

***Case No COMP/M.5283 -  
SAPPI / M-REAL***

Only the English text is available and authentic.

**REGULATION (EC) No 139/2004  
MERGER PROCEDURE**

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Article 6(1)(b) NON-OPPOSITION  
Date: 31/10/2008

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## COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 31.10.2008

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In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EC) No 139/2004 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE  
ARTICLE 6(1)(b) DECISION

### **To the notifying party**

Dear Sir/Madam,

**Subject: Case No COMP/M.5283 – Sappi/M-real  
Notification of 29.09.2008 pursuant to Article 4 of Council Regulation  
No 139/2004<sup>1</sup>**

1. On 29 September 2008, the Commission received a notification of a proposed concentration by which Sappi Limited ("Sappi", South Africa) would acquire control of the coated graphic business and certain related uncoated graphic business activities of M-real ("M-real", Finland) by way of purchase of shares and assets.

#### **I. THE PARTIES**

2. Sappi is a South African pulp and paper company, which is active worldwide in the manufacture of coated fine paper, chemical cellulose, uncoated graphic and business paper, premium quality packaging papers and a range of speciality papers.
3. M-real is a worldwide supplier of paperboard, coated and uncoated fine paper, coated magazine paper, speciality papers and pulp. It forms part of the Metsäliitto Group, a global forest industry group.

#### **II. THE OPERATION AND CONCENTRATION**

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<sup>1</sup> OJ L 24, 29.1.2004 p. 1.

4. Sappi intends to acquire the entire coated graphic paper business of M-real, as well as certain uncoated graphic paper business activities closely related to the coated graphic paper business.
5. The acquisition of the following assets is to be effected by way of business sale:
  - (a) All of the know-how, brands, order books, customer lists, intellectual property and goodwill in the coated graphic paper business and related to M-real's mills at Husum<sup>2</sup> , Äänekoski<sup>3</sup> , Hallein and Gohrsmühle<sup>4;5</sup>
  - (b) The business of the Kirkniemi mill; and
  - (c) The business of the Kangas mill.
6. The acquisition of the following assets is to be effected by way of share transfer:
  - (a) All the shares in M-real Stockstadt Holding GmbH<sup>6</sup> and its subsidiary Chemische Werke Zell-Wildshausen GmbH;
  - (b) All the shares in CN Papiervertriebs GmbH; and
  - (c) All the shares in M-real Biberist AG.
7. Post-transaction, M-real will continue to operate mills at Husum, Äänekoski, and retain the mills in Hallein and Gohrsmühle. It will also keep know-how, brands, order books, customer lists, intellectual property and goodwill in the coated graphic paper business in South Africa.
8. The parties plan to a number of agreements which are considered ancillary to the transaction:
  - (i) A non-compete arrangement with a duration of three years.
  - (ii) Transitional agreements for Husum and Äänekoski paper mill according to which, [...]
9. In addition, Sappi and M-real enter into a number of long-term supply agreements [...].

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<sup>2</sup> Sappi does not buy the plant and machinery in Husum. [...]

<sup>3</sup> Sappi does not buy the plant and machinery in Äänekoski. [...]

<sup>4</sup> Excluded from the transaction is Chromolux, a brand of wood-free coated paper (WFC) used mainly for labels and packaging.

<sup>5</sup> Excluding the know-how, brands, order books, customer lists, intellectual property and goodwill in M-real's coated graphic paper business in South Africa. The transaction also does not include plants or machinery.

<sup>6</sup> This asset includes the production and sale of pulp to third parties, however, the quantity concerned is [...].

10. Through the acquisition of shares of several legal entities mentioned in recital (6) above Sappi will obtain full control of these undertakings. Furthermore, through the acquisition of assets including M-real's brands, know how, customer lists, intellectual property rights and good will as described in recital (5) above, Sappi acquires control over parts of an undertaking. Consequently, the proposed transaction constitutes an acquisition of sole control within the meaning of Art. 3(1)(b) of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings ("ECMR")<sup>7</sup>.

