared to domestic sales. For example, the table below shows the mean transport cost as a percentage of the sales price for each plant of the parties (in total and then separately for the plants domestic sales and for export sales. The table shows the difference between the figure for domestic and export sales.[25] The data shows that the difference in average transport costs between domestic and European is [✂].

Table 1: [✂]

5.22 The merged entity already exports products to countries that are different from the countries where the products are manufactured. For example, from the UK, Sonoco delivers to Italy,

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21 [✂].

22 The Decision, para. 113.

24 The Decision, para. 102.

Canada, Ireland, Estonia, the Netherlands, Germany, France and Norway.[26] Sonoco also imports around [✂]% of its composite cans sold in the UK from its plant in Lieven, France. This shows it is possible to import composite cans into the UK from abroad.

6. OVERLAP BETWEEN THE PARTIES

6.1 In the UK the Parties have a horizontal overlap in the manufacture and supply of consumer packaging. In respect of rigid paper containers, the overlap between the businesses in the UK is for rigid paper containers with a capacity of up to 3,000ml.

6.2 This is a general description of the degree of overlap between the Parties. However, there are a large number of customers that the Parties would not closely compete for in the counterfactual. The assessment of whether an SLC will occur should reflect that.

[✂]

Table 2: [✂]

6.3 The transaction will have little or no effect on the following customers.

(a) [✂] Sonoco supplies [✂] under a contract which expires in [✂]. The contract uses open-book pricing which adjusts prices according to changes in input costs [✂].

(b) [✂] would account for [✂]% of the merged entity's sales. [✂] signed a contract with Weidenhammer in December [✂] lasting for [✂]. The contract uses open-book pricing which adjusts prices according to changes in input costs. [✂].

(c) [✂] would account for [✂]% of the merged entity's sales. [✂] contract with Weidenhammer GmbH runs until the end of [✂].[27] The [✂] budget provides for [✂] cans to be made in the UK but the production of cans for is being transitioned back to Germany. [✂].

6.4 Second, there are a large number of composite can specifications that the merging entities do not currently directly compete for. The nature of the composite can production is that each line is set up to produce cans of a specific type. The Parties estimate that the cost of a diameter change is around [✂] for a metal end seamed and [✂] for a recess membrane and it would take [✂] to get the line up to optimal speed. If it is true that these costs make it difficult for suppliers to change production, then it implies the merging Parties are not close competitors for those specifications for which their lines do not overlap. If changing specifications is possible then there are other firms that are equally well-placed as Weidenhammer to adjust their production lines to meet the requirements of a customer.

6.5 The table below shows each of the Parties' production lines, the type of composite each is configured to produce and the number of cans that each line produces. The table also identifies the overlaps. This is based on two levels of overlaps: overlaps of the same diameter and closure;

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26 [✂].

and overlaps of the same diameter. The latter reflects a more conservative approach to assessing overlaps as it assumes firms could change the closure relatively easily.

Table 3: [✂]

6.6 The table above shows the Parties do not overlap for all composite can specifications.

- Overlaps by can diameter & closure account for [✂]% of Sonoco's can volumes and [✂]% of Weidenhammer's can volumes.
- Overlaps by can diameter account for [✂]% of Sonoco's can volumes and [✂]% of Weidenhammer's can volumes.

6.7 The argument that entry and expansion of composite production lines are not easy, implies that the Parties are not close competitors for those products. To the extent that the Parties compete for those other specifications due to the ability to switch production lines, then other producers of composite cans are equally well-placed to do the same.

7. CUSTOMER BUYER POWER

7.1 The merged entity would have several large customers that would together account for [✂]% of the merged entity's sales (see [✂]**Error! Reference source not found.**). These customers would have considerable buyer power.

7.2 First, the significant volumes of composite cans that large customers purchase gives them a wide range of options (we discuss these in more detail in Section 10):

(a) The volumes of these customers are large enough that they could require an alternative composite can supplier (including suppliers not currently producing composite cans for food in the UK) to enter the market, introduce a new production line or switch a production line to the manufacture of the required products.

(b) The customers could switch some of their products to (or focus promotional efforts more heavily on) alternative packaging formats.

(c) The large customers have relationships with the Parties all over the world. The customers could react to a price increase in the UK by switching their purchases in another country to a rival.

7.3 [✂]. Given that the UK business is likely to be [✂] (see Section 9) it would be a risky strategy to impose any material price increases on these customers. If a large customer were to sponsor entry of a new competitor or switch some products to an alternative form of packaging, those sales would most likely be lost indefinitely.

7.4 The Decision claims that, as contracts are individually negotiated, customers that have buyer power will not be able to protect smaller customers.[28] Even if this is true, the CMA should recognise that the merger will not create an SLC in respect of those customers with buyer power, which will account for up to [✂]% of the merged entity's sales in the UK. The analysis would

[28] The Decision, para. 208.

then turn to whether the remaining customers (small customers – see paragraph 10.30 onwards) have sufficient options to defeat a price increase on them.

