

Completed acquisition by Cartonplastgroup Holding SA of certain assets of the Demes Business Unit of DS Smith plc

ME/4385/10

The OFT's decision on reference under section 22(1) given on 23 March 2010. Full text of decision published 22 April 2010.

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**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. **Cartonplast UK Limited**, a wholly owned subsidiary of **Cartonplastgroup Holding S.A. (Cartonplast)**, is active in the provision of rental plastic layer pads (PLPs) and the associated washing and logistical services in the United Kingdom (UK). [ ].
2. **Demes** is a business unit of DS Smith PLC and owns three depots in Leeds, Harlow and Alloa in the UK. The Harlow and Alloa sites are engaged solely in the sorting and repair of pallet pods owned in-house by customers. The Leeds plant is engaged in the provision of PLP rentals and associated washing and logistical services throughout the UK. Demes' turnover for the financial year ended 30 April 2009 was [ ], of which [ ] related to the rental and washing of PLPs.

## **TRANSACTION**

3. On 5 January 2010, Cartonplast acquired indirectly via two of its wholly owned subsidiaries<sup>1</sup> certain assets of the Demes business unit of DS Smith PLC. The assets acquired comprise those assets of the Demes business unit relevant to its activities in various EU member states in the fields of PLP

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<sup>1</sup> As regards the UK assets, Cartonplast UK Limited, and as regards the Continental Europe, Cartonplast Trading GMBH.

rentals and related activities and the sorting and repair of pallets. In the UK, Cartonplast acquired the leases, assets and employees of the Demes business unit in its three sites in Leeds, Harlow and Alloa.

4. The overlap between Cartonplast and Demes in the UK is in relation to the rental of PLPs and related activities (as carried out by Demes from its Leeds facility). Therefore, the OFT will not analyse further the acquisition of Demes' assets utilised for the sorting and repair of pallets, in Harlow and Alloa. The assets relating to the Leeds site include the leasehold interest in the Leeds premises, a stock of [ ] PLPs, two PLP wash machines, three leased vehicles, employees and the customer contracts (together, **the Demes Assets**).
5. On 5 January 2010, Cartonplast and Cartonplast UK Limited gave initial undertakings to the OFT pursuant to section 71 Enterprise Act 2002 (the Act) to 'hold separate' both businesses.
6. The OFT became aware of the transaction through its own initiative via its Mergers Intelligence Unit. The OFT sent a preliminary enquiry letter to Cartonplast UK Limited on 16 November 2009. The OFT's statutory deadline for deciding whether to refer the merger to the Competition Commission (CC), extended under section 25(2) of the Act, is 14 May 2010.

## **JURISDICTION**

7. The OFT believes that the combination of assets being acquired by Cartonplast constitutes an 'enterprise' for the purposes of the Act and therefore that the transaction has resulted in two enterprises ceasing to be distinct for the purposes of section 23(1) of the Act.
8. Given that the acquired business, Demes Assets, has UK turnover in its last financial year of approximately [ ], the turnover test in section 23(1)(b) of the Act is not met.
9. However, the OFT believes that it is or may be the case that the share of supply test in section 23(2)(b) of the Act is met and, therefore, that a relevant merger situation has been created. This is because the parties'

combined share of supply for the rental of PLPs to the glass industry, in the UK, and in which both parties are active exceeds 25 per cent.

10. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

## **BACKGROUND**

11. PLPs are used in the transport of various types of (glass, can and plastic) containers, from packaging container manufacturers to 'filler' customers. Once used, PLPs can then be repeatedly reintroduced back into the supply cycle, having been collected, sorted – and if necessary returned to the appropriate PLP provider (which may not be the provider that collected them) - and washed (for hygiene reasons).
12. PLPs are generally used to transport containers in conjunction with pallets and other transport packaging products. In particular, containers are commonly arranged on wood or plastic pallets and then stacked using PLPs as dividers. In addition, top frames may be placed on top of the stack, to allow vertical tension straps to be fitted, and disposable wrapping may be used around the stack.
13. PLPs are made of polypropylene and are available to purchase from a number of manufacturers. The parties offer PLPs to their customers (glass manufacturers) in the UK on a rental basis, undertaking the necessary logistical and washing services that are required. The glass container manufacturing industry in the UK is concentrated with only four major suppliers (Ardagh Glass, Quinn Glass, Owen Illinois and Allied Glass).

## **MARKET DEFINITION**

14. The parties both supply PLPs for rental to glass manufacturer customers in the UK, along with the associated logistical and washing services.

