Non-Confidential Version

ACQUISITION BY VARIOUS SUBSIDIARIES OF GREIF INC. OF BLAGDEN PACKAGING GROUP

GREIF'S RESPONSE DATED 2 JULY 2007
TO THE PROVISIONAL FINDINGS REPORT OF THE COMPETITION COMMISSION OF 19 JUNE 2007

CONTENTS

1. <u>INTRODUCTION</u>

1.1 This submission sets out the response of Greif Inc and Greif International Holding B.V. (collectively "Greif") on the Provisional Findings Report published by the Competition Commission (the "Commission") on 19 June 2007 (the "Provisional Findings") in connection with the completed acquisition by various subsidiaries of Greif Inc. of the Blagden Packaging Group.

1.2 As requested by the Commission, this submission seeks to bring together the critical information and evidence in rebuttal of the Provisional Findings which have been submitted by Greif to the Commission during the course of this inquiry. In the event that the Commission feels that any critical points have not been sufficiently addressed in this response, Greif requests that the Commission advises Greif in good time, prior to its final report.

1.3 The Provisional Findings are that the merger may be expected to lead to a substantial lessening of competition ("SLC") in the market for new and reconditioned large steel drums in Great Britain. This view appears to be based upon the following:-

(a) The product market is limited to new and reconditioned large steel drums only because:

- switching costs to alternative packaging products are costly and difficult; and

- past evidence of switching in response to large increases in the price of steel drums relative to alternative packaging products falls below the critical loss threshold.

(b) The geographic market is limited to Great Britain because current price differentials between large steel drums produced in Great Britain and continental Europe and the level of transport costs mean that a switch to imports would be unlikely in response to a 5% increase in Greif's UK prices.

(c) Competitive constraints are not sufficient to counter the loss of Blagden as a competitor to Greif because:

- the parties were each other's closest competitor pre-merger in terms of switching and market shares;

- Greif has the ability to price discriminate post-merger; and

- the parties are the lowest incremental cost manufacturers compared to new large steel drum competitors.

1.4 Based on the findings outlined in 1.3 above, the Commission concludes that 'there <u>might</u> be a universal price rise, or specific price rises for customers who are least likely to switch away from new large steel drums, or indeed a combination of the two'. *(Emphasis added)* (§ 8.3).

1.5 The Commission finally considers whether other competitive constraints, namely entry of new competitors or expansion by existing suppliers limited to the new large steel drum market *only* and countervailing buyer power, are sufficient to counter the risk of price increases identified at 1.4 above. The Commission dismisses these competitive constraints as insufficient to counter the finding of an SLC despite the fact that it completely fails to look at the impact of **all** competitive constraints **in the aggregate**.

1.6 Greif considers that the Provisional Findings are vitiated by such serious and manifest errors and omissions in both substantive assessment and procedure that its provisional findings of an SLC cannot be sustained.

1.7 The Commission fails to take into account any "relevant customer benefits" which arise in relation to the acquisition of Blagden by Greif, including those noted by the Commission in its Provisional Findings (paragraph 3.5), namely,

- reduced costs through efficiencies and synergies;
- improvements in steel drum technology;
- enabling steel drums to continue to compete effectively with other forms of industrial packaging.

We refer the Commission again to the presentation on Greif's investment plans for the Blagden plant and the potential cost savings and capacity changes which will result (see Annex A). These merger-specific efficiencies will lower Greif's costs per drum, enabling it to compete more effectively with other forms of packaging. Greif's past experience has always been that any efficiency improvements are partly passed on in terms of lower prices to customers. If the Commission blocks the merger, then it will deny customers these benefits.

1.8 Nevertheless, notwithstanding the fact that Greif disputes the Commission's provisional findings of an SLC, Greif has offered to the Commission a remedy which is straightforward and workable and which addresses squarely the concerns raised by the Commission as to an SLC.

1.9 The remainder of this paper is set out as follows:

- Starting in Section 2, we discuss the fundamental legal standards that should form the foundations of the merger analysis. We identify the standard of proof that applies to a finding of an SLC, and the appropriate use of evidence in reaching that standard. We provide particular examples of evidence to which the Commission does not appear to have given due weight.
- In Section 3 we identify the correct application of the SLC, as described in the Commission's guidelines. We emphasis that the key issue for a merger is not the precise delineation of the market; it is whether all constraints **in aggregate** prevent an SLC. This is a fundamental flaw that characterises the Commission's analysis.
- In Section 4 we begin our analysis of the evidence. Section 4 focuses on the potential for price increases post-merger. This section contains a substantial amount of new material, and in particular provides a critique of the Commission's concerns over price discrimination.

- In Section 5, we review the evidence available to determine the relevant product market. We consider the results of the Commission's customer survey, the evidence on switching costs, past switching, and the degree to which switching to alternative packaging might continue in the future. We believe the Commission's inflexible approach to market definition (and then the competitive assessment) does not give due weight to the constraint imposed by alternative packaging.

- In Section 6, we review the evidence used to assess the geographic market definition. We also present a new assessment of the economies of transportation, based on factory gate prices provided by Greif. This new analysis shows that drums could be cost-effectively transported from the Benelux, Germany and France.

- In Section 7, we review the evidence available to determine the pre-merger degree of competition between Blagden and Greif, and the post-merger competition provided by 'smaller' rivals. We show that Blagden was just one constraint of many on Greif's conduct, and that there is no basis to think the loss of Blagden will substantially lessen competition.

2. GENERAL REPRESENTATIONS

(A) Substantial burden of proof

2.1 The questions which the Commission is required to decide in this inquiry are set out in section 35 of the Enterprise Act 2002, and include, inter alia, whether the merger "*has resulted, or may be expected to result, in a substantial lessening of competition within any market or markets in the United Kingdom for goods or services."*

2.2 The Provisional Findings provisionally conclude that the merger may be expected to lead to an SLC.

2.3 The relevant test under the Enterprise Act 2002 was considered by the Competition Appeal Tribunal ("CAT") and the Court of Appeal in the context of the OFT's preliminary role in the *IBA Health* case. The Court of Appeal agreed with the CAT that the test of whether something "may be expected to result" was said to mean "a more than 50% chance" of it happening.[1]

2.4 Accordingly, by law the Commission is only entitled to make a finding of SLC where there exists a proper evidential basis to support the view that an SLC is more likely to result than not. Greif considers that the Commission's approach to the evidence in this case has been unduly selective and inadequate and that a proper assessment of the evidence shows that this burden of proof has not been discharged.

(B) Inadequacy of evidence to discharge burden of proof

2.5 In a lecture given by Mr Peter Freeman, Chairman of the Competition Commission, at a meeting of the David Hume Institute in the Royal Society of Edinburgh on 3 May 2007 entitled ' "A Wise Man Proportions His Beliefs to the Evidence": Scepticism and Competition Policy', Mr Freeman says that the title quotation (from Hume) reflects the way in which the Commission endeavours to conduct itself in the context of its investigations into mergers. To quote from Mr. Freeman's speech:-

> *"The CC recognises that its 'beliefs', namely the views formed and decisions taken on competition-related matters during the course of an investigation and, if necessary, any 'remedies' subsequently imposed, must be based on clear and justifiable analysis undertaken using any and all of the evidence available to it.*
>
> *"This method of reasoning not only requires robust and transparent evidence-gathering processes, it also requires the CC to use its expertise to analyse that evidence and to consider the weight that should be given to each piece of evidence. In 'proportioning' our 'beliefs', we give serious weight to points where strong and convincing evidence exists, but will be sceptical about things for which there is no good evidence."* [*Emphasis added*]

2.6 In Greif's view, the analysis and evidence relied on by the Commission in the Provisional Findings is wholly inadequate to discharge the burden of proof of the existence of an SLC.

[1] See [2004] UKCLR 683 at paragraphs 45-6 per the Vice Chancellor

(C) Use of evidence

2.7 The approach of the Commission to the available evidence has been unduly selective, leaving the Commission open to the charge of having a preordained view of the matter that has predisposed it to accept evidence that supports a finding of an SLC and to downplay or ignore evidence to the contrary.

2.8 Greif's concerns with the Provisional Findings include but are not limited to the following examples:-

(a) the Commission seems determined to dismiss the results of its customer survey[2] (in particular the responses to Q34 and Q35 of the survey) which indicate a high propensity on the part of customers to switch to an alternative supplier in response to a 5% price increase on the part of the merged Greif/Blagden entity, on the grounds that the Commission is "uncertain about the reactions of the large proportion of customers in the sample" (paragraph 49 of the Commission's report on a survey of the parties' customers) (this appears to refer to 23 customers who gave a non-behavioural response to Q34), whereas in paragraph 5.49 of the Provisional Findings the CC seems happy to rely on the results of Q28 of the survey about factors which might inhibit switching to imported steel drums where the reactions of 20 of the customers in the sample are unknown;

(b) the Commission has downplayed evidence from third parties which were positive to the merger or which expressed no or few concerns about the merger;

(c) the Commission appears to have ignored evidence that imports exert an actual or potential competitive constraint;

(d) the Commission is selective in its interpretation of the evidence given to it. For example, in paragraph 55 of Appendix C to the Provisional Findings it selectively quotes from Greif's internal Strategy Review document of August 2005, but fails to quote Greif's own views contained in the same document on growth in the IBC sector, projecting **[…..]** % per annum future growth in IBCs in Western Europe. Further, the Commission does not quote the evidence given to the Commission as to **[……..]**'s views on the growth of the IBC sector in the UK;

(e) the Commission states that Greif 'initially told us that demand for these types of chemicals (*hydrocarbon-based solvent type and the chlorinated hydrocarbons*) was declining because of wider environmental considerations. Subsequently, Greif said that the decline in the UK chemicals industry may have been overstated and suggested that declining UK demand for large industrial packaging indicated movement to bulk transport' (§ 4.8 of the Provisional Findings). This statement infers that Greif's original statement with regard to hydrocarbon-based solvents and chlorinated hydrocarbons was incorrect. This is not the case. Greif undertook further research, based on official UK national statistics, which was submitted to the Commission[3] and

[2] See Annex K which summarises the survey results.

[3] Response to Draft Provisional Findings – Putback to Greif submitted to the Commission on 31 May 2007

which **confirmed** the decline in hydrocarbon-based solvents and chlorinated hydrocarbons. The statistics unearthed by Greif's further research showed however that the **overall** UK chemicals market had grown.