### **III. COMMUNITY DIMENSION**

11. The undertakings concerned have a combined aggregate worldwide turnover of more than EUR 5 billion (Sappi: EUR 3.985 billion; M-real: EUR 1.972 billion). Each of them have a Community-wide turnover in excess of EUR 250 million (Sappi: EUR [...]; M-real: EUR [...]), and each of them does not achieve more than two-thirds of its aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension pursuant to Article 1 (2) ECMR.

### **IV. COMPETITIVE ASSESSMENT**

#### **1. Relevant product markets**

12. The transaction concerns the coated graphic paper business as well as certain related uncoated graphic paper business activities (in particular fine paper which may be further subdivided into wood free coated and wood free uncoated paper and coated mechanical paper which belongs to the broader product range of magazine paper).
13. In previous decisions, the Commission has taken the view that fine paper and magazine paper were each in a separate product market.<sup>8</sup> The relevance of this distinction was confirmed by a clear majority of the respondents in the market investigation in the present case.
14. Fine paper and magazine paper can be segmented into wood-free paper and wood-containing paper.<sup>9</sup> Wood-free paper contains little or no mechanical wood pulp and is made primarily using chemical pulp and is of a higher quality than wood containing paper.
15. The WFC segment can be further segmented, for instance by defining separate segments for wood-free coated paper ("WFC") and wood-free uncoated paper ("WFU") within the fine paper market. Within the magazine paper market; a separate segment for coated mechanical paper ("CM") may be distinguished.
16. The market investigation showed that a majority of the respondents did not consider relevant to make a distinction between WFC and WFU. For the purpose of the present case, the question of whether to make a distinction between WFC and WFU may,

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<sup>7</sup> OJ, L 24/1, 29 January 2004.

<sup>8</sup> Commission decisions of 21.11.2001, case No COMP/M.2498 – UPM-Kymmene/Haindl, and of 15.12.2000, case No COMP/M.2245 – Metsä-Serla/Zanders.

<sup>9</sup> Commission decision of 21.11.2001, case No COMP/M.2498 UPM-Kymmene/Haindl.

however, be left open, as the proposed transaction does not raise serious doubts even under the narrowest market definition.

17. In a previous decision, the Commission considered defining separate markets for each paper segment according to whether the paper was supplied in reels or sheets.<sup>10</sup> The market investigation in the present case has indicated that it may not be possible for all customers (printers) to switch from reels to sheets and vice versa. Reels are primarily bought by printers who carry out large printing job using large machines, while sheets are primarily used for smaller printing jobs. While some printers use both reels and sheets, others only have the appropriate machinery for one type of paper. However, the question of whether a distinction should be made between sheets and reels may be left open in the present case, as the proposed transaction does not raise serious doubts with regard to either of these possible segments.
18. A further distinction may be made between paper sold directly from the manufacturers or indirectly through merchants. The Commission has in previous decisions considered such a distinction relevant.<sup>11</sup> Even though it was recognized that it would typically require large volumes to purchase paper directly from manufactures, a majority of respondents to the market investigation in the present case indicated that it would not be appropriate to define separate markets according to distribution channel. However, for the purpose of the present case, the question of whether separate markets exist depending on the distribution channel may be left open, as the proposed transaction does not raise serious doubts even under the narrowest market definition.
19. In conclusion, the precise market definition with respect to fine paper and magazine paper can be left open since even on the narrowest definition of the markets, the proposed transaction does not raise serious doubts as to its compatibility with the common market.

## **2. Relevant geographic markets**

20. According to the notifying party, the geographic scope of all relevant product markets is at least EEA-wide in scope. This has been confirmed in the market investigation.

### **2.1 Fine Paper, including WFC**

21. In previous decisions, the Commission held that the market for fine paper which includes WFC is at least EEA-wide in scope.<sup>12</sup>

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<sup>10</sup> Commission decision of 04.06.2008, case No COMP/M.4513 – Arjowiggins/M-real Zanders Reflex.