## Product scope

### Cardboard layer pads and trays versus PLPs

15. In their initial submission the parties argued that there is no meaningful distinction between different types of layer pads for glass manufacturer customers, or indeed for other containers. In particular, they argued that any frame of reference should include the rental of PLPs and of cardboard (both layer pads (sheets) and trays) to producers of glass, can and plastic containers. The parties submitted that PLPs and cardboard layer pads perform exactly the same function; namely separating layers of containers during their transportation on pallets. Furthermore, the parties asserted that the glass, can and plastic packaging container manufacturers in the UK currently choose between each of these solutions, often opting for a combination of alternatives.
16. Subsequently the parties stated that the correct approach is to compare PLPs to cardboard sheets rather than to cardboard trays. They indicated that almost all glass manufacturers who have switched to PLPs since their introduction in the 1990s have moved across from cardboard sheets (and not cardboard trays). In addition, the parties stated that they have direct experience of the continuing use of cardboard sheets by glassworks delivering to large fillers such as [ ].
17. Finally, the parties stated that, even in the context of a narrow market for the supply of PLPs to the glass industry, cardboard must nonetheless be considered to provide a degree of indirect competitive constraint, given the extent of continuing use of cardboard by the glassworks. In particular, evidence provided by the parties showed that [ ].
18. However, third parties contacted by the OFT stated that the glass industry in the UK no longer uses cardboard layer pads (sheets). Instead third parties stated that they use both cardboard trays and PLPs. The price of cardboard trays in recent years has been between [ ] per use, whilst the price of PLPs has been [ ] per use (assuming three or more uses per year). Third parties stated that the choice of packaging material (cardboard trays or PLPs) is dictated by the fillers (the glass manufacturers' customers) and by the characteristics of the glass containers. Furthermore, third parties indicated that the depalletisation facilities of the fillers will also drive the choice of packaging material. In particular, they argued that high volume

producers with modern production lines require PLPs as it is not possible to 'sweep' bottles from cardboard trays, due to their raised sides. In terms of switching, while the OFT received evidence of customers switching from cardboard trays to PLPs, it received no evidence showing that glass manufacturers moved (back) across from PLPs to cardboard trays.

19. Fillers stated that the use of other layer pads or cardboard trays slows the production lines and leads to an increase in demand for staff – pushing up costs – as the layer pads/tray cannot be automatically removed. One filler stated that they specifically require corrugated PLPs for their filling lines, as the machines are designed and set up to automatically depalletise bottles from these pads only.
20. As a result, the OFT believes that substitution from PLPs to cardboard trays – given the existing price differential - is unlikely to occur in the case of a five to 10 per cent increase in the price of PLPs (the 'SSNIP' test).<sup>2</sup> Regarding cardboard layer pads (sheets), the evidence provided to the OFT has been mixed (and to some extent contradictory). However, without prejudice to the precise market definition, the OFT has examined the impact of the merger in the supply of PLPs excluding cardboard layer pads and trays. Given that there is no realistic prospect of a substantial lessening of competition on this narrowest frame of reference, the OFT does not consider it necessary to conclude on the precise market definition in this case.

#### Division into separate markets by customer type

21. The parties submitted that glass manufacturers have traditionally been the major customers of each of the parties and, indeed, have historically been the principal users of PLPs in the UK. However, the parties argued that the supply of PLPs to the glass industry does not constitute a separate market. In particular, the parties note that other packaging manufacturers have shown increased interest in supplying PLPs, and that Packaging Logistics Service (PLS) has been active in developing PLP rental to the can industry. Additionally, the parties argued that [ ]. However, the OFT is not

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<sup>2</sup> OFT's Mergers Substantive assessment guidance, paragraph 3.17: A market is defined by asking whether it would be profitable for a hypothetical monopolist to impose a small, but significant (five to 10 per cent), non-transitory increase in price on a given product or group of products.

persuaded that these considerations demonstrate that the supply of PLPs to the glass industry is not a separate market.

22. The majority of third party responses indicated that specific customer types have specific needs, and that there is a market specifically for the supply of PLPs to the glass industry. This is due to the fact that PLPs for cans (with a [ ] thickness) are not substitutable with PLPs for glass (which require a [ ] thickness). Third parties submitted that this difference is because the glass PLP must carry the load of the bottles and provide rigidity to the stack. PLPs for cans do not require the same load carrying ability, as the stack has more inherent stability.
23. Therefore, given the evidence provided, the OFT is of the view that the supply of PLPs for the glass industry may be a separate market from the supply of PLPs to other can and plastic container manufacturers. However, as there is no realistic prospect of a substantial lessening of competition on this narrowest frame of reference, the OFT does not consider it necessary to conclude on the precise market definition in this case.

