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## Anticipated acquisition by DS Smith plc of the recycling business of BPB plc

The OFT's decision on reference under section 33 given on 4 August 2004

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### PARTIES

1. **DS Smith plc** has four main divisions; paper and corrugated packaging, plastic packaging, office products wholesaling and office products manufacturing. This anticipated transaction involves the recycling division of the St Regis operation—Severnside — part of the paper and corrugated packaging division. Severnside has 14 recovered paper depots, mainly in the southern half of the UK. Severnside generated approximately £ [see note 1] in turnover in the year ended 30/4/03.
2. **BPB Recycling** is a division of BPB plc. It collects waste paper in the UK, concentrating on the collection of packaging grades of waste paper, which are then used in the production of plasterboard lining paper (PLP) with any excess being supplied to the merchant sector. BPB recycling operates five recovered paper depots at Basildon, Leeds, Bolton, Durham, and Glasgow generating turnover of £ [see note 1] for the year ended 31/3/03.

### TRANSACTION

3. St Regis and BPB UK Limited entered into a sale and purchase agreement on 28 May 2004 whereby St Regis agreed to purchase BPB Recycling for a consideration of £ [see note 1]. As part of the transaction Severnside has entered into a five-year contract with BPB to supply BPB's Davidson Mill with [see note 2] of packaging grades of waste paper [see note 2].
4. The transaction was notified to the OFT on 11 June 2004 and the administrative deadline expires on 9 August 2004. An earlier acquisition by DS Smith in the downstream market of corrugated cardboard sheet and cases is currently subject to a Competition Commission investigation. The Competition Commission is due to report by 3 November 2004.

## JURISDICTION

5. As a result of this transaction DS Smith and the recycling business of BPB plc will cease to be distinct. The parties overlap in the collection and supply of packaging grades of waste paper and 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 arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation. The ECMR does not apply.

## RELEVANT MARKET

### Product market

6. The parties overlap in the collection of packaging grade waste paper from sources such as commercial businesses, retail premises and municipal contracts, and its supply to paper mills (internal and external) that use this waste in the manufacture of corrugated case materials (CCM) and plasterboard liner paper (PLP).
7. The parties' activities in these sectors are primarily to feed their own paper mills with the packaging grade waste paper required to produce CCM / PLP respectively. Severnside is currently unable to source all of the packaging grades of waste paper required in the milling operations of the St Regis paper business. It therefore also acts as a merchant, buying packaging grades of waste paper on the open market on St Regis' behalf. It expects to be in a similar position post merger since it will also have the supply contract with BPB to service.
8. **Collection of packaging grades of waste paper** is undertaken by a variety of providers ranging from 'one man bands' to firms undertaking national contracts. At present no supplier has national coverage and sub-contractors are used where necessary to provide the geographic coverage required by a national customer.
9. Sources of packaging grades of waste paper (retailers, printing works, municipal contracts etc) either pay to have it collected or are paid for it — depending upon volume: the collector weighs up the cost of collection relative to the market value of the waste paper collected. Where large volumes are involved there is generally a contract in place, which may involve the collector installing baling machines at the customer site. For smaller volumes there are typically less formal, though often relatively long-term, arrangements.
10. **Supply of packaging grades of waste paper** — packaging grades of waste paper are an essential input into the production of both CCM and PLP in the UK. Although it is possible to produce CCM / PLP using virgin fibres, there are no mills

in the UK equipped to do so. It appears therefore that the supply of packaging grades of waste paper represents a distinct segment.