8. BARRIERS TO ENTRY

8.1 The CMA concluded that there are high barriers to entry into the relevant market.[29] The main evidence for this conclusion appears to be: the investment required to start a new line, the time taken to establish a new plant, the lack of entry of new firms and the number of firms that have left the market. Despite these concerns, the threat of entry and expansion will impose a constraint on the merged entity when one considers how such entry is likely to occur. (We discuss entry further in Section 10.)

8.2 The most likely means for new entry or expansion to occur is if a large customer sponsored the entry, which would involve few risks for the rival supplier. The customer could enter into a long term contract to ensure that the supplier obtained a return on its investment to establish the composite can facility in the UK. In contrast, it is the incumbent supplier (the merged entity) that faces the risk that its UK composite can assets will be underutilised should the customer switch to another supplier or an alternative packaging format.

8.3 The Decision notes there has been no entry in the composite can market in the UK in the past five years. There was however a significant entry in 2008: Weidenhammer. Weidenhammer entered on the back of a contract [✂], without previously having a presence in the UK.

8.4 A new entrant would not necessarily have to establish a new plant but rather extend one that already has similar facilities. For example, [✂] could with the support of a large customer expand their plants or suppliers of composite cans for food applications and could invest in complying with the relevant standards. The time periods and costs for a "new entrant" may therefore be overstated.

8.5 The Decision identifies that there has been market exit. These exits have been due to poor profitability driven by the lack of pricing power that suppliers of composite cans have. It is for this reason that the merged entity would not be able to raise prices.

9. THE RELEVANT COUNTERFACTUAL[30]

Introduction and summary

9.1 The impact of a merger is the difference between what happens following the merger (the factual) against what would have happened without the merger (the counterfactual). The relevant counterfactual may be the status quo if the market would have carried on as it had previously in the absence of the merger. The evidence might instead show that, absent the merger, there would have been a material change in the market structure. For example, the market may have lost production capacity [✂].

9.2 Applying a different counterfactual to the status quo might increase or decrease the assessed loss of competition from a merger. In an extreme case where one of the Parties to the merger

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[29] The Decision, para. 184.

[30] Compass Lexecon and FTI have assisted Sonoco in preparing this section.

would have inevitably closed (and those assets lost to the market), the merger may have no impact at all ("the failing firm defence"). If one (or both) of the Parties were planning to reduce capacity, then the relevant counterfactual ought to reflect that. The impact of the merger may be substantially less than if the status quo was used.

9.3 In this case, the evidence shows that in the counterfactual neither Sonoco nor Weidenhammer would be financially viable without some form of rationalisation. [✂].

- First, the UK has excess capacity for composite cans and demand is falling. There is no reason to expect that market conditions are likely to improve. This ongoing trend has led to past consolidation [✂].
- [✂]
- Third, Sonoco plans for the merger to offer an opportunity to achieve cost-saving efficiencies that would materially improve profitability. Rationalisation will inevitably occur in the counterfactual. The transaction will allow that rationalisation to occur in an efficient and orderly manner.

9.4 Sonoco has already made submissions in respect of the failing firm defence.[31] In a submission on 16 December 2015, [✂]. Even if the failing firm defence was not met, the CMA ought to recognise that the counterfactual is not the status quo, but rather one in which the market will undergo significant rationalisation. Using the status quo as the counterfactual grossly exaggerates the impact of the merger.

The UK composite can industry is in decline

9.5 The status quo may be the relevant counterfactual for an industry that is stable. If the industry is not changing too much then the past behaviour may be a good indicator of what would happen absent a merger. That does not apply to composite cans. Demand for composite cans in the UK has been in a decline over the past decades (as the evidence below shows).

9.6 The main reason for the decline is that customers have been switching to cheaper packaging such as plastic pouches. Products that have been traditionally only offered in composite cans now come in a variety of packaging formats. Although these different product offerings allow the food manufacturer to generate new demand for their products, there is also a substitution effect as end consumers switch from the product in composite can to the same product in cheaper packaging formats. Demand for composite cans is also falling as production moves overseas. For example, as Sonoco has identified, the growth of [✂] has led to a decline in purchases of composite cans in the UK.[32] [✂] produce and package their house brands in Germany. Their growth has displaced UK rivals who package their brands in the UK.

9.7 Although industry level data is not available for the UK, other evidence shows that demand for composite cans in the UK has been in a steady decline over the past decade. First, there has been a large amount of consolidation within the composite can sector over the past few years as firms have struggled to achieve sufficient throughput and been unable to operate profitably.

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31 [✂]

32 [✂]

Firms that have exited the supply of composite cans include: Robinson that had been operating at loss before Sonoco acquired it in 2011; [✂] that exited the supply of composite can for food applications; [✂] which Weidenhammer purchased [✂] in 2009; and ABPS which Sonoco acquired in 2012.[33]

9.8 Second, despite the consolidation, the figures available on UK composite can capacity utilisation suggests it is well below that of plants in the US and Europe. This suggests that the current level of demand is low relative to the production capacity available. There is limited information available to show total capacity for different countries. However, as an indication we can look at capacity utilisation for Sonoco and Weidenhammer in the UK, Europe and US.

