
Completed acquisition by various subsidiaries of Greif inc of the steel drum and closures business of Blagden Packaging Group

The OFT's decision on reference under section 22(1) given on 20 February 2007. Full text of decision published 8 March 2007.

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

PARTIES

1. **Greif Inc** (Greif) is the US parent company of a multinational industrial packaging group which has production facilities in the UK at Ellesmere Port, Hull and Burton-on-Trent. Greif's UK subsidiary, Greif UK Ltd, reported turnover of £60.4 million for the year ended 31 October 2005.
2. **Blagden Packaging Group** (Blagden PG) is also a multinational industrial packaging manufacturer consisting of various subsidiaries of Blagden Group NV,¹ headquartered in Belgium. Blagden PG has a UK production site in Manchester. Its annual turnover in the UK amounts to approximately £[less than 70 million].

TRANSACTION

3. The transaction was effected by means of a management buy-out (MBO) of Blagden PG, followed by immediate sale of its steel drum and closures

¹ The vending companies in the transaction are: Blagden Packaging Nederland BV, Blagden Packaging Rumbek NV, Blagden Packaging Wichelen NV, Blagden Packaging Zwolle BV, and Van Loon Consulting Services BV. The companies being sold are: Blagden France Holdings SAS, Blagden Packaging NV, Blagden Packaging Tournai NV, Blagden Packaging Femba Ibérica SL, Blagden Packaging Singapore Pte. Ltd, Bipol Co Ltd, Bipol Sib Co Ltd and certain assets of Blagden Packaging Nederland BV.

manufacturing business (Blagden) to various subsidiaries of Greif.² The MBO has retained ownership of Blagden's steel drum collection, reconditioning and recycling business.

4. Greif completed its acquisition of the share capital of Blagden on 30 November 2006. On 3 January 2007, the OFT accepted initial 'hold separate' undertakings given by the parties under s. 71 of the Enterprise Act 2002 (the Act). The statutory deadline for the OFT's decision is 29 March 2007 and the administrative target date is 20 February 2007.

JURISDICTION

5. As a result of this transaction Greif and Blagden have ceased to be distinct. The parties overlap in the manufacture and supply of new large steel drums and – by virtue of the parties' combined shares of [80 – 90] per cent – the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

FRAME OF REFERENCE

Product scope

6. The parties overlap in the manufacture and supply of new large (typical capacity of 210 litres) steel drums.
7. This form of industrial packaging is used for the transportation and storage of hazardous and non-hazardous goods, such as free-flowing and viscous petroleum products, chemicals, paints and adhesives. Designed to be weatherproof and shock-resistant, large steel drums have a long reusable lifespan and high stacking strength.
8. They can be manufactured to meet with UN regulations for the transportation of hazardous materials which include specifications for the form and quality of packaging.³

² Greif Belgium BVBA, Greif Bros Canada Inc, Greif France Holdings SAS, Greif International Holding BV, Greif Nederland BV and Paauw Holdings BV.

³ UN standards and certification are applicable to the transportation of hazardous products in order to prevent, as far as possible, accidents to persons or damage to property and the environment.

9. The parties submit that the product frame of reference for the purposes of this case consists of 'large industrial rigid packaging'. Such broader categorisation would include the following four products (all of which can be manufactured to UN specifications if so required):
- i. Plastic drums, which are extrusion blow-moulded from high density polyethylene to a size equivalent to that of a typical large steel drum. The parties argue that technological development allows for plastic drums to emulate many of the features that had been traditionally associated with steel drums.
 - ii. Fibre drums, which are constructed from convolutedly wound kraft liner paper. These have traditionally been used for the storage of dry products, but are now available with a variety of inner coatings, linings and inserts which enable them to carry liquid products. They are used in particular within the chemical, pharmaceutical, glue, paint and food industries.
 - iii. Intermediate bulk containers (IBCs): cube-shaped containers constructed using a rigid, reinforced, external cage and an internal flexible (typically plastic) bottle. IBCs may have pallet-like bases so that they can be moved by forklift. They have larger capacities – typically around 1000 litres – than either plastic or steel drums. Some types are collapsible when empty and can be stacked vertically.
 - iv. Reconditioned steel drums: used drums that have undergone cleaning, repair and refurbishment to meet with the same regulatory and safety requirements (where applicable) as new steel drums. The parties submit that a standard steel drum is capable of being reconditioned up to seven or eight times and that the reconditioned product costs around one third less than a new drum. They estimate that the supply of reconditioned steel drums into the UK amounts to some two million units per annum and provides 'lively competition in certain sectors of the new drum market'.
10. Furthermore, the parties supplied data on the correlation of demand for steel drums on the one hand and fluctuations in the cost of steel relative to the cost of plastics on the other. However, these data, while useful, did not persuade the OFT that plastic drums constrain the price of steel drums.

