

Anticipated acquisition by Smurfit Kappa Group plc of the UK corrugated packaging operations of Mondi Packaging AG

The OFT's decision on reference under section 22(1) given on 16 April 2010. Full text of decision published 19 May 2010.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Smurfit Kappa Group plc ('SKG')** manufactures corrugated and solidboard packaging, and other paper-based packaging products in 31 countries including the UK. In addition to its corrugated packaging business, SKG owns specialist plants in the UK for composite tubes, solidboard packaging, point of sale and display products and stationery.
2. **Mondi Packaging AG ('Mondi')** is an integrated packaging group and is principally involved in the manufacture of converted packaging products (including corrugated packaging, industrial bags and flexibles), packaging paper and office paper.
3. **Mondi Packaging (UK) Limited and Mondi Packaging (GB) Limited** (together, the '**target businesses**') are subsidiaries of Mondi and together own the three corrugated packaging plants in the UK (at Bux, March, and Mold) which will be transferred to SKG as part of the transaction. The target businesses' collective UK turnover in 2009 was £[] million.

TRANSACTION

4. SKG intends to purchase 100 per cent of the shares in the target businesses.
5. The target businesses purchase corrugated case material (CCM) – see paragraph 7 and footnote 1 below – both from Mondi and third parties. SKG have agreed to honour Mondi’s purchasing agreements with third parties during [].

JURISDICTION

6. As a result of this transaction SKG and the target businesses will cease to be distinct. The UK turnover of the target businesses exceed £70 million, therefore the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

MARKET DEFINITION

7. In the UK, the parties overlap in the manufacture and supply of a) corrugated sheet and b) corrugated boxes. The key input in the manufacturing process is containerboard or CCM¹ which is used as an input in the manufacture of corrugated sheet.² The corrugated sheet is then used in the production of corrugated boxes.
8. The target businesses are ‘integrated plants’ which essentially means they convert CCM into corrugated sheet and are then able to process the

¹ Or ‘Corrugated Case Material’, which is cardboard sheet liner of which there are two broad types – those made from testliner (which is made from recycled paper) and those made from kraftliner (which is made from virgin wood pulp).

² In the production process, the liners are combined with the fluting (the waved or rippled middle sheets of cardboard) to make sheets.

corrugated sheet into corrugated boxes within the same plant.³ SKG operate 'sheet plants'⁴ as well as having integrated plant operations.

CORRUGATED SHEET

Product scope

9. In DS Smith/Linpac, the Competition Commission (CC) considered that manufacture and supply of corrugated sheet for making cases constituted a separate product market.⁵
10. The merging parties submitted that the market for the supply of sheet to third parties for further processing into boxes constituted a separate product market from the self-supply of sheet which occurs at integrated plants such as the target businesses. The parties submitted that the target businesses only had sales of corrugated sheet to third parties in 2009 representing [0-5] per cent of the GB market and that [90-100] per cent of their sheet was used in self-supply. Relevant to the current case, the CC determined that the sheet product market included both sales to third parties and self-supply for further processing into boxes.⁶
11. However, in the present case, it is not necessary to conclude on the precise scope of the relevant product market since no competition concerns arise whichever approach is taken. On a cautious basis, the OFT has considered each possible segmentation.

Geographic scope

12. The parties submitted that the geographic market for corrugated sheet is GB-wide.

³ The parties submitted that around [90-100] per cent of corrugated sheet sold in the UK is produced in standalone sheetfeeder plants (that is, plants which are not integrated and do not have the capability to then go on and process corrugated sheet into, for example, boxes)

⁴ A sheetfeeder plant will produce corrugated sheets from CCM. A 'sheet plant' sources corrugated sheet and processes it into boxes.

⁵ A report on the completed acquisition of Linpac Containers Ltd by DS Smith plc, 21 October 2004, paragraph 4.9

⁶ As part of the transaction SKG will secure supplies of CCM to the target businesses.

13. In DS Smith/Linpac, the CC found that the average delivery distance for sheet was 200 miles from the point of manufacture, but that transport over longer distances was not uncommon. Further, the CC considered that there were overlapping regional supply territories with no clear breaks, and that many sheet suppliers operated a number of plants across the UK, leading to a GB market definition.
14. There are small quantities of imported corrugated sheet from France and Germany but the vast majority is supplied within the UK. In support of a GB market, the parties have submitted that imports account for only [0-5] per cent of third party sales of sheet in the UK.
15. However, given that the outcome of this case is not determined by the geographic market definition, the OFT has not found it necessary to conclude, in line with previous decisions, it has analysed this transaction on the basis of GB.