(f) the Commission fails to analyse price discrimination in any systematic way. In particular:

(i) The Commission fails to show how Greif could identify customers who have most difficulty in switching from steel drums;

(ii) The Commission does not consider the sophistication of Greif's customers, and how these customers could behave strategically to thwart price discrimination;

(iii) The Commission does not attempt any analysis of the risks involved in a targeted price rise, and how it would only take a few mistakes for such a targeted price rise to be unprofitable.

3. APPLICATION OF THE SLC TEST

3.1 The June 2003 'Merger References: Competition Commission Guidelines' state:

> *"market definition and competition assessment should not be viewed as two distinct, chronological stages – rather they should be viewed as two overlapping analyses. Market definition can be thought of as a framework within which to analyse the effects of a merger on competition". [§1.25]*

3.2 The guidelines further state:

> *"Whilst in most instances, the Commission will want to be clear as to its preferred market definition, its duty is to decide whether a merger will result in an SLC or not and, as a result, it will not devote disproportionate resources to determining exactly whether a particular competitive constraint results from within the market (and so should be included in the market definition) or from outside the market". [§2.6]*

3.3 In particular, the Competition Commission guidelines are explicit that the key consideration is not whether a particular constraint is included in the market definition, but that ***all*** constraints are included in terms of assessing the likelihood of an SLC post-merger. For example, in relation to supply-side substitution, the guidelines state:

> "*Whilst the distinction between supply-side substitution and entry is considered for market definition purposes, the more important consideration in terms of establishing whether a merger results in an SLC is the extent to which the supply-side can be expected to act as a competitive constraint, regardless of whether such a response is labelled as supply-side substitution or potential entry. "* [§2.21]

3.4 It is clear from the guidelines that, whatever the market definition, the Commission is duty bound to consider all competitive constraints ***in the aggregate*** in any merger enquiry to determine whether or not an SLC arises. The Commission explicitly acknowledges that it believes that there would be some substitution to other packaging materials in the event of a 5% increase in the price of new and reconditioned drums.[4] The Commission is therefore bound to consider this as one of the competitive constraints when assessing whether the merger would result in an SLC. However, there is no consideration whatsoever of this acknowledged constraint in the Commission's assessment of the competitive effects of the merger.

3.5 As the Commission acknowledges, the customers for new large steel drums are heterogeneous.[5] The customers use steel drums to package a range of different products, and many also use other forms of industrial packaging. The heterogeneous nature of this customer base means that the substitution possibilities considered by customers are also heterogeneous. That is, although one customer may find IBCs a substitute, another customer may not. However, that other customer may instead consider imports or smaller steel drum manufacturers a viable

4 Paragraph 5.41, Provisional Findings.
5 Paragraph 4.6, Provisional Findings.

alternative. These different substitution possibilities are parallel and independent of one another.

3.6 In response to a price increase post-merger, some customers would switch to other UK drum suppliers, others to alternative plastic drums and IBCs, others to imports and yet others to bulk packaging or reconditioned drums, and there will be some customers who may not switch at all.[6] Even if individually, the total volume switching to each alternative was below the critical loss level (i.e. even if less than 10% of volume would switch to plastic drums for a 5% price increase), if the ***aggregate*** total of switching to alternatives (e.g. other packaging, imports and other manufacturers) equals or exceeds the critical loss level, then a general price increase will not result in an SLC. It simply cannot be correct to block a merger because customers switch to more than one alternative.

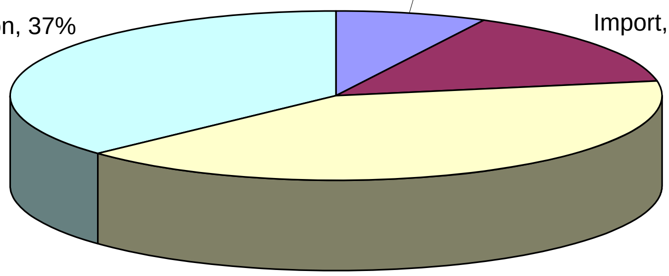
3.7 The Commission estimates that **[ ]** % of Greif's sales must be lost before a 5% price increase would be unprofitable (the 'critical loss'). The key question therefore is whether in assessing the likelihood of an SLC, Greif's loss of volume would equal or exceed the critical loss threshold of **[ ]** %. The cumulative evidence on the competitive constraints which the parties will face post-merger shows that a general 5% price rise post-merger would result in a cumulative loss of business of at least this level as some customers would switch to alternative packaging, others to imports and yet others to UK manufacturers.

3.8 For example, the customer survey asked customers how they would react to a price rise by the parties post-merger.[7] 17% of respondents said that they would switch supplier and a total of 39% of respondents said that they would look for an alternative in response to a price rise of up to 5%. These figures are clearly in excess of the level required to make a price increase loss-making. Moreover, the individual responses make it clear that this switching would be to a number of alternatives. The different alternatives for these customers are summarised in Figure 1.

[6] The existence of some customers who may not switch following a price rise ('inframarginal customers') is not relevant so long as sufficient marginal customers would switch to defeat a general price rise, unless Greif can successfully price discriminate against those customers post-merger. This issue is addressed in section 4.

[7] Questions 34 and 35 of the Customer Survey, reported as Table 18 in the Redacted Customer Survey. The results of the customer survey also show substantial switching even at smaller price rises – fully 10% of respondents said that they would switch for a 3% price rise.

Figure 1: Alternatives for those customers who would switch or search for a 5% price rise post-merger



Source: Responses to Q34 and 35 of the Competition Commission's Customer Survey

3.9 Figure 1 makes it clear that customers would switch to a number of different alternatives in response to a price rise post-merger. Even if the Commission considers that the constraint from alternative packaging or imports is insufficient to widen the market, the fact that some customers would switch to these alternatives in response to a price rise post-merger is still a constraint which needs to be taken into account in the assessment of the competitive effects of the merger. By adopting an extreme view that anything which is not included in the definition of the relevant market is not a competitive constraint the Commission is both ignoring its own guidelines, and underestimating the constraint on Greif's behaviour post-merger. The impact of alternative products and imports on any critical loss analysis must be calculated ***in the aggregate*** together with **all** competitive constraints. To do otherwise ignores the realities of the industrial packaging marketplace.

3.10 To illustrate this further, Figure 2 shows Greif's losses on major contracts between 2004 and 2006. Over the three years prior to the merger, Greif lost **[ ]**% more business to alternative packaging than to Blagden. Yet this constraint is excluded from the assessment of competitive effects, despite the Commission acknowledging that there would be some switching to alternative packaging in response to a 5% price rise post-merger.

Figure 2: [ ]

3.11 The Provisional Findings assess each constraint on the basis of whether sufficient customers would switch to that constraint **alone** for a 5% price increase not to be profitable. The cumulative impact of the competitive restraints that are acknowledged by the Commission is not assessed. The omission of any such analysis in the Provisional Findings (despite Greif's previous request that competitive constraints be considered in the aggregate) is a major error in the Commission's analytical approach. As we show in this response, all the evidence presented to the Commission shows that the **cumulative impact** of switching to alternative packaging, imports and other UK suppliers means that there will be no substantial lessening of competition post-merger.

Summary of evidence

3.12 As we show in this response, the evidence reviewed by the Commission clearly shows that there is no likelihood of an SLC:

- The Commission acknowledges that a 5% price rise would lead to switching between steel drums and alternative packaging (§5.41), and that the reaction of customers to a price rise caused by market power may be greater than that due to the price rises due to increases in input costs seen in the past (§5.35). However, the Commission completely fails to take this constraint into account **at all** in the assessment of competitive effects.
- The Commission's evidence shows that suppliers from Belgium and the Netherlands are competitive with UK supply. We understand that the Commission is investigating expansions of capacity by steel drum suppliers in these countries.[8]
- The Commission dismissed the constraint from imports from France and Germany claiming that transport costs were too high. This analysis did not adjust for differences in product mix and transport cost between countries. In this response we show that once these are accounted for then **imports from France and Germany are also competitive** with UK supply.

- The evidence shows that the three other UK drum manufacturers will exercise a strong competitive constraint:

    - These suppliers make a comparable product range to Greif and Blagden (Appendix F, §5).
    - Customers are able to switch easily to them (Appendix F, §9) – and indeed, the customer survey shows that they would seek to do so.
    - These suppliers have substantial excess capacity (§8.2) and can easily expand output with no additional cost or no risk (Appendix F, §30)
    - They do not appear to consistently price higher for all types of drum and it is not clear whether their total average costs per drum are higher or lower than Greif's or Blagden's.
    - These suppliers' excess capacity at current shift levels is far above what is needed to prevent an SLC. These suppliers have excess capacity of at least 600k drums, while the loss of a total of **[ ]**k drums would make a general 5% price rise unprofitable post-merger.

- By contrast, Blagden is considered to be the main competitive constraint on Greif, despite the fact that:

    - The Commission itself admits the evidence from customer responses is 'mixed' (§7.14).
    - Blagden's gains from competitors declined by **[……]**% between 2003 and 2005.

[8] We would expect the Commission to share any new evidence on this point with Greif for comment.

- o Greif's gross losses to Blagden accounted for less than **[ ]**% of its total sales in 2005 and were **[ ]** in 2006.
- o Just one-third of respondents to the customer survey played Greif and Blagden off against each other.
- o Customers who dual source from both Greif and Blagden do not obtain lower prices than those who do not.

3.13 Greif contends that the Commission is duty bound to investigate such a marginal conclusion with increased rigour. Greif is therefore dismayed at the number of assumptions in the Provisional Findings, together with an apparent lack of independent supporting evidence and the omission of a critical loss analysis on the **aggregated** competitive constraints, which lead to this fundamentally flawed decision.

4. PRICES POST-MERGER

4.1 The Competition Commission is unable to be specific about what would happen to prices post-merger. The Commission considers that it is possible that there "might" be a general price rise, a price rise targeted at those customers "least likely to switch away from new large steel drums" or a combination of both (§8.3).

4.2 The Commission's guidelines on how it assesses whether an SLC arises state (at §1.24) that, after identifying the relevant market, it assesses whether the merger would increase the market power of firms in that market. Market power is described in the guidelines as being the ability to raise price "consistently". Accordingly, any price rise imposed by Greif must be durable. However, a proper analysis of the evidence before the Commission points to the conclusion that any price rise which Greif sought to impose would not be durable, due, amongst other reasons to the likely substantial changes in the industrial packaging market in Great Britain, including:-

- the investment by Mauser and Schütz in UK production facilities;
- the introduction of EVOH and other barrier layer technology which allows more substances (previously limited to packaging in steel) to be packaged in plastic containers;
- the likelihood of increased imports from continental Europe, including imports from Schütz's new steel drum facility being built in the Netherlands. Mauser now has a fulltime UK-based sales force that can source competitively priced steel drums from its N. France location and customer awareness of alternatives, both in response to the current merger inquiry and the increase in marketing in the UK market by continental competitors, has increased.