In particular, no evidence was presented to demonstrate that demand for plastic drums mirrored the movements in the demand for steel drums as a result of the change in relative costs.

11. In the merger case CVC/Dynoplast⁴, the European Commission (the Commission) considered that a degree of substitution existed between steel and plastic drums and also that there appeared to be some degree of substitution between these two types of drum and IBCs. The Commission noted, however, that 'the choice of drum is largely determined by the type of product for which the drum is going to be used', and that, 'while for some products both plastic and steel drums would be suitable, for some products one type would be preferable, and in the case of still others, the choice would not exist, as only either plastic drums or steel drums would be suitable for reasons of chemical compatibility.'
12. On the demand side, substantial numbers of customers have been switching from steel drums to plastic drums over the last ten years or so. A number of third parties submitted to the OFT that they had switched, or had tried to switch, to plastic drums wherever possible, given a favourable price differential which has been underpinned by rising steel prices. Third party comment also indicates that, whilst some substitution between steel and plastic drums is feasible, scope for switching depends on the nature of the product to be transported. A KPMG report⁵ indicates that the bulk of substitution from steel to plastic appears to have happened before 2001 and has since 'halted'.
13. Some customers have submitted, however, that they are either partially or wholly captive to the use of steel drums, or have a strong preference for steel drums over possible alternatives. For such customers there is little or no scope for substitution. This was particularly so where the products being transported were corrosive or combustible or could taint plastic drums to the extent that they could not be re-used. Some third parties pointed to preferences in the ease of handling and stacking of steel drums as opposed to other types of industrial packaging.
14. There is no evidence available to the OFT from customers in support of a proposition that fibre drums are effective substitutes for steel drums.

⁴ IV/M.1349 – CVC Capital Partners/Dynoplast – 08/03/1999

⁵ KPMG – European steel drum market

15. One customer submitted that it frequently used IBCs for some its products but preferred to use steel drums for other products due to a regulatory requirement for UN rating. No other customers identified IBCs as a suitable substitute for steel drums at current prices. The above referenced KPMG report indicates that IBCs may be less suitable for global exporters given that they are 'not (yet) suited for less developed markets,' whereas steel drums have 'worldwide standard & acceptance' and are the 'only alternative for certain export markets.'
16. Third party comment indicates that reconditioned steel drums provide a limited alternative to new steel drums. Some pointed to quality issues such as cosmetic flaws and rusting that may arise with reconditioned drums and thus limit their suitability. One commentator explained that, whilst reconditioned drums have to meet certain criteria to match the regulatory specifications of the original product, they are not a 'perfect' substitute for new steel drums. There will typically be visible blemishes and/or residues from previous shipments which may render them unsuitable in some cases.
17. According to a table of members' products published by the relevant trade association, the Industrial Packaging Association, there is little overlap on the supply side between manufacturers of steel drums and manufacturers of other types of industrial packaging in the UK. The OFT considers this to be an indication that the production facilities and equipment used to manufacture the different types of packaging are significantly different from those used to produce steel drums.
18. The parties propose that there is a degree of supply-side substitutability between steel drum reconditioning and new steel drum manufacture, referring to Ramsden & Whale (R&W) as an example of a supplier of reconditioned drums having switched to the supply of new large steel drums. However, R&W indicated that it entered into the supply of new drums around ten years ago by purchasing some new production plant – rather than using existing assets. On which basis, R&W's activities in new drum manufacture are as a result of entry rather than genuine supply-side substitution.
19. Overall it appears that some limited demand side substitution is possible between steel, plastic and fibre drums and between drums and IBCs. However, for some customers only steel drums are suitable, either for all or

for certain ranges of their total product. Reconditioned drums do not appear to be substitutes in all cases. In light of the above, the OFT therefore considers that a cautious approach is warranted and that the frame of reference for the purposes of this analysis should therefore be limited to the supply of new large steel drums.