9.9 The chart below shows the capacity utilisation for 2015 for the lines in Sonoco's plants in the UK and Europe, and the overall capacity utilisation in the US. [✂].

[✂]

9.10 Third, consumer marketing data shows that the number of product launches for composite cans is declining while those of other packaging formats is increasing.[34] This provides an indication of where the market is trending. By far the highest number of product launches is in flexible packaging [✂].

Table 4: [✂]

9.11 We have analysed the profitability of Sonoco's composite can business in the UK using the company's management accounts and budgets. The results are set out in the table below. [✂] These calculations are conservative. We have excluded: [✂]; and additional contributions to its pension scheme [✂]. These omissions mean that [✂]. In addition, the ROCE is overstated as it is based on historical cost asset values, not current cost values.

9.12 Sonoco UK's US parent, Sonoco Products, is a quoted company subject to vigorous shareholder scrutiny. Shareholders expect that any businesses that are poorly performing will be sold, rationalised, or closed. [✂] Sonoco has a long history of closing businesses that do not meet those standards, as shown in the table below.

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33 [✂]

34 [✂]

Table 5: Sonoco business unit closures

Term	Closures / sales announced
2013	Closure of thermoforming operation in Ireland
	Closure of rigid paper packaging plant in the US
	Closure of small tube and core operation in Europe
	Sale of small corrugated box operation in the United States
2012	Closure of a paper mill in Germany
	Closure of paperboard-based protective packaging operation in the United States
2011	Closure of a flexible packaging facility in Canada
	Closure of a thermoformed plastic packaging facility in Canada
	Closure of a tube and core facility in France
	Closure of a fulfilment service center in the United States
	Closure of a point-of-purchase display manufacturing facility in the United States
	Sale of a plastics operation in Brazil
	Sale of a tubes and cores operation in the United States

Source: Sonoco Products 2013 Annual Report (p 20)

9.13 [✂]. We have compared the performance of Sonoco's UK business against Sonoco's US composite can business, Sonoco Products group and a range of US paper and packaging firms. The following chart shows EBIT margins for these businesses, using data from a recent brokers' research report. The chart shows that such businesses achieve margins between [✂]% and [✂]% with an average of [✂]%. [✂].

[✂]

9.14 [✂]. The production lines for composite cans are set up to produce cans of specific diameters (and can accommodate different heights). Lines can be retooled to change the diameter, but this is costly and lines cannot be regularly switched between different diameters. [✂].

- No new significant contracts could be expected to come onto the market in the short or medium term, [✂].
- Any attempts to reduce costs by closing individual lines would reduce its addressable market and number of opportunities it bid for.
- The pressure on prices from alternative packaging formats and other UK suppliers with excess capacity would have been expected to keep prices at their current levels or lower.

The transaction will enable the merged entity to achieve a reasonable profit

9.15 Once the [✂] contract ends, both Weidenhammer and Sonoco will be operating [✂] in a shrinking market. It is clear that some form of rationalisation to achieve cost reductions will be needed for the businesses to be profitable and financially sustainable.

9.16 Excess capacity in the market as a whole cannot be resolved by simply closing production lines, as different lines are needed to produce different sized cans. As discussed below, [✂] of Weidenhammer's [✂] production lines overlap in terms of can specification with Sonoco's [✂]. Cost reduction in the market overall could not therefore be achieved by simply closing production lines to eliminate surplus capacity. Instead, Sonoco's proposed rationalisation of its own business with Weidenhammer's will enable it to reduce costs by:

- Moving [✂] operations [✂] and reducing property costs.
- Improving operational efficiency by introducing more flexible team working enabling teams to work across a greater number of lines.
- Eliminating duplicated management and overhead costs associated with two businesses.

9.17 Sonoco's proposed rationalisation of its own business with Weidenhammer's will enable it to reduce costs [✂].

Table 6: [✂]

9.18 [✂]. The transaction will allow this to occur in a more efficient and orderly manner.

10. THE MERGED ENTITY'S ABILITY TO RAISE PRICES[35]

Introduction and summary

10.1 The relevant counterfactual is one in which there would be exit or rationalisation in the market. However, on a conservative basis, we have made our assessment using the status quo. We find that, regardless of the counterfactual that one adopts, the evidence does not support the claim that the merged entity would be capable of profitably raising prices.

10.2 First, as noted earlier, the merger will not affect a large proportion of customers. Customers accounting for around half of the merged entity's UK composite can sales are either protected from price increases for the foreseeable future or are switching to an alternative supplier. Many of the Parties' production lines are set up to produce composite cans at a different specification to one another. If the CMA claims that there are barriers to installing new lines, this means the merged Parties were not close competitors for a large proportion of products.

10.3 Second, to the extent that some customers may be affected by the transaction, the merged entity is not in a position to raise prices to those customers.

- The merged entity would not risk increasing prices to "large" customers. These customers would each account for a [✂] proportion of the merged entity's sales. These customers have strong outside options to defeat a price increase including (but not limited to): organising with an alternative supplier to enter the relevant market or

[35] Compass Lexecon and FTI have assisted Sonoco in preparing this section.

introduce a new line or switch a line; switching some of their products to alternative packaging formats; switching purchases to rival suppliers in other countries and retaliating in other countries or in respect of other products.