4.3 The Commission has failed to discharge the burden of proof to show that a general price rise would be durable. Its conclusions are uncertain on this point. For example, it says that it "may be" that some of new technologies which are being launched for plastic drums are not yet developed for larger IBCs (§11 of Appendix D). With respect, it is for the Commission to ascertain whether or not that is the case, particularly given the previously submitted Schütz UK marketing materials stating that these developments do indeed include IBCs. See Schütz UK January press release:

*"We can use the Schütz-developed Security Layer Technology in Worksop now, too," says Bob Banks, general manager of Schütz UK, pointing out a key advantage. This multilayer, extrusion blow-moulding process makes it possible to plasticise three to six functional layers simultaneously, thus opening up some interesting new prospects both for **IBCs** and for drums.*
(SOURCE:http://www.schuetz.de/schuetz/en/company/press/industrial_packaging/english_articles/total_processing_packaging/index.phtml.)

The evidence on the cumulative impact of the various competitive constraints shows that sufficient customers would switch in response to a general price rise to prevent an SLC post-merger.

4.4 In the rest of this section, we show that a targeted price rise to only some customers would not be profitable, and in any event that the number of customers which could be affected by such a price rise is too small to constitute a 'substantial lessening of competition'.

Greif's Ability to Identify Customers Least Likely to Switch from Large Steel Drums

4.5 In its Provisional Findings (§7.20 and 8.3), the Commission suggests that there are two ways in which price discrimination might occur being: setting higher prices for certain types of drums; and, setting higher prices for customers least likely to switch away from large steel drums. The key components of this theory appear to be:

- o The potential for arbitrage is low.
- o Greif holds detailed information about its customer base. Greif could use this to identify the price sensitivity of its customers, and therefore who would switch for a price increase.

4.6 The Commission concedes there is no evidence that prices are higher for customers that have previously not been able to switch away from steel drums (§7.20). Therefore, the theory on price discrimination is only speculation. In the following sections we consider the degree to which the theory is supported by the evidence.

Ability to arbitrage

4.7 The Commission notes that arbitrage seems unlikely given the characteristics of the market. It observes:

(a) arbitrage between different drum types could not occur because the different types are not demand-side substitutable; and

(b) arbitrage between customers is not likely due to lead times, the costs of stocking and individual drum identification (painting).

4.8 The Commission suggests that arbitrage could not occur between different types of drums because they are not demand-side substitutable (§7.21). However, there is no evidence that there is a significant difference in customers' ability to switch to alternative materials, dependent on which type of drum they purchase. Table 8 of the customer survey found that around two-thirds of customers had realistic alternatives to new steel drums, and there were no major differences in this percentage depending on the type of steel drum. For instance, 59% of buyers of plain open-head drums identified at least one alternative to new steel drums, while the figure was 65% of buyers of plain tight-head. It is difficult to see how a steel drum supplier could implement a price discrimination strategy against buyers of either type of drum on this basis.

4.9 Moreover, the Commission's findings are also inconsistent with its finding of strong evidence of supply-side substitution between the four types of large steel drums (§5.5). The product range of all the manufacturers spanned the four main types. As we explain in more detail in §4.32 – 4.37 below, this presents an inconsistency in the Commission's theory of price discrimination. Supply-side substitution means that if the price for one type of drum were raised it would be profitable for competing suppliers to shift the focus of their production or sales effort to that type of drum. This would defeat the price increase.[9] As the Commission has acknowledged that the different drum types are supply-side substitutes, there is no credible theory of price discrimination for certain drum types.

[9] Hausman, J., Leonard, G., & Vellturo, C, 1996, "Market definition under price discrimination", *Antitrust Law Journal,* Vol. 64, p384.

4.10 In terms of arbitrage between customers, we would agree that this is not straightforward given that deliveries are made-to-order. We would make one comment though: the lure of profit can drive solutions to seemingly intractable problems. As noted by Hausman (1996), “it is very easy to underestimate the ingenuity of market participants faced with the arbitrage opportunities created by price discrimination” (p.372). However, even without arbitrage, price discrimination is only profitable if Greif can successfully identify those customers who have the least outside options. As we show in the rest of this section, Greif cannot identify such customers with sufficient certainty to be able to profitably price discriminate.

Ability to identify customers

4.11 The key element to price discrimination is the ability to identify those firms to whom prices could be profitably increased. In its Provisional Findings, the Commission has not identified a group of customers to which Greif could raise prices. Although the Commission cites that Greif had information on customer requirements (e.g. drum type, customer classification, delivery address etc) the Commission has consistently failed to explain how this information can help to identify those customers who are least likely to switch from steel. This theoretical ability to discern “captive” customers becomes even less likely if, as the Commission suggests in §5.11 of the Provisional Findings, end-customer preferences (which are unobservable by the merged parties) are more important than regulations or chemical compatibility concerns.

4.12 Instead of relying on evidence, the Commission resorts to an assertion that “we think the information about its customers accumulated by Greif (which includes **[ ]**) would enable Greif to form an assessment of the price sensitivity of its customers” (§7.24). This statement is not substantiated by any reasoning of how this information could be used to form such an assessment.

4.13 We believe this falls far short of presenting a robust theory of how Greif might price discriminate. We make the following points:

(a) The information that the Commission identifies is not sufficient for price discrimination;

(b) Greif is not in a position to know with sufficient certainty which of its customers would or would not switch. This has important implications for the ability to price discriminate. Using a simple model suggests Greif would have to be correct around **[ ]**% of the time for price discrimination to be profitable;

(c) Customers have an incentive to posture themselves as being price sensitive. In a repeated game the economic literature suggests that price discrimination becomes less likely;

(d) Price discrimination would still have to overcome supply side substitution. The smaller the group of price insensitive customers, the lower the external capacity required to defeat the price discrimination; and

(e) The evidence suggests that the proportion of customers who have limited outside options is a small minority. The Commission has not disputed this point;

(f) Those customers who switch away from large steel drums to other packaging rarely return to large steel drums. The short-run benefits of any price discrimination strategy have to be weighed against the risk of a loss of long-term profits if the customer does in fact switch.

The information the Commission identifies is not sufficient for price discrimination

4.14 In both its Provisional Findings and its earlier Putbacks, the Commission has consistently failed to identify a group of customers to whom Greif could raise prices. Instead it has resorted to a vague claim that "information about its customers accumulated by Greif (which includes **[ ]**) would enable Greif to form an assessment of the price sensitivity of its customers" (§7.24). As we explain below, this claim is not justified by the evidence. The information Greif collects on its customers is related to their relative preferences for price and service quality – that is whether a customer is prepared to pay for higher levels of back-up or other services. This should be patently clear from the account plan tab "Checklist", which enables the account manager to assess whether the opportunity in the account has been maximized. Note that the only two questions about price increases relate to "cost-driven price hikes" (in other words, whether the customer is paying at least enough to cover Greif's cost of production) and "value-driven price hikes", which explicitly only cover additional services and "special or exclusive product executions" that have been custom-designed at Greif's expense for that customer alone. This information has nothing to do with the extent of a customer's outside options, or relative preference for steel as opposed to other materials. This is confirmed by the Commission's analysis of Greif's margins which found that there was no relationship between a customer's ability to use alternative packaging and the margin earned by Greif (§7.20).

4.15 The Commission notes that **[……………………………………….]** (§7.23)

4.16 In addition, Greif is said to have **[……………………………………….]**

4.17 Greif has already explained the purpose for collecting this information. This information is used to assess the level of service (and corresponding price) that best meets the needs of the customer. In a market where supply is based on individual orders, it would be odd not to adjust the service depending on the customers' wants and needs. This is legitimate commercial behaviour and does not provide any information about the outside options of the customer. In particular none of the information listed above would identify whether the customer might switch to a rival (smaller) supplier.

4.18 It is perhaps telling that despite having access to these customer reports, the Commission was not able to identify a group that could be price discriminated against. Indeed if it could identify a class, then it would be able to consider behavioural remedies for the merger. There is a good reason for this. A customer's degree of captivity for a given drum varies from product to product, industry to industry, end-user to end-user (i.e. preferences of the steel drum buyer's customer), and over time as new products are developed. There is no simple formula for knowing whether a price increase could be imposed on any given drum order.

4.19 We have already explained that there is no straightforward link between the type of drum purchased and a customer's ability to switch to alternative packaging. The customer classification also does not aid price discrimination. The customer classification would be useful if Greif knew that customers active in a particular area, such as essential oils, were only able to use steel drums. However, as shown in a previous submission to the Commission[10], there is no simple customer classification—either on its own or in conjunction with others—which allows Greif to

[10] See Annex B.

distinguish such customers. This submission showed that the choice of industrial packaging chosen by customers in the essential oils, food, flavouring and high-value pharmaceutical products varied from customer to customer, and included the full range of industrial packaging substrates, from fibre to plastic to steel.[11]

4.20 It is simply not the case that the other data mentioned – **[……………………..……….]** would facilitate price discrimination post-merger. Most customers make a range of products in their plants, so **[…………………………..]** will rarely give information on the customer's outside options. Even in respect of imports, there is no evidence that imports are confined to just those parts of the UK near the channel ports. Carricks in Scotland acts as a distributor for imported Spanish drums and there have been several instances of customers in the North of England importing from Europe.

4.21 It would also be exceptional for **[………..]** to convey information about a customer's outside options, except to the extent that large customers like BP, are in a position to sponsor expansion by competitors.[12] Finally, we fail to see any reason why **[……………………………..]** would facilitate price discrimination post-merger.

4.22 In summary, despite the suggestions of the Commission, the information falls far short of being able to identify a group of customers to whom prices could be raised. The propensity to switch encompasses an unknown combination of the factors listed above, as well as many more unobserved factors and preferences.[13] Despite the Commission's claim, the reality is that there is no simple method to identifying price insensitive customers. For Greif to judge whether a given order of drums could be switched or not would entail substantial guesswork. As shown below it would not take many misjudgements to make price discrimination unprofitable.