Geographic scope

20. The parties argue that they are constrained by actual and potential imports of new steel drums from Europe. However, they have provided no evidence of the extent to which large steel drums are imported. The import volumes they cite appear to include a wide range of different sizes of industrial container.
21. In CVC/Dynoplast, the Commission found that the need for a local production presence was a feature of the market, and that comparative prices for various Member States showed significant differences in some cases. Whilst not needing to conclude, the Commission considered that these factors were likely indications of a national geographic scope for the supply of steel drums.
22. A number of third parties submitted that imports of large steel drums were generally not commercially feasible due to high transport costs (relative to the favourable price differential on the Continent) and to delivery-time considerations. One customer indicated that access to a UK supplier was an important factor in ensuring efficient operation of its production line processes, through accurate forecasting of lead times. A competitor submitted that whilst imports of small steel drums were relatively common, only 'limited numbers' of large new drums are imported.
23. The OFT considers that the available evidence – particularly that pertaining to transportation issues – makes the UK the appropriate geographic frame of reference for assessing the competitive impact of merger.

HORIZONTAL ISSUES

Unilateral effects

24. The parties have a combined share of [80 – 90] per cent (an increment of [25 to 35] per cent) of the total supply of new large steel drums in the UK.

25. The UK supply of new large steel drums is very highly concentrated. The measure of that concentration using the Herfindahl-Hirschman Index is 7,400 to 7,500 (a delta of around 3,500). The remaining competitors in the UK have some degree of spare capacity. However, given the much smaller scale of their operations overall, what spare capacity they have would be insufficient to undermine or offset any reduction in quality or any future price increases implemented by Greif as the industry leader. Third party comment supports this view. One third party also submitted that the smaller independents did not manufacture or supply a sufficiently complete range of UN-approved products to match the full range offered by Greif and Blagden.
26. Given that steel drums are a relatively homogenous, standardised product, it is rational for customers to value the ability to tender, and/or place specific contract orders, on price terms. Prior to the merger, some customers dual-sourced their procurement of steel drums and thus benefited from an opportunity to shift purchase volumes between suppliers in response to price and/or service quality considerations. Customers have raised concerns that the merger will remove their ability, by actively negotiating and apportioning demand between the two principal suppliers in the UK, to discipline pricing behaviour.
27. The OFT therefore considers that any pre-merger competitive constraints on the parties will be significantly diminished as a result of their merger.

Barriers to Entry and Expansion

28. Due consideration is given as to whether loss of competition as a result of merger can be offset by likely, timely and sufficient entry by new competitors or expansion by existing competitors.⁶
29. The OFT considers that the principal barrier to entry and expansion is the ability to realize the scale required to counterbalance the loss of rivalry between Greif and Blagden.
30. Greif proposes that the total cost of setting up new drum manufacturing plant accounting for more than 10 per cent of UK supply would be

⁶ See 'Mergers: substantive assessment guidance' OFT516 (May 2003) paragraphs 4.17–4.26.

approximately £3 million and that it would take four to five months to become operational. A third party estimated that entry would require set up costs of £4 million, and would take rather longer, at 12-15 months.

31. However, demand in the UK for new large steel drums is in decline – a continuing downward trend that has been taking place over an extended period of time. The parties' own data indicate a reduction of around a quarter of sales over the previous five years.
32. Several third parties pointed to an ongoing process of exit (by both acquisition and liquidation) from the industry, significant examples being Economic Drums and Tanks & Drums. Declining demand and evidence of exit are generally regarded as deterrents to entry, particularly if sunk cost investment or economies of scale are essential.
33. The parties submit that there is substantial overcapacity in drum manufacture in the UK. Overcapacity and the potential for this overcapacity to be deployed in response to a new entrant may also increase the perceived risks of entry.
34. Given the much smaller scale of the remaining competitors' operations overall, what spare capacity they have would provide for insufficient expansion to undermine or offset any future price increases imposed by Greif as the industry leader.
35. Given such factors, the OFT considers that entry or expansion by new or existing competitors would be insufficient in time, scope and likelihood to address any competition concerns that arise from the merger.

Buyer power

36. Given that steel barrels are relatively standardised, switching between producers would be relatively straightforward if there were alternative sources of supply with sufficient production capacity.
37. The parties submit that their customers are educated buyers and that the majority are subsidiaries of petrochemical, oil, chemical and pharmaceutical multinationals with strong procurement leverage.

38. However, the OFT considers that the merger of the two largest steel drum manufacturers in the UK will eliminate any previous countervailing bargaining power by removing negotiating options and the ability to switch volumes feasibly between the two major alternative sources of supply. This concern is reflected in third party comment.
39. The parties argue that very large customers may be able to sponsor new entry, and suggested that this has occurred in the case of BP (customer) and Ramsden & Whale ('R&W'; a drum manufacturer). However, as discussed in paragraph 18, R&W clarified that they actually entered on a small and speculative scale around ten years ago, but that their profile had been raised by obtaining a significant supply deal with Castrol (owned by BP) three to four years ago.
40. Overall, the OFT considers that any countervailing buyer power previously held by major customers would be eliminated by the structural consequences of the merger.