- The merged entity would not be able to profitably raise prices to small customers. Small customers have strong outside options including (but not limited to): switching to a rival UK composite can supplier and switching to other types of packaging. We find that under reasonable assumptions rival UK suppliers (alone) would have sufficient capacity to defeat a price increase on small customers.

10.4 To conclude, the evidence suggests that the merged entity would be unable to [✂] increase prices.

The merged entity would not be able to raise prices to large customers

Introduction

10.5 We consider whether the merged entity would be able to raise prices to large customers. We find that "large" customers [✂] account for a [✂] proportion of the merged entity's sales. The "open-book" system allows customers to closely examine the costs that make up the price, identify unjustified price increases and react. These customers have strong outside options that would be sufficient to defeat a price increase:

- The volumes of these customers are large enough that they could organise with an alternative supplier to enter the relevant market, introduce a new production line or switch a production line to accommodate the large customer.
- The customers could switch some of their products to (or focus promotional efforts more heavily on) alternative packaging formats.
- The large customers have relationships with the merged entity all over the world. The customers could react by switching its purchases in another country to a rival.

Amount of switching required

10.6 To impose buyer power requires that the customers have sufficient outside options to defeat a price increase. The Decision identified that many customers view the merging Parties as their only options.[36] Even if this were true, that is not sufficient to show the merged entity is able to raise prices. To defeat a price increase does not require that all customers are able to switch or even the majority. A price increase will be unprofitable if sufficient customers switch such that the loss of sales outweighs the gain from the higher price. This can be estimated using "critical loss analysis". The "critical loss" is the amount of volume that would need to be lost to make a price increase unprofitable. This can be calculated using gross margins. (See Annex A for more details on critical loss calculations.)

10.7 We have used the open-book price schedules to estimate the critical loss for each large customer. The open-book price schedules identify the direct material and labour costs to produce a given

[36] See for example, the Decision, para. 140

item. On top of those costs Sonoco adds a "conversion" margin. The conversion margin covers the contribution of the product towards the fixed costs of production (e.g. depreciation, and all overheads) and profit. Therefore it is a reasonable estimate of the gross margin for a given customer.[37]

Table 7: [✂]

10.8 As the table above shows, the critical loss ranges for different customers due to different margins that Sonoco receives on production lines. For example the [✂] contract has a critical loss of up to [✂]%. Put another way, if the merged entity sought to impose a price increase on these customers they would need to have at least (in most cases much higher) [✂]% accuracy rate in predicting whether the customer would accept that price increase. A further benefit of the open-book pricing for a customer is that it would know the margin that the merged entity is achieving on it and therefore would know precisely how much volume it would need to switch away in order to defeat a price increase. When assessing whether the critical loss is satisfied, it does not matter where that volume is lost to. The reaction of customers may be very different. This is especially the case in industries where customers are diverse. As has been previously submitted[38], the high volume that large customers purchase allows them to enjoy a wide range of options to satisfy that demand. All should be aggregated as part of a critical loss. For example, all of the following should be included when calculating the loss of volume (this list is not exhaustive):

- A customer switching to a rival supplier in the UK
- A customer switching some volume from the merged entity in another country to a rival supplier.
- The customer reducing purchases of composite cans (and not purchasing elsewhere).
- The customer switching some of their product to alternative packaging.

10.9 It also does not matter on which products or where the customer takes these actions in order to harm the merged entity. For example, suppose the merged entity knew that the customer was captive to composite cans for product "A" in country "X". Even if that were true, the customer could just as effectively exercise its buyer power against the merged entity by switching to another supplier of a non-captive product "B" in country "Y". This is particularly relevant for the merged entity's large customers who typically buy composite cans and other types of packaging for many different products (see Annex B) and also purchase from the merged entity in different countries (for example [✂] purchases from Sonoco in the UK and Germany).

Options available to large customers

<u>Sponsoring the entry or expansion of a rival supplier</u>

[37] Arguably some additional costs might be variable if the merged entity lost a large customer. For example, if [✂] were to switch away, the merged entity may be able to reduce some overhead. However, the purpose of the calculations is to provide an indicative critical loss.

10.10 The Decision raised concerns that rival UK suppliers of composite cans are only large enough to service small and medium sized customers.[39] However, the reason for this is that in the absence of a long-term contract to supply a major customer, it would be highly risky and costly to install production capacity. The large customers are likely to have the necessary scale of purchases to sponsor a rival supplier to invest in a production line.

10.11 Such entry would entail little risk for the rival supplier, as the customer could enter into a long term contract to help to ensure that the supplier obtained a return on the asset. In contrast, it is the incumbent supplier (the merged entity) that faces the risk that its asset will be stranded should the customer switch. Although there may be some switching costs for the customer, the merged entity would have to weigh up the risks that, once the customer switches, it would lose the customer indefinitely.

10.12 The customer could sponsor either an existing supplier of composite cans for food or a supplier of cans for non-food applications.