There is insufficient information to profitably price discriminate

4.23 The Commission has put forward a theory that Greif could use the information collected on customers to engage in price discrimination. However the reality is that the decision for a customer to switch is built on many factors, very few of which are observable. For example, the preferences of the end-user (i.e. Greif's customer's customers) are not observable. The end-user might be quite happy to receive the product in either new steel or plastic (or other type of industrial packaging or bulk), or have strict preferences for new steel drums. These have implications for whether Greif's customers would be prepared to switch but is not easily observable by Greif. Greif would only be in a position to make <u>at best</u> an educated guess as to whether a customer was actually price insensitive.

4.24 The degree of uncertainty has important implications for the ability to price discriminate. If Greif attempted to price discriminate against price insensitive customers, it must take into consideration that it will 'get it wrong' occasionally and a customer will switch.

4.25 Hausman et al (1996) presents a simple model to identify the certainty required to profitably price discriminate[14]. It shows that in many cases it would only take a low

[11] The Competition Commission had claimed in paragraph 24 of the Working Paper on Market Definition that customers in these categories had to use steel drums.
[12] Although we note that the largest customers have the potential to sponsor entry or expansion by a smaller supplier if necessary.
[13] This also ignores the possibility that customers will disguise their preferences by engaging in strategic behaviour, as we discuss below.
[14] See See op. cit. at Footnote 9, p. 373.

number of mistakes to make price discrimination unprofitable. We set out this model in Annex C and calculate the relevant figure using Greif's data. The model suggests that Greif would have to be correct on **[ ]**% of the occasions to profitably price discriminate.[15] Put another way, if **[ ]** (approximately **[ ]**%) of the customers which Greif considered as having reduced outside options post-merger were to switch away, then price discrimination would not be profitable. Given the vagueness of the information which Greif has on its customers, Greif could not know which customers would accept a price increase with this degree of certainty.

Customers have an incentive to posture themselves as being price sensitive

4.26 Part of the problem that Greif would face in attempting to price discriminate is that customers have an incentive to posture themselves as being price sensitive.[16] A customer which would want to avoid becoming a target for higher prices therefore will make signals to indicate that they are a marginal customer (even if they are not). This obviously would make it harder for a firm to correctly identify which customers to which it could increase price.

4.27 For instance, it might be argued that a firm could attempt targeted price increases as a learning device.[17] For those customers that are lost, it has the chance to recapture the customer at a later time when the contract is put out to tender again. That is, in a repeated game the level of certainty required to profitably price discriminate (estimated above at **[ ]**% for Greif) might be lower since the loss is limited to a short length of time. In support of this theory, as the Commission notes, Greif includes in its customer reports **[……………………………………..…..]**. (§7.24)

4.28 As it turns out the relevant economic literature does not support this conclusion. The problem with the 'learning device' theory is that it assumes that customers are myopic without regard for the strategic consequences of their decision.[18] In a repeated game, customers will not want to reveal they are price insensitive by accepting a higher price, since they know they will have to accept the higher price for the rest of the time horizon. Infra-marginal customers therefore have an incentive to bluff for a finite period. The economic literature suggests that price discrimination is <u>less</u> likely in repeated games.[19]

4.29 The logical conclusion is that customers who are actually reliant on Greif's products (and in principle might be vulnerable to price discrimination) can behave strategically to posture themselves as price sensitive. For instance, they might shift part of their purchases to an alternative type of packaging, buy from a smaller rival, or sponsor entry or expansion even if it is inconvenient to do so in the short term. Standard economic literature suggests that there is an incentive to do this to avoid the risk of price discrimination.

4.30 The most obvious example of strategic behaviour is BP paying a premium to switch to R&W, and similarly switching to other smaller rivals to Greif in other countries. This decision may not have been profit-maximising in the short-run, but showed that BP

[15] Using the price and cost listed for Greif in the Provisional Findings (§7.29) the figure is 83%.
[16] See op. cit. at Footnote 9, p. 373.
[17] See op. cit. at Footnote 9, p. 376.
[18] See op. cit. at Footnote 9, p. 379.
[19] See op. cit. at Footnote 9citing Hart, O. & Tirole, J, 1988, "Contract Renegotiation and Coasian Dynamics", *Review of Economic Studies,* Vol. 55, p.509 and Schmidt, K., 1993, "Commitment through incomplete information in a simple repeated bargaining game", *Journal of Economic Theory,* Vol. 60, p.114.

was aware that it may be worth taking a short-term sacrifice to obtain better prices out of suppliers in the long-run.

4.31 Many of Greif's customers – like BP – are repeat buyers both in the UK, in Europe and around the world. They are sophisticated buyers and would be aware of the strategic implications of their purchasing decisions. They would be fully able to take measures to conceal their true price sensitivity.

Price discrimination must overcome supply side substitution

4.32 Even if we assume that Greif could perfectly identify price insensitive customers (which is improbable), price discrimination could still be defeated by supply-side obstacles.[20] This invokes simple supply-side substitution theory.

4.33 Supply-side substitution means that a constraint on one type of drum also acts as a constraint on other types of drums. In order to understand this, consider a situation where higher profits could be earned on sales of one type of drum. Such a situation creates incentives for steel drum suppliers to focus their sales efforts on this drum type to the exclusion of other drum types. As suppliers focus their sales efforts on this type of drum, then the higher margins are competed away, even if the customers of that drum type have fewer outside options than other customers. Indeed, Hausman et al (1996) are explicit that the existence of supply-side substitution means that price discrimination is extremely difficult to sustain for precisely this reason.[21]

4.34 However, the Commission seems to have ignored the logic of supply-side substitution. Despite 'strong evidence of supply-side substitution between the four main types of large steel drums' the Commission considered that manufacturers "may still be able to increase prices for certain types of drum profitably."[22] It appears from this that the Commission has failed to understand the implications of supply-side substitution for market definition. If two products are supply-side substitutes, it is not possible for a manufacturer to profitably increase prices for one product, *even if* there is no demand-side substitution.[23]

4.35 Moreover, the industry capacity devoted to the remaining part of the market is still available for price insensitive customers to switch to. The lower the proportion of the market that are price insensitive, the lower the probability that the remaining market capacity could not protect them from price discrimination.

4.36 To illustrate this point, consider the proportion of customers that might be the target of a price discrimination strategy. The most obvious candidates would be those customers that could not switch from new steel drums to alternative plastic packaging. Table 8 of the Commission's customer survey indicated that around one third of customers could not switch from new large steel drums (§5.11).[24] Assume that Greif knows exactly who they are, and therefore only raises prices against those customers.

[20] See op. cit. at Footnote 9, p. 383-384.
[21] See op. cit. at Footnote 9, p. 374.
[22] Provisional Findings, §5.5.
[23] See for example, Motta. 2004, "Competition Policy: Theory and Practice", *Cambridge Press,* 103.
[24] The Roy Graham report also indicated that the proportion of customers who were fully captive to new steel drums was low. The report showed that the proportion of Greif's volume purchased by customers who could not shift any of their purchases to plastic was around **[…..]**%. As yet the Competition Commission has not rebutted this figure.

4.37 Note that although this infra-marginal group of customers may claim to have no realistic alternatives to new steel drums, they do have realistic alternatives to Greif, at the very least for a significant proportion of their volume. The results of the survey suggest that many may be prepared to switch to the other UK drum suppliers or to imports. [25] However as noted above it would only require that Greif made a mistake **[ ]**% of the time for price discrimination to be unprofitable. Therefore, even if Greif were able to exactly identify the third of customers who claim that they don't have a realistic alternative to new steel drums, it would only require **[ ]**% of the one-third, i.e. equivalent to **[ ]**% of the total market volume, to switch to either rival suppliers or imports to defeat the price discrimination.[26]

<u>Only a small number of customers are vulnerable to price discrimination</u>

4.38 We have shown above that the adoption of a price discrimination strategy by Greif is risky, and it would only take a small proportion of misjudgements for such discrimination to be unprofitable. In order for price discrimination to constitute an SLC, the Commission needs to show that the impact of such discrimination is 'substantial'. To do this, the Commission needs to quantify the proportion of customers vulnerable to price discrimination post-merger, and show that this is sufficient to constitute a substantial lessening of competition.

4.39 In its Provisional Findings, the Commission fails to either identify or quantify the customers which could be vulnerable to price discrimination post-merger. However, it is clear from the evidence presented that any such customer group would be very small indeed. In Appendix D, the Commission quotes the following evidence:

- Department for Transport and PIRA Consulting have stated that there are very few dangerous substances for which the Packing Instructions would be restricted to a single type of industrial container (Appendix D, §27).
- Greif produced a study of its Top 40 customers which showed that **[…..]**% by volume of its customers' products could be packaged in plastic drums or IBCs. In total, just **[ ]** customers could switch less than half their steel drum purchases to plastic drums or IBCs. These accounted for just **[…..]**% of Greif's volume in 2006.
- Blagden estimated that **[…….]**% of its sales would have difficulty in using other materials.
- The Commission's Customer Survey found that for each type of drum purchased, between 57% and 69% of customers had a realistic alternative form of packaging.
- The Commission has stated that new plastic technologies could cause increased switching (§10 of Appendix D). As shown by evidence provided by Greif in the form of Schütz marketing materials, these new technologies are currently being introduced into the UK market. Schütz stated in its April 2007 press release

[25] We note the Competition Commission suggests that other suppliers have higher costs than Greif. (§7.29). Although this doesn't imply they will have higher prices (and we address this point later), even if they did, the spare capacity could still defeat the price discrimination. As discussed above, strategically, it would still be in the interests of buyers to accept higher prices for finite time period to posture themselves as marginal customers.

[26] While **[ ]**% might appear very low, the intuition behind this is quite simple. If you are only raising price to a part of the market, then the excess capacity needed to satisfy those that are prompted to switch will be lower. **[ ]**% of Greif's post-merger volume would be around **[ ]**% of **[……..]** drums. As noted by the Competition Commission, rival suppliers could increase capacity by 600,000 drums a year at current shift levels (Appendix F, §15) and 830,000 by adding another shift (Appendix F, §31).

regarding its new UK plastic drum capacity, previously submitted to the Commission on 8 May 2007 (Annex D), that *"The electrostatically equipped model, type F1-EX, now also offers the opportunity to transport filling products with a flashpoint of < 60° Celsius. Until now, this could only be done in steel drums."*

4.40 These estimates of the proportion of customers who are likely to switch away from new large steel drums vary greatly. However, what they all have in common is that customers who cannot switch from steel drums form only a "small minority" of large steel drum customers. Indeed, in the draft Provisional Findings, the Commission referred to "a *small* minority of customers who cannot switch away any of their requirements away from steel drums." (draft Provisional Findings, §7.20, emphasis added) In the Provisional Findings, the word small has been removed, so that the text refers to "a minority of customers". No new evidence is presented in the Provisional Findings to justify the removal of the word "small". Nor, despite Greif's request to the Commission to consult an independent industrial chemist, has the Commission presented any data or analysis to refute the evidence provided by Greif.