### **Geographic Scope**

24. The parties both operate from their depots in the UK and do not service any contracts outside of the UK from these depots. Furthermore, no European PLP rental businesses serve UK customers from European depots. The parties submitted that cost and logistical factors are likely to make it uneconomical to provide a PLP rental service without a UK depot to supply the PLPs and provide the associated washing and logistic services.
25. Third parties agreed that the appropriate frame of reference was national, as transport times and costs are likely to make servicing UK customers from a European base uneconomical.
26. The OFT therefore believes that the scope of the relevant geographic market is national.

### **Conclusion on market definition**

27. Based on the evidence provided, and without prejudice to the precise market definition, the OFT examined the impact of the merger in the supply of rental PLPs for the glass industry in the UK. However, as there is no

realistic prospect of a substantial lessening of competition on this narrow frame of reference, the OFT does not consider it necessary to conclude on the precise market definition in this case.

## **HORIZONTAL ISSUES**

### **Market shares**

28. Considering the rental of PLPs to the glass industry in the UK as a separate frame of reference, post-merger the parties' estimate their combined market share as [80-90] per cent with an increment of [15-25] per cent. The parties believed that two glass manufacturers made up the remainder with their own in-house PLP 'pools' accounting for [0-10] per cent and [0-10] per cent of the supply of PLPs, respectively.
29. Evidence available to the OFT indicates that one of the glass manufacturers mentioned by the parties had not set-up their own in-house pool but rather was using a third party supplier ([ ]) as an alternative to the parties and that the parties had overestimated the size of the other glass manufacturer's in-house pool of PLPs. Based on this revised market share data, post merger the parties' combined market share would be [80-90] per cent with an increment of [15-25] per cent.
30. Regardless of their precise combined share, it is clear that the parties were until recently the first and second largest suppliers for the rental PLPs market to the glass industry in the UK with the large majority of the existing share of supply. Such a position clearly gives rise to preliminary concerns.
31. However, the parties stated that Demes had been a weak (and weakening) competitive constraint to Cartonplast over recent years, limiting the extent to which it can be considered a close competitor of Cartonplast. In particular, the parties provided evidence indicating that Demes [ ].
32. The OFT's investigation did not fully support the parties' arguments in this respect. A number of third parties regarded the parties as directly competing and considered them to be each other's closest competitors. In particular, some third parties expressed the concern that the merger would

eliminate the choice of available suppliers for the rental PLPs with the result that the price of rental PLPs would increase.

33. One customer was particularly vocal in its concerns. Its primary concern was that Cartonplast had actually raised prices to it post-merger. Evidence available to the OFT confirms that a price increase was applied to that particular customer across all types of PLPs but was highest for corrugated PLPs. The customer argued that although it had expected a price increase to occur – given that it had been charged a relatively low price for a prolonged period - the actual level of the price increase was higher than the customer considered would have been possible or acceptable if Demes had remained active as an independent supplier.
34. The OFT understands that this price increase occurred as a result of the contractual arrangements between Cartonplast and the customer, which allow for renegotiation of prices. A price increase had originally been due to occur in August 2008, based upon demonstrable increases in operating costs, but that price increase had not in the end been applied at that time. By 2010, when the merger occurred, operating costs had increased still further. [ ].
35. On the basis of these representations and the further documentary evidence provided to the OFT - showing that such price increase was planned some time in advance of the merger - the OFT accepts that Cartonplast would, absent the merger, have sought to apply a price increase to this customer. However, the OFT cannot dismiss the possibility that the level of the actual price increase may have been influenced by the merger and the loss of Demes as an alternative supplier.
36. On the basis of the relatively high combined share of supply and the apparent closeness of competition between the parties, the OFT might be expected to have prima facie concerns that, absent countervailing factors, the merger would create competition concerns. The OFT has therefore examined below whether there are other actual or potential suppliers that are capable of constraining the merged entity.