- The customer could sponsor entry of an existing supplier of composite cans for either food or non-food applications. The customer could sponsor (say) [✂] to install a new production line in order to supply a certain type of composite can.[40] One of the customer's overseas suppliers may also be interested in setting up a production line near the customer.
- The customer could also sponsor a producer of composite cans for non-food applications to switch a line to produce cans for food applications. The CMA has raised concerns that producers of composite cans for non-food applications would face costs to make the factory suitable for food applications.[41] However, as manufacturers of composite cans for non-food applications often already supply supermarkets, Sonoco believes that many of those manufacturers would already have similar hygiene standards to Sonoco.[42] Therefore any costs to meet food hygiene standards are likely to be minimal. There would be few additional costs that a non-food manufacturer would incur in order to supply for food applications.

10.13 The evidence shows that much of past entry and expansion has been on the back of major contracts. These have been already provided and include the following Europe examples:[43]

- [✂]
- Weidenhammer entered the UK market and acquired Chesapeake's Bradford business.
- Weidenhammer opened a dedicated line to produce [✂] cans [✂].

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39 The Decision, para. 94.

40 As noted above, to defeat a price increase does not require a customer to switch all purchases. It only requires it to switch enough. Switching (or threatening to switch) the purchases of only one type of composite can may be sufficient to deter the merged entity from raising prices.

41 The Decision, para. 86.

42 [✂]

43 [✂]

- Weidenhammer's Mechelen, Belgium facility is a bespoke production facility [✂].
- Weidenhammer's Inofita in Greece focuses on [✂].

10.14 The nature of supplying large customers therefore has features of a bidding market. Rivals are in effect competing to install or allocate a production line to supply the customer on a long term basis. Because these contracts are large and irregular, they are likely to encourage vigorous competition. The merged entity would have to consider that customer-sponsored entry was a serious risk. The added risk is that should a customer take such an action, the loss to the merged entity would be indefinitely leaving its own capacity unused.

Switching products to alternative packaging

10.15 As has been previously submitted, the Parties face the on-going risk that customers will switch products to alternative packaging following a price increase.[44] The Decision identified several reasons why some customers were not prepared to switch including: maintaining the brand image; the physical characteristics of the composite can; switching costs and tender data (showing prices are lower for alternative packaging).[45] However, these arguments do not prove that switching to alternative packaging is not a constraint.

10.16 First, it does not matter that "some" customers are not able to switch their products to other packaging formats. What matters is whether "enough" customers could switch, or whether the customer (that faces a price increase) could switch "enough" volume away. This means that what it is most relevant is not the overall market's views on substitution, but rather the options available to individual customers or groups of customers and whether any customers that are captive to composite cans can be identified. It may be that, although some, or even most, customers wish to continue to supply products in composite cans, there is sufficient switching at the margin between composite cans and other options to defeat a price increase.

10.17 Second, although there may be switching costs involved in entirely switching a product to another packaging format, there are significant benefits for the customer. The merged entity notes there are likely to be few switching costs moving from a rigid composite can to another type of rigid can (such as plastic or tin).[46] Sonoco believes that the transition for some customers could be quite simple. For example, confectionary products are packed by hand and so there would no material costs involved in switching.

10.18 Switching from a rigid composite can to flexible packaging (such as plastic) would entail greater costs. However, we understand that in some instances the firm offering the alternative packaging will pay the customer's switching costs.[47] Furthermore, as the Decision notes, packaging such as plastic is much cheaper than composite cans.[48] Sonoco estimates plastic flexible packaging may

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44 [✂]

45 The Decision, p. 8.

46 [✂]

47 This would not be expected to increase the price that a customer pays. The optimal price is determined by variable costs. Fixed costs, such as paying for switching costs, would affect the decision for the supplier on whether to make the offer or not but should not affect its prices.

48 The Decision, para. 57.

be around [✂]% cheaper than a composite can.[49] The Decision argues this price difference suggests flexible packaging is not in the same market.[50] On the contrary, the price differential makes flexible packaging [✂] attractive to customers as it offers the opportunity to achieve higher margins. The lower prices make it worthwhile for the customer to switch even if it has preferences for composite cans. Whether it is worthwhile for a customer to switch therefore depends on whether different packaging formats will create new demand or induce consumers to switch from composite cans in exchange for lower prices. One would expect that the merged entity's customers would be constantly weighing up that possibility in pursuit of higher profits. The danger that this presents for the merged entity is that, although customers may be more reluctant to switch (compared to if there were no switching costs), a customer that switches is likely to be lost indefinitely. This raises the stakes for the merged entity.

[✂]

10.19 Third, even if entirely switching a product to alternative packaging is not feasible, there are other ways a customer can reduce purchases of composite cans that would avoid the barriers that the Decision identifies. For example:

- Rather than dropping composite cans altogether the customer could offer its product in multiple packaging formats. This approach would allow those end consumers with strict preferences for composite cans to purchase them, whereas other end consumers can enjoy the product in a cheaper packaging format. The switching of those marginal consumers would harm the merged entity.
- If the product was already available in multiple formats, the customer could exercise its buyer power against the merged entity by focusing its promotional efforts on products in other (cheaper) packaging than composite cans. An increase in price on composite cans would make those other packaging formats relatively more profitable. Switching efforts to those products would not appear to entail any of the costs that the Decision identifies and does not rely on end consumers viewing different packaging formats as substitutable.
- Customers that buy composite cans for a range of products could exercise their buyer power against the merged entity by introducing alternative packaging formats for another product that is not captive to composite cans.