4.41 Moreover, even with perfect information, not all the customers who have difficulties in switching from large steel drums would be able to be profitably discriminated against. The Roy Graham study identified just **[…..]** current Greif customers who would have difficulty in switching their purchases from large steel drums. Of these **[…..]** customers, one, **[…………………..]**, has a contract which runs to 2011, which limits any price changes to those due to Greif's actual raw material costs. It is consequently not possible for Greif to price discriminate against this customer. Another **[……..]**, purchased a total of **[…..]**drums from Greif in 2006.[27] This customer purchases sufficient volumes of drums to sponsor expansion. **[…………...]**global, MEPS-based contract has just been extended by 6 months to the end of 2007 (with a rollover clause). As the Commission notes in the Provisional Findings, the threat of such sponsored expansion would lead to Greif offering lower prices to these customers (Provisional Findings, §8.20). Removing these two customers reduces the potential volume of Greif's existing customers who could potentially be discriminated against from **[…....]**% to just **[…....]**%.

4.42 Moreover, even customers without contractual protection have outside options which they can use to prevent them being vulnerable to price discrimination. As we show in section 6, imports from Germany, France, Belgium and the Netherlands would all be competitive with UK supply in the event of a 5% price rise post-merger.

4.43 Furthermore, as the Commission acknowledges, there is "significant spare capacity" (Provisional Findings, §8.2) at other UK drum suppliers. Customers could switch to these suppliers to avoid a 'targeted' price rise by Greif. Even if Greif were able to identify the customers least likely to switch, the Commission has not claimed that other suppliers would be able to do so. Indeed, as we show below, the Commission has repeatedly failed to show any means by which such customers could be systematically identified.

4.44 These factors mean that the set of customers who are even theoretically vulnerable to a targeted price rise are even smaller than those who lack alternatives to large steel drums.

Any price discrimination may not be profitable in the long-term

[27] The **[…....]** purchases in Table 10 of the Provisional Findings contain only deliveries to **[……......]**.

4.45 Steel drum volumes have been consistently declining as customers switch to alternative packaging. Historically, customers who switch away from steel drums to other forms of packaging (whether plastic drums, IBCs or bulk) do not switch back to steel drums. This means that if Greif makes a mistake, and price discriminates against a customer who then switches away from steel drums, then Greif loses the future stream of profits from that customer. This increases the risk of a price discrimination strategy.

4.46 The riskiness of such a strategy is underlined by the continued development in packaging technology which continues to reduce the proportion of customers who have difficulty in switching away from steel drums. In this context, we note that by the time the Commission publishes its report, a new plastic drum technology will be offered in the UK at prices lower than those of steel drums (Appendix C, §58). This technology will allow yet more customers to switch away from large steel drums, as Air Products appears to be considering. This continued advancement in technology highlights the risks of trying to selectively increase prices to customers who cannot currently switch away from steel drums. Even if such a price increase were successful in the short-run, in the longer term it may increase the proportion of customers who switch away to other materials, so that the long-run impact may be negative.

Conclusion

4.47 The Commission has completely failed to carry out any analysis of price discrimination which could credibly show that it would be profitable to price discriminate post-merger. Indeed, all the evidence shows that price discrimination would not be a profitable strategy. We note that:

- Supply side substitution would defeat price discrimination on a particular type of drum;
- There is no simple mechanism to identify price insensitive customers. Greif does not have the level of certainty over its customers to profitably engage in price discrimination. It would need to be right around **[ ]**% of the time;
- Identifying customers is more difficult because they have an incentive to posture themselves as being price sensitive; and
- The number of customers who have no realistic alternatives to new steel drums is low. Even if Greif were somehow able to identify these customers and attempt to price discriminate, it would only take a small amount of sales to switch to make the price discrimination unprofitable.

4.48 Considering the evidence above and the nature of the market casts serious doubt on whether there would be a sufficient profit incentive for Greif to attempt price discrimination.

(a) First, Greif would have to correctly guess a very high proportion, which would be very difficult considering customers have an incentive to disguise their preferences.

(b) Second, there is a high loss in ‘getting in wrong’ since customers who have switched to alternative packaging have generally not returned to steel.

(c) Third, there is only a "small minority" of customers who would be subject to price discrimination. These factors taken together lead one to doubt whether there would exist a sufficient profit incentive for Greif to price discriminate.

4.49 In this respect, the incentive for price discrimination is analogous to that in the recent merger between First Group and Great Western. In that case, the Competition Commission identified nine routes where competition might be affected by the merger. However, the small scale of these routes, and the potential negative impact of such a strategy went wrong meant that the Commission concluded that the merger would not result in an SLC. As noted by the Commission

> *"…the extent of the profit incentive on those routes and flows to raise fares or reduce frequencies purely in order to transfer passengers from bus to rail is limited. In our view, it is insufficient to lead FirstGroup to adopt a strategy of raising fares or reducing frequencies, especially given the uncertainties as to the shorter- and longer-term effects of doing so. We therefore do not expect the merger to result in an SLC on the overlap flows".*[28]

4.50 In this case, even if Greif could perfectly identify all customers who are restricted to the use of steel drums, it would at best identify only 'a small minority of customers'. If it were to attempt to raise prices to these customers, it would need to be confident that its estimations were accurate. In particular, if a customer were wrongly judged to be unlikely to switch from steel drums, but instead changed to IBCs, then it is highly unlikely that that customer would ever be regained. In this respect, the short-run benefit of a price rise has to be offset against the future profits foregone from losing a customer forever. Given the small number of customers who could potentially be discriminated against, it is highly implausible that such a strategy would be profit-maximising.

4.51 The Commission concedes there is no evidence that price discrimination is currently occurring. As such, we would urge the Commission to consider its theory on price discrimination very carefully. In the absence of firm evidence, the ability and incentive of a firm to price discrimination is purely speculative. The Commission must base its decision on "strong and convincing evidence" and be "sceptical about things for which there is no good evidence".[29] The Commission's theory on price discrimination does not meet that standard.

[28] *FirstGroup plc and the Greater Western Passenger Rail franchise*, 8 March 2006, §11.

[29] See "'A wise man proportions his beliefs to the evidence': Scepticism and Competition Policy", speech by Peter Freeman, 3 May 2007.

5. PRODUCT MARKET DEFINITION

5.1 The Commission concludes that a hypothetical monopolist of large steel drums could rely on the 'stickiness' of enough of its customers (and indeed the existence of some customers who would have no alternative at all) to make a small but significant price increase profitable. This conclusion, supported by the Commission's definition of the product market as limited to new and reconditioned large steel drums, is based on the following indicators:

- Different propensities of different customers (and individual customers in relation to the different uses they made of new large steel drums) to switch to alternative products;
- Significant increases in the price differentials between large steel drums and plastic packaging products in the past had not resulted in the level of switching that the Commission might expect of close substitutes, even when taking into account the fact that these increases may be viewed by customers as transitory.

5.2 Greif accepts that different customers (and individual customers in relation to the different uses they made of new large steel drums) have different propensities to switch to alternative products. However, the fact that customers may prefer different substitutes or even a range of different substitutes to large steel drums does not exclude such substitutes from the market definition. Extreme reliance on market definition has been extensively criticised in a number of papers both by academics and practitioners, and has led to a decrease in emphasis on market definition and market shares, and a move towards directly assessing the 'unilateral effects' of a merger. As Shapiro (1996) noted:

> *"Any attempt to make a sharp distinction between products inside and outside of the market can be misleading if there is no clear break in the chain of substitutes"* [30]

5.3 Greif accepts that "it is usually necessary for the Commission to infer, from whatever information is available or can be collected, what the likely outcome of the SSNIP test would be. This can then be used to determine market definition."[31] The evidence which has been collected is examined below.

[30] For a critique of the extreme reliance on market definition see Shapiro (1996), "Mergers with differentiated products", Antitrust, Vol 10 No2.
[31] Paragraph 2.11, Merger References: Competition Commission Guidelines, June 2003.

5.4 Table 1 below details the evidence from the Commission's Customer Survey for and against the inclusion of alternative products in the product market. This evidence shows that customers would switch to alternative packaging in response to a 5% price increase.

Table 1

EVIDENCE IN FAVOUR OF AN SLC	EVIDENCE AGAINST AN SLC
Narrow market definition (new & recon. large steel drums)	**Wider market definition (to include IBCs, plastic drums, and bulk)**
41% of respondents said that **reconditioned drums** are a 'realistic alternative' **Around 90%** of respondents identified some barriers to switching to an alternative product. **Two thirds** of respondents claimed they could not switch **currently** to alternative products.	**45%** of respondents said that **IBCs** are a 'realistic alternative' – in percentage terms IBCs are cited by customers as a closer substitute than reconditioned steel drums **33%** of respondents said that **plastic drums** were a 'realistic alternative' **16 – 20%** of respondents said that **bulk** is a 'realistic alternative' **14 – 24%** of respondents said that **small steel drums** are a 'realistic alternative' **57 – 69%** of respondents identified 'realistic alternatives' to new steel drums (depending on type of drum) **31%** of respondents could **<u>currently</u>** switch some of their products from new steel drums to other forms of packaging **28%** of respondents had switched some orders from large steel drums to alternate forms of packaging **in the past 12 months** **19%** of respondents had switched some orders from large steel drums to alternate forms of packaging **in the last 6 months** **17%** of respondents would switch (to another steel drum supplier, alternative products or imports) in response to a **5%** price increase and a further **22%** would search for an alternative, i.e. **39%** in total **30%** of respondents would switch in response to a **6-10%** price increase and a further **42%** would search for an alternative, i.e. **72%** in total **15%** of the total annual expenditure of respondents could **currently** be switched to

	alternative products

5.5 It should be noted that the overwhelming evidence from the Commission's survey strongly indicates that the potential loss of volume to alternative products far exceeds the critical loss threshold of **[…….]**%.[32]

5.6 The Commission accepts that regulation and chemical compatibility do not prevent the majority of customers from switching to alternative packaging (§ 5.11, Provisional Findings).

5.7 Reconditioned drums have been included by the Commission in the product market on the basis that switching costs are minimal. The Commission seeks to justify its decision to exclude plastic drums and IBCs from the market definition on the basis that switching is costly and difficult.