## **Existing alternative suppliers of rental PLPs to the glass industry**

### Loadhog

37. Based on the evidence provided to it by third parties, the OFT understands that Loadhog has been active in the PLP rental market since 2005 when it introduced a new PLP (smart pad), which has wavy edges designed to stop bottles moving when in transit and therefore it is different from the PLPs provided by the parties. Loadhog now has a market share of [10-20] per cent and it is currently supplying [ ] glass manufacturer with approximately [ ] pads and [ ] washes per year, which is [ ]. In addition, Loadhog is planning to expand its services. Evidence provided to the OFT indicates that Loadhog's PLPs are being (or have been) trialled [ ]. One third party, [ ] stated that Loadhog's PLPs could be considered a viable alternative to the PLPs provided by the parties. However, another third party indicated that Loadhog's PLPs are different to the parties' PLPs and [ ].
38. In light of the evidence provided by the parties and third parties, the OFT considers that Loadhog provides a degree of competitive constraint to the parties given that, even if its PLPs are not considered a substitute for all glass manufacturers, it is currently being used by one and at least one other is examining whether it is a viable alternative.

## **New alternative suppliers of rental PLPs to the glass industry**

### Introduction

39. The parties argued that new entry (most likely sponsored by glass manufacturers) would be easy and sufficient to make the threat of entry a sufficient deterrent to any attempt by the parties to raise prices or worsen another part of their offering. This is because the rental of PLPs involves a relatively low technology product and a limited upfront investment in assets, principally a stock of PLPs, a washing machine and ancillary equipment. They argued that the practical feasibility of new entry in this market is demonstrated by the fact that the OFT's investigation has indicated the entry into the UK over the last decade of Cartonplast itself and of Loadhog. The parties argued that an investment in the region of [ ] is required for a new entrant to be capable of servicing the requirements of two of the larger customers.

40. Furthermore, the parties argued that glass manufacturers can encourage new entry by others or even enter the market themselves by setting up their own pools of PLPs. Evidence provided to the OFT suggests that glass manufacturers have actively sponsored entry of a new supplier of rental PLPs in the UK (Cartonplast). However, the parties stated that Cartonplast's entry in the rental PLPs business in the UK in 2001 was supported from glassworks customers that Cartonplast already served in Europe with its existing pool of PLPs. However, no further evidence from third parties supported the view that customers have the ability to self-supply.
41. One third party indicated that to set up a pool of pads for four million uses, which would cover one third of the market, would require an investment in the region of £3.5 million. Another third party estimated that it would cost them £5 million to set up a PLP pool.
42. Based on the evidence available to it, the OFT understands that entry into the rental of PLPs to glassworks in the UK on the basis of a green-field entrant does not seem to be likely, timely or sufficient enough to make the generic threat of entry a sufficient deterrence to any attempt by the parties to raise prices or reduce quality in the short term.<sup>3</sup> However, the same conclusion would not apply in the case of an entrant that was building on existing capabilities and was being supported by customers to enter the market.
43. Based on evidence provided to it by the parties and third parties, the OFT understands that there are some potential PLP suppliers that have indicated a willingness to enter the market, following the merger, or are in the process of entering. These suppliers are not reflected in the existing market shares, as analysed above, but the OFT examined below whether they will be capable of constraining the merged entity going forward.

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<sup>3</sup> However the OFT is mindful of the fact that an offer from a potential Greenfield entrant, PLP24, is [ ]. As is explained in paragraph 49 below, the evidence available to the OFT is not sufficient to show that such entry would be likely, timely or sufficient to constrain the merged entity; it does remain, however, indicative of the fact that Greenfield entry remains a real possibility in this area.

PLS

44. PLS is a company that currently rents PLPs to the can industry. It informed the OFT that it [ ] to enter the market for the rental of PLPs to the glass industry. PLS stated that initial entry into this market could be absorbed [ ], which are capable of washing [ ] pads a year. However, PLS also stated that the main constraint [ ] was [ ]. This issue was confirmed by [ ].
45. Based on evidence available to it, the OFT understands that PLS [ ], at the time of this decision, to supply rental PLPs and washing services to [ ] at a price [ ]. In addition, [ ]. This would satisfy the OFT's condition that entry occurring within two years would be sufficiently timely to provide effective competition post merger.<sup>4</sup>
46. The OFT recognises that it is somewhat uncertain, [ ]. The scale and timing of PLS' entry will inevitably depend [ ]. It is not appropriate for the OFT to second guess all of these issues in detail: the question for the OFT is whether the existence of PLS going forward will enable customers to constrain, through actual and/or threatened switching, Cartonplast, at least to the same extent that Demes did pre-merger.
47. The OFT believes that the circumstances under which PLS [ ] enter the market by providing rental PLPs to [ ] glass manufacturer are not applicable to every potential entrant. The OFT is conscious that PLS had spare capacity within its existing washing facilities and [ ]. The OFT considers that PLS specifically has the ability to expand its rental PLPs services from the can industry to the glass industry. This is confirmed by the fact that it already supplies ([ ]). However, the OFT believes that PLS has the capacity to grow and provide a competitive constraint to the merged entity, at the least, equivalent to that previously provided by Demes by offering a competitive alternative to the glass manufacturers.
48. The OFT understands that PLS' entry has been prompted by the merger such that it would not have been expected to occur had not the merger taken place.