Unilateral effects

Shares of supply

16. On a GB-wide basis, in the third party supply of sheet (that is, excluding self-supply of corrugated sheet that integrated plants will proceed to make into boxes themselves and their own self-supply from standalone sheet feeders), the parties have a combined share of [15-25] per cent (with an increment of [0-5] per cent). Other players include Boxes & Packaging ([15-25] per cent), DS Smith ([15-25] per cent) and Prowell ([5-15] per cent). Including self-supply from standalone sheetfeeder plants, the parties have a share of supply of [15-25] per cent (with an increment of [0-5] per cent). The parties will continue to face competition from Boxes and Packaging ([15-25] per cent share), DS Smith ([15-25] per cent share), and Prowell ([5-15] per cent share).
17. There is a third segmentation which is to consider the sheet used to manufacture all boxes as potentially being available to third parties. On such a basis, the parties account for [15-25] per cent of supply (increment [5-15] per cent), DS Smith ([15-25] per cent), SAICA ([15-25] per cent) and the rest spread widely among other 'box' plants.

18. Customers contacted by the OFT indicated that these competitors were credible alternatives to the merging parties. Indeed, some customers choose to purchase sheet from several suppliers in order to obtain favourable prices and ensure sources of supply. They informed the OFT switching occurs and is relatively easy.
19. At the local level, one third party complained that, because of transport costs, the parties were the only suppliers located close enough to its plant to economically supply it with corrugated sheet. The OFT considered this complaint carefully, but noted that another sheet customer proximate to the complainant told the OFT that it could obtain sheet from several alternative suppliers. Moreover, this sheet customer had negotiated price decreases in the past.
20. Another third party complained that the price of sheet had not moved (upwards) in line with the price of CCM, and that therefore CCM customers' margins were being squeezed whilst sheet customers were being subsidised. This argument, however, is consistent with excess demand for CCM but excess capacity in the sheet market.⁷ Further, it is not clear that this complaint is merger specific as SKG is not acquiring any of Mondi Group's paper mills as part of the current transaction.
21. There is spare capacity among corrugated sheet manufacturers in GB which the parties estimate to be in excess of [20-30] per cent. They submitted that competitors could easily increase the number of shifts in order to increase their production levels. They argued that in the event of SKG increasing its prices adequate suppliers remain in the market which existing customers could purchase from instead.
22. Consequently, the OFT does not consider that unilateral effects are likely to arise in the supply of sheet as a result of this merger.

Coordinated effects

23. In DS Smith/Linpac the CC examined whether that merger was likely to create or strengthen coordinated behaviour in the industry, especially in the

⁷ See: Review of merger decisions under the Enterprise Act 2002, A report prepared for the CC, OFT, and Department for Business, Enterprise and Regulatory Reform (now know as the Department for Business, Innovation and Skills) by Deloitte.

upstream sheet market but concluded it did not.⁸ In this case, given the target businesses very limited sales to third parties, the OFT did not consider that this merger raised coordinated effects concerns in relation to corrugated sheet.

Barriers to entry or expansion

24. Given that the OFT had no concerns that a substantial lessening of competition would arise as a result of the merger on any basis, it has not been necessary to consider barriers to entry in any detail.

Buyer Power

25. Where relevant the potential strength of customers has been discussed above.
26. Given that the OFT had no concerns that a substantial lessening of competition was created on any basis, it has not been necessary to consider buyer power in any further detail here.

Third Party Views

27. Third party views have already been discussed in other parts of the decision where appropriate.

Conclusion

28. Consequently, the OFT does not believe this merger will lead to a substantial lessening of competition in relation to the supply of corrugated sheet in GB.

CORRUGATED BOXES

Product scope

29. As mentioned above, the parties also overlap in the manufacture and supply of corrugated boxes in the UK.

⁸ Paragraphs 5.50–5.100.

30. In DS Smith/Linpac the CC considered that the manufacture and supply of boxes (corrugated boxes) constituted a separate product market. This analysis was followed by the OFT in SAICA/SCA⁹.
31. The OFT has considered whether the manufacture and supply of corrugated boxes should be further delineated, for example by the strength or size of the corrugated box. However, from the supply-side perspective, third parties indicated that it is easy to switch production to meet any specification.
32. The parties argued that the product market should be as least as wide as corrugated boxes but could also include packaging made from other materials (for example, plastics or wood). However, customers gave mixed responses when asked if they would be willing to switch to other materials if the price of corrugated boxes were to rise, although some indicated that they already use packaging made from a variety of materials. This, in part, reflected that some customers are end users of the packaging whereas other customers are intermediate distributors. On the demand side, some end customers indicated that they could switch to other types of packaging such as plastic crates for some goods.
33. However, it is not necessary to conclude on the precise scope of the relevant product market since no competition concerns are raised even limiting the market to that for all corrugated boxes, excluding all other packaging materials.