Switching costs are not sufficient to justify a narrow market definition

5.8 The argument that switching is costly and difficult, based on the results of the Survey, is spurious. A 'realistic alternative' must already take any switching costs into account. Each of IBCs, plastic drums and bulk shipments as 'realistic alternatives' in the Customer Survey exceed the critical loss threshold of **[ ]**% (IBCs: 45%, plastic drums: 33%, bulk: 16 – 20%) and must therefore be included in the product market definition.

5.9 Moreover, the evidence for an SLC based on switching costs identified by respondents to the survey is extremely weak. Respondents were not asked to quantify any associated costs or the relative difficulty in overcoming such barriers. Respondents were also not asked to clarify the timescale required to gear up to any switch. If the Commission wished to draw any inferences from the 90% of respondents who identified some barriers to switching to an alternative product, it should have put supplementary questions to the respondents on these specific issues. It has not done so, despite the fact that Greif has previously flagged up these points to the Commission.

5.10 Identification of barriers *per se* is no indication as to the extent to which such barriers prevent switching, as evidenced by the Commission's own conclusion on switching to imported drums. In this case, 80% of respondents identified some barriers to switching to imported drums, but significant numbers of respondents would nevertheless switch for a price rise of 1-5%. The Commission therefore concluded that non-price limitations (i.e. switching costs) to importing are reasonably low. On

[32] In the Appendix C §48, the Competition Commission downplays the relevance of the 17% of survey respondents who said they would switch (and further 22% who would search) in response to a 5% increase in price. The Competition Commission notes "[w]hether it exceeds the critical loss would depend on the proportion of orders that customers would switch, and the answers to the survey also showed that most customers who could switch to other packaging could only do so for a proportion of their orders" (§48) The Commission is not comparing like with like. Survey respondents told the Competition Commission that 15% of volumes could currently be switched to alternative packaging. This alone would be sufficient to prevent an SLC. But as we have shown in Figure 1, switching to alternative packaging was just one response that respondents identified for Q34 and Q35. The most common response was switching to other UK drums suppliers (41%), but importing (15%), or a combination of reactions (37%) were also identified. The Competition Commission goes on to note that "the results of this question do not directly apply to market definition, as customers were asked about reactions to an increase in price by the merged entity rather than to a general increase in the price of new steel drums" (§48). The effect of a 5% increase by the merged entity that directly applies to the possibility of an SLC is surely even more pertinent that its applicability to market definition. This dismissal of Table 18 is another example of the Competition Commission's failure to consider the aggregate or cumulative impact of the competitive constraints facing Greif.

consideration of the high percentages of respondents who had a 'realistic alternative' to large steel drums, despite the barriers to switching, the same conclusion must be reached on switching costs to IBCs, plastic drums and bulk, i.e. that they are reasonably low.

5.11 Further evidence, other than responses to the Customer Survey, which has been presented to the Commission on potential switching costs, is detailed in Table 2 below.

Table 2

EVIDENCE IN FAVOUR OF AN SLC	EVIDENCE AGAINST AN SLC
POTENTIAL SWITCHING COSTS	
Submissions made on behalf of BP plc: • 'The use of plastic drums in place of steel drums would also require significant investment in new filling and handling equipment…………BP would expect the cost of the new equipment required to fill and handle plastic drums to be in the region of £50,000 - £250,000 per filling location'.	Evidence supplied from Feige GmbH (quote dated 17 January 2007) on the cost of supplying an automatic filling line from approximately £25,000 for a static line to £32,000 for a mobile filling line. To Feige's knowledge, the total number of automated filling lines in the UK is a maximum 15 lines. Costs associated with modifications to a manual filling line are negligible.
• 'BP is captive to steel drums for at least the next 12-18 months….There are possible alternatives; however they would be costly in both time (12-18 months to implement) and money, and would not necessarily be suitable for all products'.	Negligible costs associated with a switch from steel drums to plastic drums, as evidenced by letter from **[ ]** dated 2 May 2007. **[ ]** modified its fully automated filling line in 2004 by making minor technical improvements at a cost of less than a few thousand Euros. **[ ]**'s customers changed to plastic drums 'without any problem'. Results of the European Commission's Market Enquiry on Case No. IV/M.1349 – CVC Capital Partners/Dynoplast, where customers considered that difficulties in switching from steel drums to plastic drums (relating to the installed filling line) either did not exist or were not considered a significant obstacle to switching.
Comment from the Provisional Findings: 'Some customers and third parties told us that a switch from steel drums to plastic drums or IBCs was costly and difficult; one of the main difficulties identified was end-user resistance to a change in packaging'	End-user resistance to a change in packaging has not prevented significant switching to alternative products: • BP Castrol has switched 100% of its purchases from steel to plastic drums in South Africa and India • Dow Polyols and Surfactants North America switched its customers unilaterally from steel to plastic drums in March 2007, as evidenced by Dow's letter to its customers dated 12 /2/2007 • **[ ]** switched its entire purchases of 200,000 drums per annum from steel to plastic drums in 2005 • Greif has submitted evidence on its losses, which shows that in 2004 approximately **[ ]%** of Greif's total volume for the year was lost to alternative packaging. These percentages only cover losses where Greif has specific and conclusive market intelligence and actual losses to alternative packaging are undoubtedly higher.

5.12 It is clear from the evidence presented in Table 2 that switching costs associated with filling line modifications are not considered by the majority of customers to be a significant obstacle to switching. BP's estimations of modification costs cover a vast range from £50,000 to £250,000. The Commission appears to have accepted BP's estimations without any investigation as to the reasons behind this significant difference in costs. These modification costs have not, in any event, prevented BP from switching its Castrol product customers from large steel to plastic drums in South Africa and India. Moreover, **[………………………..]**

5.13 It is very important to assess what underlies the difference between BP's submission and for example, the evidence supplied by **[ ]** and the results from the Dynoplast customer survey. Following the failure of its 2004 e-bid process, BP has withdrawn all business from Greif UK and has sponsored the expansion of Ramsden and Whale (by paying a premium for its steel drum purchases).

5.14 The Commission advised that it had been alleged that Greif had deliberately undermined the e-bid process by pulling out at the last minute. Email correspondence submitted to the Commission clearly evidences that this was not in fact the case and that Greif negotiated with BP in good faith. **[ ]**. Any reliance by the Commission on BP's evidence on switching costs is unsatisfactory, in light of the Commission's apparent failure to verify or investigate the quoted costs **[………………………..]**. Moreover, BP has already demonstrated the viability of outside options by switching from Greif UK to an alternative supplier.

5.15 Moreover, **[…………………………………………….....]**

5.16 Aside from actual line modification costs, the Commission appears to rely primarily on the time required by customers to implement a switch and end-user resistance to a change in packaging as barriers to switching.

5.17 The evidence submitted by independent parties such as Feige GmbH (the world's leading filling equipment manufacturer) and **[ ]** (the largest customer Greif has seen switch from large steel to large plastic drums) clearly indicates that implementation of a switch from steel to plastic can be effected very quickly. No factual counter-evidence has been presented to suggest that the time required by customers to implement a switch would be of any material length, irrespective of the type of filling line currently utilised by individual customers, other than BP's submission that it might take up to 18 months (although even BP gives a lower bound of 12 months). As stated above, any reliance on BP's submission is unsatisfactory .

5.18 The Commission has provided no counter-evidence to Greif's evidence that manual filling lines can be modified within a few days to accept plastic drums. No evidence has been presented to suggest that automatic filling lines cannot also be modified to accept plastic drums within a similar timescale. In fact, **[……]** confirms that it only had to undertake some minor technical improvements on its fully automated filling line, at a cost of a few thousand Euros. In any event, Feige confirms a delivery time after technical and commercial clarification of approximately 3 months only for a new automatic line. In addition, the costs and timescale associated with modifications to a filling line to accept IBCs would not be greater than the costs and timescale associated with the installation of a new fully automated line. On the basis of Feige's quote such modifications would fall well below BP's lower estimates of 12 months and £50,000. It appears that the Commission fails to address this evidence and instead prefers to rely on unsubstantiated claims of BP.

5.19 End-user resistance is impossible to quantify objectively. However, evidence of past switching clearly indicates that this is **not** a significant barrier. Dow advised its customers by letter dated 12 February 2007 that it was switching from steel to plastic drums in March 2007, i.e. Dow gave its customers **only one month's notice**. Moreover, market acceptance of alternative products such as IBCs and plastic drums will have increased significantly over the last 10 years.

Past evidence of switching does not justify a narrow market definition

5.20 The Commission further seeks to justify its decision to exclude plastic drums and IBCs from the market definition on the basis that past evidence of switching in response to large increases in the price of steel drums relative to alternative packaging products falls below the critical loss level.

5.21 In 2004, new steel drum prices increased by 10 to 13 per cent relative to plastic drums and this was followed by a **[ ]** per cent fall in new steel drum volumes in the UK market in total in 2005. The Commission speculates that not all of this **[ ]** per cent loss is attributable to switching to IBCs and plastic drums, on the basis that part of the fall is likely to be due to a fall in overall UK demand for large packaging and a migration to less direct substitutes such as bulk packaging. The Commission also states that the evidence 'suggests' that the increase in IBC sales in 2005 was moderate compared with the fall in large steel drum volumes and that plastic drum sales has been broadly stable in recent years. The conclusion reached is that the fall in steel drum volumes in response to large increases in the price of steel drums relative to plastic drums was not as large as the critical loss level.

5.22 The Commission states that steel drum prices could increase by **[ ]** per cent before reaching the differential in steel and plastic input costs in 2004 (Appendix C to the Provisional Findings, § 33). The Commission further calculates a range of price increase by which new large steel drums could increase from their current levels before reaching the differential between steel drum and plastic drum prices in 2004. This percentage range is however redacted (Appendix C, §34), but it is to be assumed that it lies over 5%. Based on the 2004/2005 data, the Commission infers that a 5% price increase in steel drums would not prompt switching to alternative packaging over the critical loss level.

5.23 The Commission recognises that previous price increases in the steel drum market have been linked to raw material increases and were therefore considered by customers to be both transitory and justified (§5.35). The data on the costs of steel and plastic drums in Table 5 of in Appendix C supports the fact that these were temporary price differentials. There was no difference in the raw material costs of steel and plastic drums in 2002. By 2004, steel costs were 30% more than plastic costs. However, by 2006, this gap had almost closed, and steel input costs were just 4% more expensive. It is therefore clear that any consequent changes in the price of a drum were transitory.