11. It appears appropriate to consider only 'merchant' supply of packaging grades of waste paper to third parties as the relevant frame of reference since only the parties both use such waste paper in-house and also sell it on the open market. This open market supply is undertaken to minimise transport costs when the parties collect packaging grades of waste paper in areas where they do not have mills. This may occur as a result of holding national collection contracts (e.g. with a supermarket chain), or in the case of BPB is partly due to the closure of two of its production mills in recent years. Other collectors of waste paper (including the parties) that are also users of packaging grade waste enter into swaps to minimise transport costs. The parties submit, and third parties confirm, that mill owned groups would not allow their own downstream operations to go short of packaging grades of waste paper in order to sell on the open market as the mills would simply have to buy on the open market to replace the waste paper sold.
12. However there may be a dimension relevant to the total supply of packaging grades of waste paper to the extent that this impacts on the total procurement of waste paper. Third parties have raised issues in relation to this which are discussed below.
13. The parties have identified three types of packaging grade waste paper: 1) old cardboard case (OCC), 2) the off-cuts from corrugated case factories (KLS) and 3) 'mixed waste' which contains elements of all types of waste paper.
14. KLS comprises off-cuts from corrugated sheet and case manufacturers and is identical in composition to the OCC collected from supermarkets etc, the only exception being that KLS is cleaner. It therefore appears appropriate to consider KLS and OCC together.
15. Mixed waste paper incorporates a variety of paper fibres, possibly including OCC / KLS, but also cardboard packaging, newspaper etc. Mixed waste paper is valued below the sum of its component parts, with buyers of the various grades of waste paper always willing to pay more for a 'pure' product.
16. There are technical differences between using the two types of packaging grades of waste paper –KLS / OCC have a higher proportion of the longer fibres required in the manufacture of CCM/PLP. A paper mill's freedom to switch between grades of waste paper is strictly limited by technical requirements. Proportions of OCC / KLS and mixed waste paper used cannot typically be varied by more than 10 per cent points – though this in itself is sufficiently substantial to impose some competitive constraint on prices of a specific grade. Additionally, sources of OCC

/ KLS and mixed waste paper differ: a much higher proportion of mixed waste paper is generated from municipal contracts rather than contracts with businesses.

## **Geographic market**

17. **The collection of packaging grades of waste paper** — although there is no determined range over which it is economic to collect and transport packaging grades of waste paper, 30-60 miles appears to be the consensus for non-baled material, increasing if the material is baled. As a consequence, all paper mills with waste paper collection businesses tend to operate some swap arrangements. Under these arrangements they agree to supply packaging grade waste paper to a competitor's mill in return for that competitor supplying the same amount of such waste to one of its own mills and so minimising total transport costs. However, exceptionally, BPB has transported packaging grade waste paper generated in the Manchester/ Yorkshire area to its Aberdeen mill, which it finds to be profitable given the cost advantages of operating the mill in Aberdeen at full capacity. It appears overall, however, that there is a local element to the collection business.
18. **The supply of packaging grades of waste paper** — the parties submit that the geographic market for the supply of packaging grades of waste paper is, at least, European and evidence from both the parties and third parties appears to support a frame of reference that is wider than UK in scope:
  - A variety of independent reports provided by DS Smith, as well as the balance of third party opinion, indicate that the price of waste in the UK is influenced by global demand and supply conditions, in particular by changing demand from China for packaging grades of waste paper.
  - While there is very little import of packaging grades of waste paper into the UK — primarily due to the quantities of such waste paper available in the UK relative to the size of its manufacturing base — there are substantial exports in the order of 25- 30 per cent and these have risen substantially over the past few years.
  - However, relative pricing data compared with import volume shows a strong correlation: when the price of packaging grades of waste paper rises in the UK relative to the continental European price, imports will increase. BPB itself imported over 3,000 tonnes of OCC from the Republic of Ireland in the year ended 31 March 2004.
19. There are also UK-specific factors influencing the market price of packaging grades of waste in the UK. Many merchants have indicated that there is variability

in demand for exports: typically the rate achieved on exported volume is higher, but there is not always demand. The result is that many merchants limit the proportion they choose to export, preferring to establish secure supply relationships with UK paper mills rather than benefit from higher spot prices over short periods driven by export demand.

20. There is also evidence to suggest that waste suppliers do not necessarily choose to take the highest price on any given day, instead preferring to develop long-term supply relationships which are expected to generate greater stability, security of collection and profitability over the longer term. However, the increasing demand for packaging grades of waste paper in the Far East (and prices therefore outstripping UK waste paper prices) has led to a fundamental change in the UK supply base over the past few years, with virtually all packaging grade waste paper suppliers now equipped for export. This implies responsiveness to broad changes in world demand for recovered paper, even though many respondents would not switch their supply decisions overnight in response to differential prices.
21. The geographic market for the collection of packaging grades of waste paper is not considered to be wider than regional, although there may be local considerations in certain parts of the country. While the geographic market for the supply of packaging grades of waste paper is considered to be wider than the UK in scope. The relevant markets considered are therefore:
  - The collection of packaging grades of waste paper at the local level;
  - The supply of OCC/KLS to third parties in at least the UK and,
  - The supply of mixed grades of waste paper to third parties in at least the UK.