Geographic scope

34. In DS Smith/Linpac, the CC considered the geographic market for boxes to be GB.¹⁰ In this case the parties agreed that approach. They advised that they each supply customers up to around 600 kilometres from their plants, and that this would tend to support a GB geographic market.
35. Although, it did not ultimately conclude on the geographic market, the European Commission, has examined corrugated boxes on the basis of a narrower geographic scope of 200 or 300 kilometres from the production

⁹ Anticipated acquisition by Sociedad Anonima Industrias Celulosa Aragonesa of the conventional board business of SCA Packaging Ltd, OFT decision of 4 September 2008.

plants.¹¹ The OFT did not conclude on this point in its most recent case in this sector, SAICA/SCA, but considered the merger on the basis of a local analysis¹² as well as a national one.

36. Third party responses in relation to distance from case suppliers were mixed, but generally supported a 200km from plant market definition. The maximum distance deliveries are made is largely dependant on the frequency of deliveries and whether customers require deliveries at short notice. Most competitors delivered to customers anywhere from 150km to 300km away, although several noted that deliveries can be much further away.
37. Given that the outcome of this case is not determined by the geographic market definition, the OFT has not found it necessary to conclude. On a cautious basis, the OFT has therefore assessed this merger on both a local basis taking as its starting point a 200km radius of each of the production plants, and on a national (GB) basis.

Unilateral effects

Shares of supply

38. The parties have a combined market share of [15-25] per cent, with an increment of seven per cent in the supply of corrugated boxes on a GB basis. There are a number of alternatives including DS Smith ([15-25] per cent), SAICA ([15-25] per cent) and a range of smaller players including Rigid VPK, Boxes and Packaging, Cepac, Encase and TRM.
39. Although, the OFT has been unable to obtain accurate share of supply data, on a more cautious narrower basis discussed above (200 km radii around each of the target businesses), for each of the isochrones around the target business' plants there are at least 15 competitors present and there are five main alternatives to the merging parties (Boxes and Packaging, Cepac, DS Smith, Rigid Packaging, and SAICA).

¹⁰ Paragraph 4.23.

¹¹ For example, Case No. COMP-M.2391 (CVC/Cinven/AssiDomän) and Case No. COMP-M.2032 (SCA Packaging/METSA Corrugated).

¹² ME/3733/08: Anticipated acquisition by Sociedad Anónima Industrias Celulosa Aragonesa of the conventional corrugated board business of SCA Packaging Ltd.

40. Customer responses to the OFT indicate that many customers multi-source and that the products produced by competitors are viewed as being generally substitutable, although some customers perceived differences between SKG's and the target business's corrugated boxes in terms of pricing and quality. Customers that hold tenders advised that as long as there are four to five bidders, their tenders are competitive. Some customers noted that they also use smaller competitors for some of their box requirements. Customers were generally satisfied that they could constrain the merging parties should they attempt to unilaterally raise prices.
41. Competitors indicated that they are not capacity constrained and would easily be able to offset any adverse effects arising from the proposed merger in a timely manner by increasing their production volumes to an extent which would offset the rival production lost as a result of the proposed merger (whether viewed from a national or local perspective).
42. Consequently, the OFT does not consider that unilateral effects are likely to arise as a result of the proposed merger.

Coordinated effects

43. In DS Smith/Linpac, the CC considered that there was little likelihood of coordination in the production and supply of boxes because of the relatively low level of market concentration, the varying scale and structures of box producers and the relative low costs of entry into the market.¹³
44. In SAICA/SCA,¹⁴ the small market share increment and the fact that no third party identified SCA as a maverick, led the OFT to conclude that the merger was unlikely to strengthen or create the conditions conducive to coordination.
45. In the current case, the OFT does not consider that the proposed merger will change the structure of supply to such an extent as to create or enable

¹³ Paragraph 5.52.

¹⁴ Paragraphs 28-29.

collusive behaviour, at either a national level, given the small increment added by the merger, nor indeed on a more localised basis.

46. In any case, there appears to be evidence of strong competition between firms that indicates that co-ordination would not be sustainable: (a) attempts at expansion by B&P, (b) recent expansion by Prowell into the UK (and as such a strong credible commitment to compete), and (c) expansion of SAICA's paper production capacity.
47. The OFT has not received any evidence to suggest that coordination already takes place, whether on prices, geographic territories or product categories.
48. For the reasons given above, the OFT does not therefore consider that this merger is likely to create or strengthen coordinated behaviour, although it has not found it necessary to conclude on whether the main conditions for coordination are present in this market.¹⁵

Barriers to entry and expansion

49. The parties submitted that barriers to entry and expansion are low, which was confirmed to the OFT by third party respondents.
50. However, given the outcome of the competition assessment does not depend on it, the OFT has not found it necessary to conclude on the strength of the barriers to entry and expansion.