5.24 If the Commission is correct that it takes time for a customer to change from steel to a plastic drum or IBC, then it would not be surprising if they are reluctant to do so in response to a transitory rise in price. By the time the customer had implemented the change, the price differential may have closed, therefore marginal customers might adopt a ‘wait and see’ approach. The fact that such a high proportion of customers did switch in response to these transitory changes is therefore surprising, and it is only logical to conclude that a much greater proportion would switch for a non-transitory price rise. An anti-competitive price rise post-merger would mean that steel drum prices were higher than they otherwise would be (regardless of the current differential between steel and plastic raw material costs) therefore marginal customers would not 'wait and see'.

5.25 Indeed, the Commission has strong evidence that the imposition of a **non-transitory** unjustified 5% price increase would undoubtedly prompt a higher level of switching than the levels in response to the 2004 price increases. Indeed, **17%** of respondents to the Customer Survey would switch (to another steel drum supplier, alternative products or imports) in response to a **5%** price increase and a further **22%** would search for an alternative, i.e. **39%** in total.

5.26 Customers have also explicitly advised the Commission that they would react more strongly to an unjustified price increase. Baker Petrolite stated:

> *"…should the merged company raise its prices by, say, 5 per cent, Baker Petrolite would accept the increase if it was justified by raw material price movements and the market had moved to this extent…However, if the increase was not justified, it would be difficult to accept the increase. Potentially other arrangements (if any viable ones were available) would have to be explored."*

5.27 Moreover, Greif has previously objected at length to the reliability of the data underlying the conclusions in paragraph 5.21 above and has criticised the current price differential used by the Commission as a basis for comparison (see Annex E – Report by LECG entitled 'Analysis of Appendix D assessment of substitution'). These concerns have not been sufficiently addressed by the Commission. In particular, the Commission has not explained whether the IPA actually collects any data on IBC volumes from manufacturers. It is Greif's understanding that the IPA does not in fact collect any such data.

5.28 On the basis of paragraph 5.21 above, losses attributable to alternative packaging in the **total** UK steel drum market in 2005 were less than **[ ]**%. However it would be quite conceivable for **Greif** to lose **[ ]**% of its volume to alternative packaging. In Table 11 of Appendix C, the Commission sets out the percentage of sales that have been lost by Greif over the past few years to alternative packaging. This shows that Greif has lost significant volumes to alternative packaging when Blagden was still operating in the market. The main switching occurred in 2004 (calculated by the Commission at around **[....]**% of volume) which was seemingly in response to transitory changes in price. However on account of an error in the data provided in the Market Information Questionnaire, the figures calculated by the Commission underestimate the % of volume lost to alternative packaging. We set out in Annex F the correct calculations based on all major contracts lost by Greif to alternative packaging. It shows that in fact up to **[…..]**% of Greif's volumes has been lost to alternative packaging over the past few years. (We note that in comparison, Greif's losses to Blagden – according to the Commission, Greif's closest competitor – were much lower.) If **[....]**% can be lost in these circumstances, it seems very possible that Greif could lose much more if it imposed an unjustified 5% increase in price.

5.29 Further, Greif's percentage losses to alternative packaging are without doubt **an underestimation** of the real total. Greif can only include those losses of which it is **aware,** i.e. where the customer has explicitly advised Greif that it has moved to alternative packaging or where Greif has specific and confirmed market intelligence.

Increased potential to switch and current structural changes to the market do not justify a narrow market definition

5.30 Having recognised past switching from new large steel drums to IBC's and large plastic drums, the Commission then states that the evidence is unclear on whether the move to IBCs and plastic drums is continuing or whether it has stabilized. The implication underlying this statement is that levels of switching in response to a price increase comparable with the 2004 increase would be **lower** than the levels observed in 2004/2005. There is in fact substantial evidence to show an ongoing decline, and only vague assertions of stabilisation.

5.31 The Commission states that the recent entry by Mauser Group into UK production of large plastic drums and IBCs, and by Schütz Group into UK production of large plastic drums, might imply potential for growth in these types of packaging, perhaps from customers switching from new large steel drums. This implication appears to be dismissed without any robust investigation. Instead, the Commission states that:

'Mauser told us that its entry was at least partly motivated by a need to replace current imports of IBCs (although this would use only around 40 per cent of its new capacity). Schütz indicated that, while it had been planning to establish production in the UK for some time, the timing of its launch now had been prompted by Mauser's move.'

The Commission does not provide any explanation as to what Mauser intends to do with its remaining **60%** capacity, nor why Schütz had been planning to establish large plastic drum production in the UK **'for some time'** (Note: Schütz already produces IBC's in the UK). Neither of these critical points appears to have been investigated by the Commission in its hearings with Mauser and Schütz.

5.32 The telephone meeting conducted by the Commission with Mauser UK establishes that 60% of the capacity of Mauser's new plant is available for **new** business. The industrial packaging market in total in the UK is declining, so logic dictates that Mauser will be competing to win **existing** business away from **existing** UK-established manufacturers. Schütz's new large plastic drum capacity in the UK will also be competing to win business away from existing suppliers. Logically, both Mauser and Schütz **must** be anticipating the further conversion of new large steel drum customers to plastic products. Indeed, the Mauser interview notes state that *"approximately 250,000 drums per annum might still switch (from steel drums)."* Schuetz's April 2007 press release regarding its new UK large plastic drum facility (referred to in §4.3 above) confirms this: *"A very promising new generation of drums has been developed on the basis of our revolutionary multilayer extrusion process," says Mr Banks. "This applies particularly to the **substitution of conventional steel drums**…."* Based on the summaries published by the Commission of its meetings/hearings with Mauser and Schütz, no satisfactory investigation of the business plans and justification for entry into the UK by either of these companies has been undertaken, despite published evidence of Schuetz's intent having been submitted to the CC. Any such investigation by the CC would have revealed the intended target customers and confirmed the anticipated level of switching. We believe that the CC is duty bound to factually explain why, in a shrinking UK industrial packaging market, the published intent by Greif's UK competitors to substitute steel drums with their sizeable investments in plastic products constitutes "unclear" evidence of continuing substitution.

5.33 The Commission questions Mauser UK about multi-layered drums, despite the fact that Mauser has no current plans to manufacture such drums in the UK. Mauser

UK's representative states that he is 'unaware of any solvent producers who use a multi-layered drum and suspects there would be resistance to switching'.[33] Perversely, the Commission does not investigate this issue with Schütz **at all**, despite the fact that Schütz (not Mauser) is currently manufacturing these drums—which as per the previously submitted Schuetz marketing materials, are ideal for packaging solvents such as toluene, etc--in the UK. It should be noted that multi-layer technology is also available for IBCs.

5.34 Entry by both Mauser and Schütz in the UK market, as direct competitors of Greif in the wider industrial packaging market, heralds a fundamental change in the structure of the UK market and a very significant increase in the levels of competition previously experienced by Greif UK from alternative packaging products.

5.35 Greif contends that entry by these alternative packaging competitors into the UK market, accompanied by - in the case of Schütz - incontrovertible, published statements of intent to substitute conventional steel drums with their products in the UK - is **clear evidence** that they intend to exploit the existing **and increasing** potential for customers to switch away from large steel drums and cannot be construed in any other way. The motives of competitors must be carefully considered in assessing any information provided by them. Competitors generally have an incentive to express negative views about any proposed transaction that would result in a stronger competitor and increased competition.

5.36 The Commission accepts that advances in plastics technology have increased the range of products which can be packed in IBCs or plastic drums (Appendix B, §21; Appendix D, §10). The Commission seeks to downplay the impact of these advances by stating that coated or multi-layered plastic drums are more expensive than plain plastic drums. The fact that coated or multi-layered plastic drums are more expensive than plain **plastic** drums **does not** make them an uneconomic alternative to new large **steel** drums. Indeed, the Commission states that *'one supplier told us that it was planning to manufacture three-layered drums in the UK from July this year, and that prices would be typically [x] per cent below the steel equivalent'* (Appendix C, § 58). As these drums are in fact cheaper than large steel drums, they have a clear attraction for customers that the CC appears to have deliberately underplayed by comparing the pricing of these products with that of plastic—rather than steel—drums.

5.37 The impact of technological advances on the structure of the industrial packaging market is further downplayed by the Commission on the basis that customers are unwilling to switch to 'unproven technology'. The only direct evidence in support of this contention appears to be the submission by Company X that *'although new coatings for drums were being developed they were not yet proven and Company X was not willing to take the lead in switching*'.[34]

5.38 However, in contrast to Company X, Air Products (Chemicals) states that:

'They were looking at new 6 layer IBCs, which were more resistant, and might enable a higher proportion to be switched. They would take a decision in 2 to 3 months'.[35]

[33] Summary of telephone meetings with Mauser UK, April 2007
[34] Summary of hearing with Company X, held on Tuesday 27 March 2007
[35] Summary of telephone conversation with Air products (Chemicals), held on 11 April

The timescale given by Air Products of 2 to 3 months highlights the **imminent** threat of further switching away from new large steel drums. Clearly, once customers with a high market profile such as Air Products switch to newly-developed alternative packaging products, other customers will follow.

5.39 The Commission's further remark:, 'In addition, we understand that the technology for producing these types of plastic drum is not currently available in the UK, although one supplier told us that it was planning to manufacture three-layered drums in the UK from July this year…' (Appendix C, §58), has very little merit considering the fact that Schütz has confirmed that production of exactly these types of drums is commencing **before the CC will publish its report.**

5.40 Greif has previously advised the Commission (and provided evidence in the form of marketing literature from manufacturers and press articles) that **only** substances which require filling at temperatures > 65º cannot be filled in plastic. The **overwhelming** majority of 'hot-filled' products are filled at temperatures < 65º . Greif estimates that products which require filling at > 65º probably account for < 0.5% of Greif's volumes. This 'barrier' to substitution, identified in Appendix B § 22 is essentially irrelevant.

5.41 The Commission asserts that the collection and reconditioning of used plastic drums is not as well developed as it is for steel drums and that some potential purchasers have advised that this is a significant constraint. However, there are already a number of reconditioners that collect plastic drums today. The reconditioning division of Sotrelentz which was not sold as part of the deal with GEM actually specialises in plastics. Others include Manchester Drums, S&H Containers, P2P, Sumo, Delta, M&N Containers. Greif was told recently by the head of P2P's UK plastics recycling that he would be happy to receive more used plastic drums and had no issue with reselling them, either as regrind or reconditioned drums. Commission interviews with these firms would confirm that there are no significant constraints in this regard. Schütz and Mauser already run global collection schemes for IBCs (including in Europe and in the UK) so it is to be expected that they will introduce plastic drums into this service as they build their customer base in the UK.