<sup>11</sup> Commission decision of 24.10.2007 – case No COMP/M.4753 – Antalis/MAP.

<sup>12</sup> Commission decisions of 24.10.2007, case No COMP/M.4753 – Antalis / MAP, recital 33, of 25.07.2005, case No COMP/M.3822 – Stora Enso / Schneidersöhne, recital 15 and of 15.12.2000, case No COMP/M.2245 – Metsä-Serla / Zanders, recital 11. In a recent case the Commission found evidence that pointed towards national markets for a specific paper product, carbonless paper, but finally the question whether the relevant markets were national or EEA-wide open was left open. Commission decision of 4.6.2008, case No COMP M.4513 – Arjowiggins / M-real Zanders Reflex.

22. The parties submit that WFC products are supplied across Europe.<sup>13</sup> Sappi distributes its WFC paper to customers directly from each of its seven mills<sup>14</sup> (Alfeld and Ehingen, both in Germany, Gratkorn, Austria, Maastricht and Nijmegen, both in the Netherlands, and Blackburn, United Kingdom) and six distribution centres across the EEA. Similarly, M-real distributes WFC paper directly from each of its WFC producing mills<sup>15</sup> (Biberist - Switzerland, Stockstadt and Gohrsmühle, both in Germany, Äänekoski, Finland and Hallein Austria) across the EEA. Furthermore, the parties submit that a large proportion of their WFC sales are negotiated EEA-wide. More than [...] of Sappi's sales and more than [...] of M-real's sales are to their top 5 merchant customers which operate EEA-wide and with whom framework agreements are negotiated at the EEA-wide level.<sup>16</sup> Finally, the parties submit that price levels are rather homogenous throughout the EEA.<sup>17</sup>
23. The market investigation confirmed that the WFC market is at least EEA-wide in scope.
24. First of all, WFC is produced at only a small number of production sites within the EEA and supplied to customers throughout the EEA. The six largest producers which account for approximately 80% of the EEA market are, besides Sappi and M-real, Lecta with production sites in Spain, France, and Italy, Stora Enso with production sites in Germany and Finland, Burgo with production sites in Italy and Belgium, and UPM Kymmene with production sites in Germany and Finland.<sup>18</sup> Customers – for the majority of the sales big merchants with activities in several member states – also negotiate central sales agreements at an EEA-level (see recital 26).
25. Transport costs are not a limiting factor. According to the parties' best estimates, transportation represents 8% to 10% of total cost.<sup>19</sup> The incremental transport costs per 100km would be between [...] for M-real's mills<sup>20</sup> compared to a product price within a range of [...].<sup>21</sup> Respondents in the market investigation confirmed that it is possible to source WFC over long distances and that transport costs play only a minor role in choosing a supplier.

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<sup>13</sup> Parties' Submission of 11 October 2008, at 1.1.

<sup>14</sup> Independently from the present transaction, Sappi announced on 5 August 2008 that it has entered into a consultation process with employee representatives at its Blackburn mill with a view to cease production of the Blackburn Mill.

<sup>15</sup> The parties intend to end production of WFC in the Hallein and Gohrsmühle mill post transaction.

<sup>16</sup> Parties' Submission of 11 October 2008, at 1.2.

<sup>17</sup> Parties' Submission of 11 October 2008, at 1.3.

<sup>18</sup> See Annex 2 to the Parties' Submission of 20 October 2008 (Map of European paper mills)

<sup>19</sup> Form CO, page 65.

<sup>20</sup> Parties' submission of 20 October 2008, at 4.

<sup>21</sup> See Annex 7.8a of the Form CO (Prices for M-real's WFC brand "Euroart Plus" (sheets)). Only prices in [...] are outside this range.