VERTICAL ISSUES

41. The parties also overlap in the global manufacture and supply of 'closures' for drums. These comprise 'flange and plug' components which allow for the drums to be filled, sealed and emptied. Some steel drum manufacturers produce their own closures, whilst other procure them from third parties. The evidence available to the OFT indicates that the supply of closures is global in geographic scope. No substantive concerns were raised over the horizontal effects of the merger on the supply of closures. This horizontal aspect of the merger is therefore not the subject of any further analysis in this decision.
42. One third party raised a potential vertical issue relating to the supply of closures.
43. Blagden is active in the production of closures from plant located in China, which is included in the bundle of assets acquired by Greif. However, Blagden also procures closures from third party manufacturers. Greif produces closures in Europe for its own drums, and also supplies to third party drum manufacturers.

44. One competitor was concerned by the prospect that, as a consequence of the merger, Blagden would source all of its drum closure requirements in-house, thereby limiting UK demand on the basis of Greif/Blagden's powerful post-merger position. However, it is apparent that closures are manufactured and transported to drum manufacturers on a global basis. The position held by the merged entity in the UK would be insufficient to amount to foreclosure from the wider global supply network.
45. The OFT considers that this vertical aspect of the transaction does not amount to a credible theory of harm distinct from the main horizontal effects of the merger.

THIRD PARTY VIEWS

46. We received unsolicited complaints from third parties after the merger was announced in October 2006, and a further expression of concern from a customer in response to our ITC. A substantial majority of customers who responded to our questionnaire, or who were otherwise contacted, were also concerned about the effects of the merger on competition.

UNDERTAKINGS IN LIEU

47. Where the duty to make a reference under section 22(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.
48. The OFT's Mergers Substantive Assessment Guidance states that, undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation.
49. Greif offered behavioural undertakings not to increase ex works prices for new steel drums to existing customers of Greif UK and Blagden UK – subject to fluctuations in the costs of raw materials and the rate of UK inflation. These undertakings were to be in place for a period of three years from the date of acquisition.

50. The OFT's guidance states a clear preference for structural remedies. In this case, the proposed behavioural remedy raises serious questions as to whether such pricing behaviour would be capable of restoring the previous competitive dynamic. In addition, given that it is subject to increases and decreases in the costs of raw materials and the rate of inflation over a three year period, both the capacity to monitor and the transparency of such a remedy would in the OFT's view not be sufficiently clear.
51. The OFT therefore does not believe the undertakings offered are sufficiently clear cut to address the competition concerns outlined above.

ASSESSMENT

52. The parties overlap in the manufacture and supply of new large steel drums and drum closures.
53. Evidence before the OFT indicates that the supply of closures is global in geographic scope and that a number of competitive sources of supply remain post-merger. No credible theory of harm in the supply of closures is attributable to the merger at either a horizontal or a vertical level.
54. Some customers who have used steel drums in the past now use industrial containers made from other materials such as plastic and fibre. However, for some customers, only steel drums are suitable for either all or for certain ranges of their total requirements. Reconditioned drums do not appear to be substitutable in all cases. The cautious frame of reference for this competition analysis is therefore the supply of new large steel drums.
55. Available evidence pertaining particularly to transport issues makes the UK the appropriate geographic frame of reference for assessing the impact of the merger on the supply of new large steel drums.
56. The parties' combined shares of the supply of new large steel drums in the UK amount to [80 - 90] per cent. Supply of this product in the UK is very highly concentrated.
57. Third party comment submitted that the remaining significantly smaller competitors had insufficient capacity to meet substantial order requirements and that they did not manufacture or supply a sufficiently complete range of regulation-compliant products to match the full ranges

offered by Greif and Blagden. Customers have raised concerns that the merger will remove their ability (having previously been able to actively negotiate and apportion demand between the two principal suppliers) to discipline pricing behaviour.

58. In addition to this loss of competition which the OFT attributes to the merger, demand in the UK for new large steel drums has been in continuing decline over a number of years and third parties have pointed to an ongoing process of suppliers exiting the industry. Additionally, the available evidence indicates that there is significant overcapacity in steel drum manufacture in the UK. Entry by new competitors would therefore be insufficient in time, scope and likelihood to address any competition concerns that arise from the merger.
59. The OFT considers that any countervailing buyer power previously held by major customers would be eliminated by the structural consequences of the merger.
60. Consequently, the OFT believes that it is 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

61. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.