10.20 There is evidence to show that customers of composite cans have been switching to other packaging formats. The Decision identifies that Sonoco has "only" lost around [✂]% of its sales to other food packaging over the past five years.[51] This is a significant amount for a firm [✂]. As noted earlier, it does not take a lot of volume to be lost to make a price increase unprofitable (see paragraph 10.6). Increasing prices would only speed switching to alternative products and, once gone, these customers are unlikely to return.

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50 The Decision, para. 58.

51 The Decision, para. 67.

10.21 Fourth, switching by customers is highly unpredictable. The Decision argues that some customers are not prepared to switch their products to alternative packaging, which would suggest they are "captive" to composite cans.[52] This would only matter if the merged entity was able to identify such customers. That is unlikely. As the Parties have already submitted, most products are now offered in multiple packaging formats.[53] Sonoco has provided numerous examples of where it has competed against rivals offering other types of packaging.[54] The table in Annex B shows that the products of [✂] the merged entity's large customers produce are offered in alternative packaging formats. There appears to be few products genuinely captive to composite cans. Sonoco conducts research in the supermarket [✂] to find new product manufacturing opportunities.[55] It would be highly surprising if suppliers of alternative packaging were not doing the same for products in composite cans.

10.22 The merged entity would not risk imposing a price increase on products that have been traditionally been only supplied in composite cans. As the Parties have submitted already, there have been several recent examples of products that have traditionally been offered in composite cans that are now offered in other packaging formats (either in additional to composite cans or completely switching).[56] This includes: [✂] and cocoa that has been offered in multiple formats; and [✂] that has entirely switched to other formats. The CMA ought to query any customer that claims to have no other options. For example, in [✂] unexpectedly announced to Sonoco that it was switching from pre-formed composite cans to a cheaper carton supplied by a rival. That is contrary to the claims in the Decision that large customers would not consider self-supply.[57]

10.23 To the extent that any products are actually captive, it would be easy for customers to disguise that fact. For instance, they could invite suppliers of other types of packaging to bid as an alternative packaging format. The customer may also do one-off runs of products in alternative packaging as promotional products to test customer demand or as an implicit threat to its composite can supplier. Sonoco advises that large customers hold workshops looking for new packaging ideas, which would send a clear signal that customers were actively considering alternatives.[58] We understand that customers often bring prices of alternative goods to the Parties to use as leverage. It would be very difficult for the merged entity to distinguish between genuine interest in other formats and mere posturing. Customers that use co-packers may also be able to disguise the purpose to which the can is going to be used (if the co-packer purchases the can on their behalf).

Switching purchases to plants in other countries

10.24 Large customers could take advantage of their purchasing power to switch purchases to plants in other countries. This could take different forms, all of which would harm the merged entity.

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52 The Decision, para. 66.

53 [✂]

54 [✂]

55 [✂]

56 [✂]

58 [✂]

The customer could: import composite cans from overseas; switch purchases for a plant overseas to a rival; and move some production of products to plants overseas.

10.25 First, as noted earlier (see section 5), it would be economical for a customer to purchase from overseas if the merged entity was to put up prices.

10.26 Second, the large customers could switch purchases from the merged entity to a different supplier overseas. Even if the customer was captive to the merged entity in the UK, it could effectively exercise its buyer power against the merged entity by switching to a rival in another country. Similarly where a customer produces a product in different countries and has a different supplier of composite cans, it could harm the merged entity by switching some production to the overseas site.

10.27 The merged entity would have several customers that purchase from it in other countries. For example:

10.28 [✂] purchases from Sonoco in the UK and Germany.

10.29 [✂] purchases from Sonoco in the UK, Germany and Poland.

[✂]

The ability of small customers to switch

10.30 "Small" customers account for around [✂]% of the merged entity's revenue. The outside options available to smaller customers differ to those of the large customers. However, the evidence does not support theory that the merged entity could raise prices to these customers.

10.31 Small customers have a range of options including: switching to alternative packaging; switching to rival UK composite can producers; and importing.

- It is possible that some customers may be captive to the merged entity due to their requirements. Given these customers purchase small amounts on an ad hoc basis it would be difficult and costly for the merged entity to assess whether the customer is captive.
- Outside options available to small customers

10.32 Small customers are those customers that purchase less than [✂] in sales. As the purchases of small customers are small and ad hoc, they do not have ongoing supply agreements with the Parties. Given the [✂] size of purchases it would be more difficult for a small customer to sponsor entry. It may be possible for several small customers to combine their orders to enable them to reach the necessary scale to enable a new supplier to enter the market. In any case, even if it would be difficult for these customers to sponsor entry, they have other outside options available to them.