26. Respondents to the market investigation also confirmed that the big merchants groups negotiate and conclude central agreements for the whole of the EEA. This is in line with the explanation the parties gave on their contractual relationships with their customers.<sup>22</sup> These agreements normally set out distribution rights, types of product, target volumes, general terms of doing business, a ceiling price (if applicable), and rebates which are agreed on a pan-European business for larger merchants.
27. Although there are price differences throughout the EEA in the market for WFC paper, these do not point towards the existence of national markets with different competitive conditions. The parties provided representative examples of average country prices for WFC qualities.<sup>23</sup> Price differences are generally below 10% and, in many cases, below 5%. These differences can be explained by the fact that the size and identity of customers in Member States vary and different rebates and discounts apply. In Member States where only small volumes are traded, average prices might not be representative. Furthermore, transport costs which differ from country to country are included in the average prices per Member State and exchange rates affect the prices of certain Member States.<sup>24</sup>
28. Finally, customers were asked whether they would switch to suppliers in other countries if prices of fine paper in their home country were to increase by 5-10% on a permanent basis while other prices remained constant. Respondents – both direct and indirect customers – answered that they do not consider the markets on which they source to be national in scope. In case of such a price increase they would switch to the country with the lower price, which could include for some customers supplies from outside the EEA. Against this background, the market for WFC is considered to be at least EEA-wide.<sup>25</sup>

## **2.2 Magazine paper, including CM**

29. In a previous decision, the Commission also held that the market for magazine paper including CM is at least EEA-wide.<sup>26</sup> Similar to the findings for WFC, the market investigation has confirmed that this geographic market definition is still valid. Like WFC, CM is only produced at a few production sites within the EEA. Transport costs are not a limiting factor for EEA-wide supplies of CM. Customers confirmed that the market where they source CM is at least EEA-wide in scope and that they would switch their demand to suppliers outside their home country in case of a permanent price increase by 5-10%.<sup>27</sup>

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<sup>22</sup> Parties' submission of 20 October 2008.

<sup>23</sup> Annex 8 and 9 of the submission of 11 October 2008.

<sup>24</sup> Parties' submission of 20 October 2008, at 2.

<sup>25</sup> This also applies for sub-markets based on the different distribution channels as well as the supply in reels or sheets.

<sup>26</sup> Commission Decision of 21.11.2001, case No COMP/M.2498 UPM-Kymmene / Haindl, recital 33.

<sup>27</sup> This also applies for sub-markets based on the different distribution channels as well as the supply in reels or sheets.

### 3. Competitive Assessment

#### 3.1 General conditions in the sector

30. The parties submitted that the coated graphic paper markets in the EEA are characterised by overcapacities. According to them, Western Europe as the world's major paper exporter is currently in decline. In particular, major emerging markets that have historically been major export destinations for Western European paper are developing significant production capacities. Therefore, exports from Europe are likely to shrink in the future.
31. Industry reports also foresee declining exports from Western Europe to third countries.<sup>28</sup> They expect paper manufacturers to close capacities because they need to adapt to declining exports to other parts of the world and in order to reduce the current overcapacities. Price increases are considered to be difficult to maintain. In particular, the overall capacity in Western Europe for WFC is expected to grow from 10,980,000 tons to 11,040,000 tons only (0.5%) whereas capacities in China are expected to grow from 4,000,000 tons to 6,630,000 tons (65.8%) between 2007 and 2012.<sup>29</sup>
32. In the present investigation, market participants were asked to give their view on the development in demand and production capacities and their expectations for the future trends in the WFC and CM segments. It has broadly been confirmed that demand is decreasing, that input costs are increasing and that there is overcapacity in the European paper industry at present. As the profitability of capacities decreases with input costs rising, paper manufacturers react by reducing capacities. Therefore, customers consider it likely that suppliers of WFC and / or CM paper will reduce their production capacities within the next years. In their view, in a context of low profitability, paper manufacturers' strategy is to close less competitive capacities in order to shift volumes to more competitive mills in more attractive markets.<sup>30</sup>
33. The parties also plan to cut capacities. On 5 August 2008 Sappi announced that it has entered into a consultation process with employee representatives at its Maastricht PM5 mill in the Netherlands (WFC capacity: 60,000 tons) and at its Blackburn Mill in the United Kingdom (WFC capacity: 99,826 tons) with a view to ceasing production in these mills.<sup>31</sup> Furthermore, it is intended, following the transaction, to end production of WFC in M-Real's mills at Hallein in Austria (total paper capacity of 310,000 tons) and Gohrsmühle (total paper capacity of 370,000 tons).<sup>32</sup> According to the internal documents submitted by the parties, all closures were already planned before and