## **HORIZONTAL ISSUES**

### **The collection of packaging grades of waste paper**

22. There are a wide range of firms competing for collection contracts, including mill-owned groups collecting for their own in-house needs, waste management firms and independent waste paper merchants. Additionally, there is very little overlap between the existing networks of the two firms. In the area of most overlap, South Yorkshire, the parties have estimated that together they collect less than 10 per cent of the total volume of all grades of waste paper and less than 15 per cent of packaging grades of waste paper currently available for collection. This is the area of the UK with the highest concentration of industrial activity and corresponding high numbers of mills and waste merchants.

23. The transaction will bring together two largely geographically complementary networks, giving the merged entity the broadest collection network in the UK. This will enable it to bid more effectively for national supply contracts, to chains such as supermarkets. However, this will represent an efficiency gain rather than a loss of competition and customers will retain the option of using a network of local and regional players if they do not wish to use the service offered by the merged firm.
24. Consequently, at the collection level the merger does not give rise to any horizontal concerns.

#### **The supply of packaging grades of waste paper**

25. As in the collection of packaging grades of waste paper, there are a wide variety of suppliers of packaging grades of waste paper, ranging from the large waste management companies to localised waste merchants, in the UK. Further, around 25 - 30 per cent of all packaging grade waste paper is currently exported from the UK. If prices were to rise in the UK it is to be expected that at least some volume would be diverted back to the UK so as to neutralise the impact of the price rise. One third party indicated that tough regulations on the proportion of UK waste paper which must be recycled, coupled with the relatively small manufacturing base in the UK and therefore the limited requirement for cardboard, implies that larger quantities will be recovered going forward, and that much of this will be exported in order to achieve the best price.
26. The parties, using total market figures provided by the Confederation of Paper Industries, have estimated that their combined share of third party supply of OCC/KLS in the UK in 2003 amounted to 5-10 per cent (increment less than 5 per cent). While their combined share of total supply of OCC / KLS in the UK (i.e. including in-house supply) amounted to 30-35 per cent (increment 5-10 per cent). For the same year the parties together supplied less than 5 per cent of the OCC/KLS sold to third parties in Europe, with their combined share of the total supply of OCC / KLS, including in-house consumption, at around 0-10 per cent of total European supply. The parties, even combined, therefore represent a relatively small share of the supply of OCC/KLS to third parties [see note 3.]
27. The combined share of supply in the UK of mixed grades of waste paper to third parties as a result of this merger is 30-35 per cent (increment 10-15 per cent), and of all supply in the UK of mixed grades of waste paper is 55-60 per cent (increment 5-10 per cent). However 62 per cent of the mixed waste collected in the UK is exported [see note 3].