<u>Switching to other suppliers of composite cans</u>

10.33 The volumes of small customers are low enough that current rival UK composite can suppliers would be able to meet their demand. The Decision identifies that the two rival UK composite can

suppliers [✂] compete for small and medium sized customers. [✂] and [✂] would only require a small amount of excess capacity in order to defeat a price increase by the merged entity.

10.34 As noted above, small customers account for only around [✂]% of UK sales of the Parties. If we assume the merged entity has around [✂]% share of supply, then the merged entity's small customers use around [✂]% of capacity used in the market [✂].

- We assume the merged entity achieves a margin of around [✂]% on sales to small customers. Sonoco has indicated to us that this is a reasonable estimate for small customers. Applying the critical loss, [✂]% of small customers would need to switch to make a price increase unprofitable. This means the critical loss equates to around [✂]% of the merged entity's total volume [✂].
- The Decision estimates the combined market shares of the merged entity's [✂] as being up to [✂]%. If so, these rivals would require excess capacity of around [✂]% in order to be able to supply a sufficient volume to small customers to defeat a price increase [✂]. We do not have access to information on the actual spare capacity of these competitors (although no doubt the CMA could obtain this information itself) but we note that the merging Parties' both have spare capacity that well exceeds [✂]% (see [✂]**Error! Reference source not found.**) and we would therefore expect other competitors to do so (even if their spare capacity is not as great as the Parties as the Decision claims[59]).

10.35 The spare capacity of [✂] is likely to understate the actual capacity available for customers to switch to. Although the merged entity's facilities are certified for food applications, the merged entity has some customers that could switch to suppliers of composite cans for non-food applications. For example, the merged entity supplies composite cans to suppliers of [✂]. These composite cans could also be produced by manufacturers of composite cans for non-food applications. Some customers are also likely to be prepared to switch to single wrap can producers [✂].

Switching to other types of packaging

10.36 Although switching to local rivals is likely to be sufficient to defeat a price increase, there are, in any case, other options available to small customers. For example, the customers may instead choose a different type of packaging. As with large customers, small customers may offer their products in a range of packaging and could switch some volumes between them. Customers that are purchasing for one-off promotional products may instead choose to use another type of packaging such as metal or plastic.

10.37 As these purchases are on an ad hoc basis then switching costs may be low (since there would a learning curve regardless of the supplier the customer chose). If the order is entirely new, then rival suppliers would be on an equal footing as the merged entity.

[59] The Decision, para. 148.

10.38 As an illustration of the different options that customers have sought, Sonoco has made many quotations to interested buyers who have ultimately chosen either another or alternative type of packaging.[60]

Importing

10.39 Small customers may also be able to import. As noted earlier, transport costs are relatively low. So long as the customer's order was sufficiently big [✂], it would be able to enjoy those transport costs.

The merged entity would not be able to identify "captive" customers

10.40 The Decision notes that [✂] may not be able to meet the requirements of some customers. Although this would be true, it would only matter if the merged entity was able to identify those captive customers and price higher to them. It is highly unlikely that the merged entity would be able to identify captive customers to the necessary degree.

10.41 As small customers purchase on an ad hoc basis, it would be costly and difficult for the merged entity to investigate and make a judgment on the price sensitivity of each customer. In many cases the merged entity would have no knowledge of what the can was being used for. Furthermore, the customer would make every effort to disguise the fact that they are captive to the merged entity. The merged entity would in most cases be unable to tell whether the customer was able to switch to rival UK composite can manufacturers, switch to other types of packaging or to overseas suppliers.

Conclusions

10.42 To conclude the evidence does not support the argument that the merged entity would be able to raise prices to customers. The reasons for each customer are summarised below.

Table 8: [✂]

11. SONOCO PRICING IN OTHER SEGMENTS[61]

Introduction

11.1 Although the impact of mergers can be sometimes difficult to predict, in this case there are natural experiments to show what could be expected following the merger. Based on the market definition in the Decision, there are locations and products for which Sonoco is already either a monopolist or has a very high market share. For example, Sonoco is the only supplier of a range of composite can specifications in the UK; and Sonoco supplies around [✂]% of composite cans for food applications in the US. If the narrow market definition used in the Decision is correct and the transaction would allow the merged entity to raise prices, then Sonoco would already be capable of charging higher prices for those products and locations. However, that is not the case.

60

61 Compass Lexecon and FTI have assisted Sonoco in preparing this section.

The evidence shows that it treats those customers where it has a "monopoly" no differently to those customers where it faces more direct competitors.

11.2 Sonoco produces a range of can specifications that its rivals do not. If Sonoco did not face other constraints, then we would expect it to be pricing higher for those "non-overlap" products. There is no evidence to suggest that Sonoco prices any differently for non-overlap products than overlap products.

- In the US, Sonoco has a share of supply of around [✂]% of composite cans for food applications. If Sonoco did not face other constraints, then we would expect it to be pricing higher in the US than the UK and be earning high profits. [✂].
- The reason that Sonoco conducts its business in this way is that it is forced to. Regardless of whether it has a direct competitor for composite cans or not, it still faces significant constraints including: the threat of customers switching to other suppliers; the threat of customers switching to cheaper packaging; and the threat of customers moving production off-shore.