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<sup>28</sup> EMGE World Graphic Papers, March 2008, page III.

<sup>29</sup> EMGE World Graphic Papers, March 2008, page 25, figure 55.

<sup>30</sup> See, for example, the answer of Antalis (non-confidential version) to question 13 relating to expected capacity reduction within the EEA in the next years.

<sup>31</sup> After the closures, Sappi will produce WFC in Alfeld, Ehingen, Gratkorn, Maastricht (reduced capacity after the closure of Maastricht PM5) and Nijmegen. In Lanaken, Sappi produces CM.

<sup>32</sup> After the closures, WFC will be produced in Äänekoski, Biberist and Stockstadt. In Husum, Kangas, and Kirkniemi CM is produced.



independently of the transaction.<sup>33</sup> Although the utilisation rate at the mills owned by the parties is generally above 90%, the parties consider production to be unprofitable in some mills and therefore opted for the closures.

### 3.2 Horizontal Effects

34. The main overlap between the parties' activities is in the segment of WFC paper and to a lesser degree in relation to WFU paper and CM paper (cf. table 1).

**Table 1: Market shares of the Parties, 2007**

RELEVANT MARKET	SAPPI	TARGET	COMBINED
WFC paper	[10-20]%	[10-20]%	[20-30]%
CM paper	[0-5]%	[10-20]%	[10-20]%
WFU paper	[0-5]%	[0-5]%	[0-5]%

35. The markets for WFC paper and CM paper are technically affected. In these markets, the combined market share of the parties reaches [20-30]% and [10-20]%, respectively. On the other hand, the market for WFU, where the parties have, according to their best estimates, a combined market share of [0-5]%, is not regarded as being affected by the concentration.

36. Both parties are also active in the supply of pulp to third parties in Europe. However, with a combined market share of less than [0-5]% (parties' best estimates), this market is regarded as not being affected by the concentration.

37. The proposed transaction does not lead to increased vertical integration. While M-real is vertically integrated upstream into forestry products, this will not change post transaction because Sappi is only acquiring M-real's coated graphic paper business (and related activities; see above).

#### 3.2.1 WFC paper

38. Sappi is the leading producer of WFC paper in Europe, while M-real is the third largest. Their combined *capacity* share in the EEA WFC paper market would be [30-40]% (Sappi: [20-30]%, M-real [10-20]%). If, however, the announced closures at M-real's mills in Hallein and Gohrsmühle are taken into account, M-real's market share would be [5-10]% instead of [10-20]% (combined [30-40]%), and M-real would only be the sixth largest producer. The combined capacity share would be further reduced to [20-30]%, if the closure of Sappi's Blackburn and Maastricht PM5 mills is taken into account.

39. While Sappi would achieve a *market* share of [20-30]% post-transaction, there are a number of large competitors present in the EEA WFC market who would be able to

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<sup>33</sup> For M-real: Annex 6.8a of the Form CO and for Sappi: Annex 6.8b of the Form CO.

exert competitive pressure on Sappi, cf. Table 2. Among the largest competitors are Lecta, Stora Enso, Burgo and UPM-Kymmene. Furthermore, Asian suppliers are gaining a foothold in Europe. In the first quarter of 2008, the volume of imports from Asia grew by [5-10]% as compared to the first quarter of 2007.