28. The parties have a high share of the supply of mixed grades of waste paper, primarily due to St Regis being the largest buyer of this type of waste in the UK. Mixed grades of waste paper accounts for only 26 per cent of all packaging grades of waste collected in the UK, and 62 per cent of this is exported. The specific technical nature of the St Regis operation permits it to use more mixed grades of waste paper than most other competitors. However, the majority of this waste paper is purchased by Severnside from independent merchants or from local authority recycling depots rather than collected through its own depot network. Further, the parties have estimated that there is currently 6.25m tonnes p.a. of mixed grades of waste paper going to landfill which could be additionally recovered if prices of mixed grades of waste paper were to rise. Overall, these factors indicate that mixed grades of waste paper will not raise competition concerns in spite of the higher shares of supply in this segment than in the OCC/KLS segment or in packaging grades of waste as a whole. This view is supported by a lack of third party concerns in this area.
29. However, there have been a number of concerns about this merger expressed by a variety of third parties, in particular independent waste paper merchants.
30. Some independent waste paper merchants were concerned that the merger would reduce the number of buyers for their waste paper, potentially leading to a reduction in the price that they are able to attain. However, at the national level the transaction will only reduce the number of potential buyers of waste paper by one, and there are a number of other mills remaining. Further, DS Smith expects to remain a buyer of packaging grades of waste on the open market following the merger.
31. Other concerns raised focus on the market behaviour of the integrated DS Smith group which includes both the St Regis and Severnside businesses.
32. Third parties alleged that Severnside punishes independents that bid against it for collection contracts by refusing to buy waste paper from these firms for use in the St Regis mills. Third parties were asked to provide evidence that this occurs. However none has been received. On the other hand, Severnside provided specific evidence of suppliers it continues to source from subsequent to losing collection contracts to the supplier. Retaliation would not be appear to be a sensible approach, as refusing to source from a supplier indicates that Severnside will not be buying paper at lowest cost for the St Regis milling operation. It argues that it would not put itself at a competitive disadvantage in its more important paper milling operations so as to capture business at the recovered paper level.
33. Several independent waste merchants also argued that there is a set price being paid by all mills for waste at any point in time. Third parties were asked to provide

evidence of this. However none has been received. DS Smith denies these allegations arguing that it pays a wide variety of prices depending upon volume, quality, negotiating strength and other factors. Co-ordinated effects are not to be expected in this sector for a variety of reasons. The most important feature of the argument that there is no co-ordination of prices is the high level of exports from the UK and the increasing capability amongst UK paper merchants to export. This would suggest that any attempt by the UK mills to collectively drive down the price of waste would lead to increased exports of waste from the UK

34. In addition, conditions more generally do not appear to indicate collusion. There are 11 remaining mill groups in the UK post-merger, with St Regis by far the biggest in size. This suggests that the merger would have no material impact on the likelihood or stability of collusion. Therefore, given the apparent absence of conditions conducive to collusion and the failure of complainants to provide evidence of such pricing, it appears that these complaints are speculative.
35. One third party provided a letter which asked him to provide full details of his contract with a source of waste paper to Severnside, which was undertaking a review of the source's overall nationwide approach for the disposal of waste. It was argued that this action by Severnside gave it information regarding the contractual terms being offered by a direct competitor in the waste paper collection business. Severnside provided evidence to show that this had been an unique arrangement carried out at the request of the customer (the waste generator). It explained that its usual audit processes do not involve the collection of information relating to the prices charged by rival suppliers of collection services. In any case, it appears to the OFT that the concerns expressed are not linked to the merger situation.
36. One third party indicated that it was aware of Severnside offering a relatively small source £ [see note 1] per tonne, whereas the current price to merchants is £45 per tonne. This may be explained by the lower cost of sourcing direct, as a result of the insulation this brings from external price shocks and the option faced by merchants of exporting when world prices rise (integrated collectors of waste consistently argue that they would never increase open market sales if prices rose: since the costs of putting the mill into 'down time' far outweigh the benefits of exploiting higher market prices for packaging grades of waste. The parties have provided cost estimates that support this view).
37. A further contention was that Severnside uses revenue generated from the sale of Packaging Recovery Notes (PRNs) [see note 4] to build up its collection business. However, all mills generate PRNs when recycling recovered paper, and are able to either take the revenue generated in this way into account when setting the price they charge their customers or, alternatively, enter into some arrangement with

the waste generator to provide them with the relevant PRNs. However, PRNs are available on the open market and could also be acquired by independent collectors if waste generators require this.

38. Finally, third parties expressed concern that Severnside would push up the price of waste for competing mills in the UK post-merger, either by cutting imports or increasing exports, reducing the volume of waste available in the UK for third parties. This argument can be dismissed as a result of the high proportion of UK packaging grade waste that is currently being exported. This prevents Severnside from exploiting any power it could generate as the biggest purchaser of waste in the UK.
39. Therefore, the merger does not raise competition concerns in either the OCC/KLS or mixed waste segments for either collection or supply to third parties.

