Investigation into possible collective dominance in the publication paper industry

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1. On 20 June 2000, the Commission received a notification by which the Finnish firm UPM-Kymmene proposed to merge with the German company Haindl. On the same day, the Commission received a notification of a second concentration which concerns the resale of two of the six Haindl mills, Parenco in the Netherlands and the Walsum mill in Germany, by UPM-Kymmene to the Norwegian paper manufacturer Norske Skog. The two concentrations concerned the economic sectors of pulp and publication papers and in particular in the production and sale of wood containing printing paper. The only affected markets were the markets for newsprint and wood-containing magazine paper. After an in-depth investigation, the Commission cleared both concentrations on 21 November 2001.

2. The market contains some global players, some medium-sized players and some very small players. Top suppliers in the newsprint market are UPM-Kymmene, Stora Enso, Norske Skog, Haindl and Holmen; other companies are principally SCA, M-Real/Myllykoski, and Palm. In the market for wood-containing magazine paper, top suppliers are UPM-Kymmene, Stora Enso, Haindl, and M-Real/Myllykoski; the remaining players are comprised of principally SCA, Burgo, Sappi, and Norske Skog. Note that M-Real/Myllykoski and Norske Skog are considered either top supplier or fringe depending on the considered market.

3. The Commission investigated whether the two proposed concentrations would result in the creation of a collective dominant position (1) in the markets for newsprint and wood-containing magazine paper by a subset of large firms called top suppliers. In particular, the Commission analysed:
   1. The impact of the merger on competition;
   2. Whether the characteristics of the market makes the market conducive to tacit co-ordination;
   3. The sustainability of the co-ordination, that is to say:
      — whether any one of the top suppliers would have the ability and incentive to deviate from the co-ordinated outcome, considering the ability and incentives of non-deviators to retaliate;
      — whether buyers/fringe players/new entrants have the ability and incentive to challenge the top suppliers’ anti-competitive behaviour.

In addition, the Commission has examined the nature of past competition.

Market characteristics

4. The publication paper industry is characterised by long-run competition in capacity and short-run competition on prices under capacity constraints. That is to say that in these markets, the level of capacity and average demand determines the long-run average price level whereas short-run demand determines the short-run price at a given capacity level. These characteristics are very similar in the market for newsprint and in the market for wood-containing magazine paper and can be summarised as follows: i) both newsprint and the main grades of wood-containing magazine paper can be considered as homogeneous products, although some variations within the different paper grades exist; ii) there has been some degree of fluctuations in the market shares of the top suppliers, in the markets for newsprint and wood-containing magazine paper respectively. These variations in terms of market share are limited for wood-containing and more pronounced for newsprint; iii) there exists a high degree of transparency on capacities, deliveries, on average prices but lack of transparency in relation to investment decisions, iv) demand is inelastic and cyclical; v) there is some uncertainty to the degree of cost symmetry, espe-

(1) Collective dominance is usually associated with the joint exercise of market power through the tacit co-ordination of market behaviour of a group of firms.
cially in the newsprint market; vi) there is a high level of multi-market contacts and links; vii) buyer power is limited; viii) an up-to-date technology is easily available; ix) the pulp & paper industry has the characteristics of a sunk cost industry (i.e. high entry barriers).

Assessment

Impact of the proposed operations on the market structure

5. In the newsprint market, the Commission has examined whether the operations may have led to the creation of a collective dominant position by the four companies UPM-Kymmene/Haindl, Stora Enso, Norske Skog and Holmen resulting in a four-firm concentration ratio of [60-70%] in terms of sales. In terms of capacities the four-firm concentration ratio would be [70-80%]. In the market for wood-containing magazine paper, post-mergers, the top three suppliers companies, UPM-Kymmene/Haindl, Stora Enso, M-Real/Myllykoski would still account for of [60-70%] of the market in terms of capacity and of [60-70%] in terms of sales. The proposed transactions reduced the number of the leading firms in this industry from five to four in the newsprint market/ from four to three in the wood-containing magazine paper market, Haindl has been particularly active in the last five years as it accounts for a large part of the total increase in capacity.