**Table 2: Market shares of the Parties in WFC, 2007**

	MARKET SHARE
Sappi	[10-20]%
Target	[10-20]%
Combined	[20-30]%
Lecta	[10-20]%
Stora Enso	[10-20]%
Burgo	[10-20]%
UPM-Kymmene	[10-20]%
Arjowiggins	[5-10]%
Others	[10-20]%

40. The market shares and the capacity shares submitted by the parties have largely been confirmed in the market investigation. All manufacturers of WFC mentioned above provided their sales and their capacities on a mill-by-mill basis. Based on this data, the combined market share of the parties would be [30-40]% (instead of [20-30]%) and the combined capacity share would be [30-40]% (instead of [30-40]%)<sup>34</sup> and [30-40]% (instead of [20-30]%)<sup>35</sup>.
41. In case the market was segmented according to distribution channel, Sappi would obtain a market share of [20-30]% in the direct sales channel and [30-40]% in the indirect sales channel. According to the parties, direct sales account for [20-30]% of total sales of WFC paper. If a distinction was made between WFC sheets and reels, Sappi would obtain a market share of [30-40]% in sheets and [20-30]% in reels.
42. Neither the combined market shares (under any possible market definition) nor the combined capacity shares point to the possibility of non-coordinated effects after the merger. Customers in the market investigation have largely confirmed that the merger will have only a limited impact as alternative suppliers are available. The transaction is seen as part of a consolidation of the European market which is inevitable and that will lead to the

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<sup>34</sup> If the plants which the parties intend to close are included.

<sup>35</sup> If the plants which the parties intend to close are excluded.

reduction of capacities. In that perspective, the continuation of M-real's business is seen positively by customers as a way of capacities being reduced without supplies being disrupted.<sup>36</sup>

43. For the above reasons, it is considered that the proposed transaction does not raise serious doubts as to its compatibility with the common market and the EEA Agreement on the market for WFC paper.

### 3.2.2 CM paper

44. Sappi is the seventh largest producer of CM paper in the EEA, while M-real is the fourth largest.
45. While Sappi would achieve a market share of [10-20]% post-transaction, there are a number of large competitors present in the EEA CM market who would be able to exert competitive pressure on Sappi, cf. Table 3. Among the largest competitors are UPM-Kymmene, Stora Enso, Burgo, Myllykoski and Norske Skog.

**Table 3: Market shares of the Parties in CM, 2007**

	MARKET SHARE
Sappi	[0-5]%
Target	[10-20]%
Combined	[10-20]%
UPM-Kymmene	[20-30]%
Stora Enso	[10-20]%
Burgo	[10-20]%
Myllykoski	[5-10]%
Norske Skog	[5-10]%
Leipa	[5-10]%
Others	[10-20]%

46. The market shares submitted by the parties have largely been confirmed in the market investigation. The combined market share would be slightly lower than estimated by the parties ([10-20]%).

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<sup>36</sup> It was submitted that for Germany the transaction will lead to major changes in supply. However, as Sappi acquires M-real's Coated Graphic Paper Business as a whole it can be expected that it has a vital interest to stabilize customer relationships.

47. In case the market was segmented according to the distribution channel, Sappi would obtain a market share of [40-50]% in the indirect sales channel and [10-20]% in the direct sales channel. However, direct sales account for approximately [90-100]% of all CM paper sales and given the overall market share of Sappi post-merger of [10-20]% in the CM market segment, a market share of [40-50]% in the small direct sales channel does not raise competition concerns.
48. If a distinction was made between CM sheets and reels, Sappi would obtain a market share of [20-30]% in sheets and [10-20]% in reels.
49. As the combined market share of the parties is rather modest, the transaction is unlikely to result in non-coordinated effects. This was confirmed in the market investigation.
50. For the above reasons, it is considered that the proposed transaction does not raise serious doubts as to its compatibility with the common market and the EEA Agreement on the market for CM paper.

## **V. CONCLUSION**

51. For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EC) No 139/2004.

For the Commission

*signed*

Benita FERRERO-WALDNER  
Member of the Commission