Buyer power

51. During the course of its investigation the OFT found some evidence of countervailing buyer power especially among larger customers who submitted that they possessed sufficient buyer power to mitigate any unreasonable price increase.
52. However, the OFT has not found it necessary to conclude on this point in this case.

Conclusion

53. Consequently, the OFT does not believe this merger will lead to a substantial lessening of competition in relation to the supply of corrugated boxes either in GB or in the isochrones around each of the target businesses.

VERTICAL ISSUES

54. There are two vertical aspects to the merger, a) supply of CCM to third parties (a market previously defined as being EEA-wide) and b) the supply of sheet to third parties in the UK.
55. The OFT considered whether as a result of the transaction the merging parties would have the incentive to restrict the supply of CCM to third parties. As discussed above, SKG will honour the target business' pre-existing agreements to purchase CCM from third parties, and has, in addition agreed to purchase CCM from Mondi (the parent of the target businesses). Evidence supplied by the parties indicated that Mondi accounts for just [0-5] per cent of the EEA third party demand¹⁵ for CCM.
56. The OFT considered whether as a result of the transaction the merging parties would have the incentive to restrict the supply of corrugated sheet to third parties. As discussed above, Mondi has only a [0-5] per cent share of supply of sheet to third parties in the UK. Further, there has been recent expansion in the supply of corrugated sheet (for example, by Prowell's) and several third parties noted that there is significant excess capacity which is likely to incentivise third party sales.
57. Therefore the OFT does not consider that the merger raises the likelihood that any other purchaser of CCM or corrugated sheet would be foreclosed and that a substantial lessening of competition would result.

¹⁵ That suppliers can establish the terms of coordination; that suppliers are able to monitor each other's behaviour and punish deviations from the terms of coordination if necessary; and that there are no external factors present which could disrupt coordination.

¹⁶ In DS Smith/Linpac, the CC concluded that the market for CCM was wider than the UK and likely to be EEA-wide. The EC has also concluded that the geographic market for CCM is at least EEA-wide – Case COMP/M.2391 CVC/Cinven/Assidoman, Case COMP/M.499 Jefferson Smurfit/St. Gobain, Case COMP/M.613 Jefferson Smurfit/Munksjo, Case COMP/M.1208 Jefferson Smurfit/Stone Container, COMP/M.3935 Jefferson Smurfit/Kappa.

ASSESSMENT

58. The parties overlap in the manufacture and supply of corrugated sheets and corrugated boxes in the UK.

Corrugated Sheet

59. The OFT has assessed the proposed transaction on the basis of corrugated sheet on a national (GB) basis.
60. In the GB-wide third party supply of sheet (which does not include corrugated sheet that integrated plants will proceed to make into boxes themselves), the parties have a combined share of [15-25] per cent (with an increment of [zero-five] per cent). Including self-supply, the parties have a share of supply of [15-25] per cent (with an increment of [zero-five] per cent). The parties will continue to face competition from Boxes and Packaging ([15-25] per cent share), DS Smith ([15-25] per cent share), and Prowell ([five-15] per cent share). Even on the basis of the supply of all sheet used in the manufacture of all boxes, the parties would represent only [15-25] per cent (increment [five-15] per cent)
61. Unilateral concerns were not considered to arise given that the increment is modest on any basis and post-merger the merged entity will face competitive constraints from major suppliers DS Smith and SAICA as well as some other national and regional suppliers.
62. Given the target businesses very limited sales to third parties, the OFT did not consider that the merger raised coordinated effects concerns in relation to corrugated sheet.

Corrugated Boxes

63. The OFT has assessed the proposed transaction on the basis of corrugated boxes only (omitting packaging made from other materials) at both a GB and a local level (200km around the target businesses).
64. At a GB level the parties' share of supply is [15-25] per cent (with an increment of [five-15] per cent).

65. Unilateral concerns do not arise as a result of the transaction. On a GB level the increment to the share of supply is low and post-merger the target businesses will face strong competition from several other suppliers. On a local level, the parties will continue to face competition from a number of competitors. Although, there were several third party concerns, overall third parties commented that they appeared to have choice and a degree of buyer power.
66. The OFT does not believe that the proposed merger will create or strengthen coordinated behaviour as the structure of supply will not be greatly changed as a result of the merger. In addition, the OFT has received no compelling evidence to suggest that collusive behaviour is presently occurring in the industry.
67. Finally, while the proposed merger does have a vertical element to it, primarily in relation to the supply of CCM and corrugated sheet to third parties, competition concerns do not arise given the parties low shares of supply of CCM and fact that they supply such limited amounts of corrugated sheets to third parties.
68. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

69. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.