### **Barriers to Entry**

40. Third parties have consistently indicated that the collection of packaging grades of waste paper is a segment that can be entered relatively easily by very small-scale businesses on a localised basis. Overall, there appears to be a gradual shift towards contracting on a broader geographic scale such that smaller collectors will have more difficulty competing on such a basis, though the possibility appears to be present. The cost of entry is difficult to estimate as this depends upon the scale of entry, which range from the cost of 'a man with a van' to depots costing in the region of £0.5-0.75m.
41. There has been some recent capacity expansion, in particular by the waste management firms, with new recovered paper depots being built. The general trend towards recycling continues in the UK as a result of stricter environmental legislation laid down by European directives, and there is the potential to grow by collecting waste currently going to landfill. There is already a very high utilisation rate of recovered paper in the UK which suggests that any additional waste which is recovered may be expected to be sold for export.

### **VERTICAL ISSUES**

42. There is a vertical issue in that the DS Smith group includes the Severnside recovered paper business as well as the St Regis paper mills – the largest user of the recovered fibres in the UK. No third parties raised a foreclosure argument but some argued that competing mills would not wish to buy waste from Severnside and by increasing its network this makes it more difficult for third parties to source from alternative suppliers. Some argued that it is difficult for third party

collectors to bid against DS Smith for collection contracts; this is discussed and addressed above at paragraph 32.

### **THIRD PARTY VIEWS**

43. The mill-owned operators of waste collection were typically unconcerned, as were the waste management companies. In addition, sources of waste for collection were mostly unconcerned. Independent waste paper merchants were typically concerned about the transaction, as was [see note 5]. These concerns are addressed above in paragraphs 29 to 39.

### **ASSESSMENT**

44. The parties overlap in the collection of packaging grade waste from sources such as commercial businesses, retail premises and municipal contracts, and its supply to paper mills (internal and external) that use this waste in the manufacture of corrugated case materials (CCM) and plasterboard liner paper (PLP). For the purposes of this assessment, the impact of the anticipated transaction has been considered for the collection of packaging grades of waste paper, the supply of OCC/KLS to third parties and, the supply of mixed grades of waste paper to third parties.
45. There are a large number of competitors for the collection and supply of packaging grades of waste paper in the UK, including integrated mill groups, waste managers and independent waste paper merchants. Barriers to entry to collection and supply appear to be low and in addition there is substantial competitive constraint from the export of waste, with currently around 25-30 per cent of packaging grades of waste paper collected in the UK being exported.
46. The parties' estimated combined share of third party supply of OCC/KLS in the UK in 2003 amounted to 5-10 per cent (increment less than 5 per cent). For the same year the parties together supplied less than 5 per cent of the OCC/KLS sold to third parties in Europe. The combined share of supply in the UK of mixed waste to third parties as a result of this merger is 30-35 per cent (increment 10-15 per cent) [see note 3].
47. Concerns have been put forward, primarily by independent waste paper merchants, about their ability to compete with the merged firm. There have been unsupported allegations that Severnside retaliates against firms that bid aggressively against it for collection contracts, as well as allegations that there is some form of coordination amongst the UK mills in the price they pay for packaging grades of waste paper.

48. The parties have made a strong case that this merger will not lead to a reduction in competition due to the presence of various competitive constraints, and waste managers and other integrated firms have not typically raised concerns about the transaction. Complaints have originated from independent waste merchants, who are reluctant to see further consolidation amongst major payers in the industry, believing that this merger will make it harder for them to compete for collection contracts and reduce the prices they are able to obtain for the product they supply. To the extent that this benefits customers, this is not a legitimate competition concern. Also, it is not clear that any alleged difficulties experienced by these independents are merger-specific, and except for one situation (which arose from specific circumstances not resulting from the merger), third parties have not provided any evidence of the alleged practices.
49. 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 for goods or services in the United Kingdom.

## **DECISION**

50. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

## **NOTES**

1. Figure excised at the parties' request.
2. Information excised at the parties' request.
3. Exact figures in this paragraph replaced with a range at the parties' request.
4. Packaging Recovery Notes are used in the UK as a market-based solution to increasing recycling and meeting recovery requirements set down by European directives. PRNs are generated by recyclers of waste and sold to originators of waste, for example in this case the producers of goods packaged in cardboard cases.
5. Information excised at third party request.