Sonoco's prices are constrained by prices for alternative packaging formats

11.3 As noted earlier, the UK composite cans manufacturers have only a certain number of production lines and each produces a specific diameter composite can. Analysing the margins on these lines can provide an indication of the likely behaviour of the merged entity after the transaction. Sonoco already has several lines that produce cans with specifications that no other UK rival offers. If there were concerns that the merged entity would face insufficient constraints post-merger then one would expect that Sonoco would already be pricing higher for those "non-overlap" products (as evidenced by higher margins). [✂].

11.4 To test this we have analysed the conversion margins earned on each of the products that Sonoco manufacturers in its two plants. The conversion margin represents the difference between variable costs and the price, and is shown in the open book price calculations shared with customers. It covers the contribution of the product towards the fixed costs of production (e.g. depreciation, and all overheads) and profit.

11.5 We have assessed the conversion margins earned by Sonoco compared to margins earned on can types (in terms of diameter and closure) which Weidenhammer and other UK manufacturers are capable of producing without incurring retooling costs. These are set out in the table below.

Table 9: [✂]

11.6 The reason that Sonoco does not charge higher prices for non-overlap products is simply that Sonoco faces constraints that go beyond the existing suppliers of composite cans in the UK. As noted earlier, customers have a wide range of alternatives to switch to including: sponsoring a supplier to install or allocate a line; switching to other packaging formats, switching to other UK rivals, purchasing from overseas suppliers.

Sonoco treats US customers in the same way as UK customers

[✂]

Table 10: [✂]

11.7 At an aggregate level, Sonoco's US composite can business [✂] generates an EBIT margin [✂] in line with its overall business and that of the US packaging industry as a whole (see [✂]**Error! Reference source not found.**), despite it having a share of supply of composite cans of over [✂]%; demonstrating that US prices for composite cans are constrained by prices for other packaging products.

12. **ANNEX A: [✂]**

13. **ANNEX B: Non-exhaustive examples of other packaging formats**

Company	Product in composite can	Other packaging formats product offered in	Examples of other packaging formats of rivals
[✂]	[✂]	[✂](Plastic bags)	Various confectionaries.
		[✂](Plastic tubs)	
		[✂](Paper box)	
	[✂]	[✂](Plastic bags)	
		[✂](Foil)	
	[✂]	[✂](Plastic bags)	
		[✂](Bars)	
	[✂]	[✂](Foil)	
		[✂](Plastic bags)	
	[✂]	[✂](Foil)	
		[✂](Plastic bags)	
	[✂]	[✂] (Plastic bags)	
	[✂]	[✂] (Plastic bags)	
	[✂]	[✂] (Plastic bags)	
		[✂] (Foil)	
[✂]	Gravy Granules (Supermarket labels)		Plastic packet, tub, jar
	[✂]Breadcrumbs		Plastic packets
	Breadcrumbs (Supermarket labels)		Plastic packets
[✂]	[✂]	[✂] (Plastic bags)	
	[✂]	[✂] (Foil and paper)	

Company	Product in composite can	Other packaging formats product offered in	Examples of other packaging formats of rivals
[✂]	[✂]	[✂] (Plastic bags)	
	Cocoa	[✂]Cocoa (Jar)	Plastic packet, tub, metal tin
[✂]	[✂]	[✂] (Plastic bags)	
	[✂]	[✂](Plastic bags)	
	[✂]	[✂] (Plastic bags)	
	[✂]	[✂] (Plastic bags)	
[✂]	[✂]Cocoa	[✂]Cocoa (Jar)	Plastic packet, tub, metal tin
	[✂]Hot Chocolate	[✂]Hot Chocolate (Packet)	Plastic tub, jar, metal tin
	[✂]Hot Chocolate		Plastic packet, tub, jar, metal tin
	[✂]Hot Chocolate		Plastic packet, tub, jar, metal tin
	Salt (Supermarket labels)		Plastic pouch, tub, box
	Cocoa (Supermarket labels)		Plastic packet, tub, jar, metal tin
	Chocolate Sprinkles (Supermarket labels)		Plastic packet
	Bicarbonate of Soda (Supermarket labels)		Plastic packet
	Baking Powder (Supermarket labels)		Plastic packet
	Custard (Supermarket labels)		Plastic packet, bag, metal can, aseptic
[✂]	[✂]Gravy Granules	[✂]Gravy Paste (pouch)	Plastic tub
		[✂] (packet)	
		[✂]Gravy Powder (box)	
		[✂] (plastic jar)	
	[✂]Custard Powder	[✂]Custard Powder (bag)	Packet

Company	Product in composite can	Other packaging formats product offered in	Examples of other packaging formats of rivals
		[✂]Custard Powder (packet)	
	[✂]Breadcrumbs		Plastic pouch, bag, tub
	[✂]Salt	[✂]Salt (plastic)	Plastic pouch, bag, tub, box
	[✂]	[✂] (bag)	Plastic bag, tub, box