Possibility to co-ordinate

8. Co-ordination might have occurred through two mechanisms:
   • first through the co-ordination of investment in new capacities, in order to limit capacity in the market place raising thus the level of average prices in the long-run;
   • second, through co-ordination of output downtimes to support short-run prices during a slowdown of demand (there is no need to co-ordinate in the short-run in a period of a high level of demand).

9. Co-ordination of investment in new capacities might have operated along a process of announcements and counter-announcements. All market players have a series of potential investment projects, that is to say prospective sites where they could build new paper machines. Investment decision-making usually involves a number of parameters, and is ultimately related to return on investment. The Commission, after examining the elements brought forward by the parties, concluded that it was unlikely for oligopolists to be able to use announcements to co-ordinate tacitly and that it is unlikely that they could detect a potential deviator. In particular, the Commission considered that the oligopolists would require sufficient transparency in order to judge whether a project would have the required rate of return. Otherwise, announcements would not be taken seriously by the other firms and would not have any impact on their investment decision-making.

10. Regarding co-ordination on down-times, the parties first argued that this mechanism had no impact on prices. They then claimed that it is not possible to either define or detect downtime, because of a lack of transparency. They sustained that down-time may take so many forms that it would not be possible for firms to recognise when to co-ordinate; it would also be very difficult to define an optimal operating
rate at a given time. They also said that it is not possible to detect a deviator. Consequently, there would be high incentives for the oligopolists to cheat, as soon as they have an opportunity to do so. Finally, they argued that the punishment of a deviator from an agreement on downtime would be extremely costly and not credible.

11. However, the Commission did not share the view of the parties that co-ordination of downtime was not a possible co-ordination mechanism in the newsprint and wood-containing magazine paper markets respectively. First, the Commission did not find that downtime has no impact on prices. Also, it was difficult to argue that down-time could be hidden from market players, since there was transparency on downtime through various channels. Suppliers normally tell their customers about forthcoming downtime on machines which supply such a particular customer. This has been confirmed by a submission of one of the major competitors. Due to customers’ multi-sourcing policies, the oligopolists very often deliver the same clients. Moreover, there are statistics available in the market about stock levels and downtime levels.

12. Secondly, retaliation tools appeared credible. When a competitor deviates, the remaining top suppliers can take aggressive actions without having to change prices for all their remaining customers. This may induce some customers to switch all or part of their demand away from the deviator and to substitute supply from the other top suppliers, and may drive down the price paid by important customers of the deviator. Moreover, in a period of low demand, capacities are available if needed to support retaliation. These capacities may be used to target important customers of a deviator without affecting the whole market. This is credible as the main customers of the top suppliers are usually well-known by the other ones. Moreover, the number of swing machines and their corresponding capacities are not marginal and export sales are not mainly based on long-term contracts. Both can be used as potential sources of capacities and therefore as a credible punishment device.

13. The Commission concluded that the mechanism identified above for the co-ordination of investments would not sustain the creation of a tacit co-ordination in the markets for newsprint and wood-containing magazine paper respectively. However, it maintains that tacit co-ordination of downtime is a possible co-ordination mechanism, which could support the creation of a collective dominant position of the four (respectively three) top suppliers in the newsprint market (respectively the market for wood-containing magazine paper).

14. However, any such co-ordination would likely be undermined by action of fringe players. Indeed, the Commission believed that the remaining fringe players can play an active role in their respective markets and make tacit co-ordination unsustainable. These fringe players are SCA, Abitibi, Sappi, Palm and Burgo. These players could break co-ordination by investing when the oligopolists would try to refrain investment to reach higher prices and by increasing production when the oligopolists would try to shut down their machines temporarily (the definition of downtime). These firms would have the means to take advantage of the tacit co-ordination among top players, to improve their competitive positioning and increase their market shares.