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<sup>4</sup> See Mergers-Substantive assessment guidance, paragraph 4.23

PLP24

49. Evidence available to the OFT indicated that another firm, PLP24, [ ], has indicated a willingness to enter the market. It has already made a proposal to [ ] glass manufacturer for the supply of rental PLPs in the UK. Based on the evidence provided by the glass manufacturer, the proposition of PLP24 is [ ]. The OFT believes it is possible that with the support of one or more glass manufacturers PLP24 may enter and expand and therefore provide a further potential constraint on Cartonplast in the future. However, it does not have the same degree of evidential support in relation to PLP24 that it does in relation to the entry and constraint from PLS. The OFT cannot, therefore, place strong reliance on the entry of PLP24 in making its assessment in this case.

### **Conclusion**

50. Accordingly, in light of the available evidence, the OFT does not believe the merger raises competition concerns. There is persuasive evidence that a new supplier, PLS, is entering the market and the OFT believes that the competitive constraint from PLS going forward will be sufficient to restore the level of pre-merger rivalry provided by Demes within a two-year period. The OFT's conclusion that the merger does not raise competition concerns is further supported by the existence of Loadhog, which already has a significant share of the market and is considered as a viable alternative by at least one third party, [ ]. The OFT also notes PLP24's proposal to a glass manufacturer to enter the market.

### **THIRD PARTY VIEWS**

51. The OFT received comments and views about the merger from a large number of third parties, including competitors and customers of the merging parties. In particular, some customers raised concerns regarding the transaction, on the basis that the merger would allow the new entity to raise prices of rental PLPs or reduce the quality of their service. In particular the customers were concerned the merger would reduce the number of credible suppliers of rental PLPs to UK customers and that it would eliminate competition between the current two largest UK rental PLPs suppliers. The concerns expressed by third parties have been dealt with where appropriate above.

52. Some concerns were not merger-specific, and have therefore not been included in this decision.
53. Other third parties, including customers, were not concerned with the merger and believed that other suppliers (actual or potential) of rental PLPs could take business from the merged entity.

## **ASSESSMENT**

54. The parties both supply PLPs for rental to glass manufacturers in the UK, along with the associated logistical and washing services. On a narrow product market, considering that PLPs are in a separate market from cardboard sheets and trays and that PLPs for the glass industry are in a separate market from PLPs for the can industry, the parties' combined market share is [80-90] per cent with an increment of [15-25] per cent in the UK.
55. A number of third parties expressed concerns about the merger because they consider that the parties are close competitors in the rental of PLPs market, that the merger will eliminate the availability of alternative products and options to customers and that post merger prices for rental services of PLPs are therefore likely to increase.
56. However, notwithstanding preliminary concerns based on the parties' combined market share, the OFT does not believe that the merger creates a realistic prospect of a substantial lessening of competition in the UK for a number of reasons.
57. Based on the evidence available to the OFT, PLS, a supplier of rental PLPs to the can industry, is entering the market with the support of glass manufacturers. The OFT believes that the competitive constraint from PLS going forward should be equivalent to that which Demes provided pre-merger, within a two year period. PLS' entry was prompted by the merger and would not have occurred absent the merger. The OFT therefore believes that PLS' entry should be sufficient to replace the competitive constraint lost by the merger.
58. In addition, the OFT's conclusion that the merger does not raise competition concerns is further supported by the existence of Loadhog, an

existing supplier of PLPs to one glass manufacturer, which is looking to expand and which is considered as a viable alternative by at least one third party, [ ]. A further potential supplier, PLP24, is also actively looking to enter the market.

59. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

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

## **ENDNOTES**

61. Subsequent to the decision, the OFT received information that PLS had not yet agreed to supply rental PLPs to glass manufacturers but that it was still in negotiations with them.
62. Regarding paragraph 57, the OFT clarifies that the word 'support' does not imply 'financial support'.