Conclusion

5.42 The Commission's conclusion on product market definition is not supported by the weight of evidence:

- the survey responses support a wider market definition;
- the weight of evidence on switching costs does not justify a market definition limited to new and reconditioned large steel drums, but supports a wider product market definition; and
- the levels of past switching prompted by transitory price increases, justified by raw material price increases, cannot **in isolation** provide sufficient justification for the finding that a non-transitory, unjustified price increase would not prompt levels of switching equal to or above the critical loss threshold of **[…....]**%. Consideration must be given to fundamental changes in the market place and a more severe customer reaction to any unjustified price rises.

5.43 The case for a narrow market definition is marginal at best. Nonetheless, irrespective of the market definition, the Commission cannot ignore the consistent and irrefutable evidence of the very considerable competitive constraint imposed by alternative packaging products. The historical evidence of switching coupled with the future likelihood of continued and increasing levels of switching, given the significant investment of two global competitors in Great Britain, cannot be ignored. Any conclusion that a universal price rise could be profitably imposed by the merged parties, based on the product market definition alone, is seriously flawed.

6. GEOGRAPHIC MARKET DEFINITION

6.1 The Commission further concludes that the geographic market is limited to Great Britain, based on the prevailing price differentials between manufacturers in GB and main land Europe and transport costs. The evidence for and against this conclusion is detailed in Table 3 below.

Table3

EVIDENCE IN FAVOUR OF AN SLC	EVIDENCE AGAINST AN SLC
IMPORTS	
Responses to the Competition Commission's Customer Survey showed that: • **Around 80%** of respondents to the Competition Commission's Customer Survey identified some barriers to switching to imported drums. However, in paragraph 19 of Appendix E, the Competition Commission notes that *"the high degree of price sensitivity suggests that non-price limitations to switching to imports are considered to be reasonably low."*[36]	Responses to the Competition Commission's Customer Survey showed that: • **12%** of customers would switch to imports for a **1%** price difference • **43%** would switch for a **5% price difference** • The Commission concluded that non-price limitations to importing are reasonably low
	Sulo currently imports into the UK from Germany.
The Competition Commission's analysis estimated that German suppliers would have to be 9 – 20% cheaper than Greif's UK prices to make imports economical, but they are only 5 – 8 % cheaper.	Schuetz could not see any negative impact on the UK customer as a result of the merger as they can import drums from alternative sources in Europe in the event of a price rise by Greif/Blagden. Although this process of importation would be **slightly more expensive** for the UK customer, it would regulate the extent to which Greif/Blagden could raise prices. *(Emphasis added)*
Another supplier estimated that prices in Continental Europe were approximately 5 % lower than in GB. **N.B. This evidence cannot be relied upon as it appears to be based on an estimate only.**	Greif's prices in Belgium, Netherlands and France are **[…….]**% cheaper than its UK prices (10 – 15% required to be economical to import).
	Blagden's prices in the Netherlands are **[…]**% cheaper than its UK prices (10% required to be economical to import)
There are limited alternative suppliers to the parties in Belgium and the Netherlands	Price comparisons in Appendix E to the Provisional Findings do not adjust for different product mix and the included delivery costs
	Schuetz is constructing a new steel drum plant in the Netherlands.
Open head tapered drums, which can be	Heymeyer Kleve manufactures on the German/Dutch border with importation costs to the

[36] Competition Commission, Appendix E, §19.

economically imported, are not a substitute for all types of steel drums and only account for 20% of the UK market Imports of new large steel drums are currently very limited, accounting for less than 3% of total UK new large steel drum sales	UK which are equivalent to a Dutch supplier. Feraxo (formerly Van Haelewijn) in Belgium acquired a new high speed drum line end 2005/beginning 2006 increasing capacity significantly Open head tapered drums, which account for at least **[ ]** % of the UK market (although it should be noted that **[ ]**), can be economically imported as they are stacked inside each other; **[ ]**% of Greif's volume is supplied to customers who take both open and tight head drums and **[ ]**% of customers supplied take both open head and tight head drums.

Barriers to switching to imports

6.2 The Commission notes that the customer survey respondents identified a number of factors that would inhibit them from switching to imported drums. Some of the concerns included: longer delivery times, additional transport costs and warehousing. Despite this, the customer survey provided evidence that customers would switch for comparatively small price differences suggesting that, to the extent they exist, customers do not consider barriers to importing high.

6.3 First, Table 15 of the customer survey showed that the premium on imports would not have to be high to lead to customers importing. Table 15 showed that:

- For a mere 1% difference in price, 12% of customers would be prepared to import
- For a 3% difference in price, 17% of customers would be prepared to import
- For a 5% difference in price, 43% of customers would be prepared to import

6.4 Second, the responses to Q34 of the customer survey (corresponding to Table 19) showed that when faced with an increase of price of new large steel drums from Greif and Blagden, many would consider importing. For instance, some of the responses for prices increases by Greif of 5% or less were:

Look at alternatives to steel or imported drums

Look more to Europe Maybe own transport to Germany etc.

Consider reconditioned drums Switch to other new drum manufactuers Look at option of importing

Look for alternative suppliers including imported drums.

Look for other suppliers UK or import

Look to the European market, however the security of supply remains key.

Source alternative product, possibly from republic of Ireland.

This would be anti-competitive and other suppliers would be sought both at home and abroad.

6.5 The responses show that importing is an option in the minds of customers. As the Commission acknowledges in Appendix E, this "high degree of price sensitivity suggests that non-price limitations to switching to imports are considered to be reasonably low."[37] If the price were competitive with UK delivered prices, customers would therefore be willing to switch. We consider the comparative delivery prices between different European countries in the next section.

Transportation costs

6.6 The Commission assessed the price differential (on a factory-gate basis) that would be needed for imported drums to be the same price delivered to the customer as GB drums (Table 4 of Provisional Findings). The Commission has also assessed the price differential in the context of a 5% price increase, which was found to be between 9-20% for continental countries aside from Belgium and Netherlands.

6.7 We have set out in Table 4 below the differentials as we understand the Commission computed them. In the first column is the transportation cost data. Based on the transportation costs, the second column shows the factory price that would make it equal to the delivered UK price with a 5% increase in price. The third column expresses that figure as a percentage difference to the original factory price. The final column shows the differences between Greif's delivered prices in those regions compared to the UK delivered price.

6.8 The table can be interpreted as follows. Given a UK delivered price and average delivery cost, we can assess an average UK factory gate price. Shipments from the continent incur a higher delivery cost than UK suppliers therefore they would have to have a lower factory gate price in order to be competitive with UK suppliers. The third column in the table below shows how much % lower a continental supplier's factory gate price would have to be to price competitive (this takes into account a 5% increase in factory gate prices by UK suppliers). Greif's delivered prices in each country are compared to Greif's UK delivered price (as a proxy for factory gate prices) to estimate if the required differential exists. If the price differential in the fourth column is greater than the differential in the third column, we can assume that a supplier from that region could supply the UK cost effectively.

[37] Competition Commission, Appendix E, §19.

Table 4: […………………………]

6.9 From the table it appears that the price differential between, respectively, Belgium and the UK, and the Netherlands and the UK are sufficiently large to allow drum manufacturers to supply the UK cost effectively. On the Commission's analysis, Belgian and Netherlands manufacturers could profitably supply the UK in the event of a SSNIP if their average prices were 5% lower than UK prices. In fact, average prices are **[ ]**% lower showing that they could in fact earn higher margins by supplying the UK than in supplying their domestic market. On the other hand the table suggests that it would not be cost effective to supply from France or Germany, since the required difference in price is between 9-20% and the actual difference is only between **[ ]**%.

6.10 Based on the table above and evidence provided by third parties, the Commission has defined the geographic market as Great Britain. As we understand, Belgium and Netherlands were excluded on the basis there was only limited competition to Greif or Blagden.

6.11 However, as shown in the evidence recently submitted to the Commission, Feraxo (previously van Haelwijn) has recently installed an additional new steel drum line in Belgium, with one-shift production capacity of 1,000,000 drums a year. In addition, Schütz is believed to be in the process of constructing a steel drum line at its Netherlands facility. Both these developments have the potential to dramatically change the landscape for suppliers of new steel drums in the UK.

6.12 The evidence from SEFA, the European drum association shows that sales of steel drums have been flat in continental Europe for the past decade, and we have previously submitted evidence of excess capacity in each country (Annex G). As market growth is limited, it therefore appears that these manufacturers will have significant excess capacity available for the UK market. It is therefore completely rational that they would use this unused capacity to sell into the UK at margins which are even higher than they can earn domestically. As previously noted, it would only take volume losses of around **[ ]** to defeat a general price increase, and significantly more spare capacity than this is available from competitors in the Netherlands and Belgium which are capable of profitably supplying the UK market.

6.13 Moreover, the Commission's analysis used delivered prices which were an average across all drums. There are two flaws with this comparison.

6.14 First, these prices do not take account of differences in the mix of products sold between countries. For example, open-head steel drums are more expensive than tight-head drums. Therefore a higher price in one country might simply reflect that they produce a higher proportion of open-head drums, but say nothing about actual price differences.

6.15 Second, the prices above are delivered prices, so that delivery to the continental customer is already included. If average delivery costs are higher in the EU, then EU suppliers will not appear competitive, even when that is the case.

6.16 In order to remove these issues, we have asked Greif to provide its annual average factory gate prices for each of Belgium, the Netherlands, Germany and France, for each type of drum (open-head plain, open-head lacquered, tight-head plain, tight-head lacquered) for 2006. As Greif has acquired Blagden's European operations, it is also to provide the same data for Blagden's Belgian and French operations. The data is set out in Table 5 below.

Table 5: […………………………]

6.17 We can combine the ex-works price with the same delivery costs as for Table 4, and compare against the UK delivered price. This is shown in Table 6 below. The UK prices are expressed with a 5% increase, in order to perform the SSNIP test. Prices from Germany and France are expressed as a range since there is more than one transport costs data point for each country in Table 4 above. If the European delivered price is less than or equal to the UK delivered price, then it is economic to transport from that country.

Table 6: […………………………]

6.18 These results confirm that suppliers in Belgium and the Netherlands are competitive with UK based suppliers. Belgium and Netherlands delivered prices are below UK delivered prices for **[ ]** drum. As such, we can conclude that UK is constrained by suppliers in Belgium and Netherlands, and those countries would be included in the relevant geographic market. This is particularly important given the expansion of steel drum capacity in these markets by both Feraxo (formerly van Haelewijn) and Schütz, and the current competitive threat posed by Hemeyer, one of the largest German steel drum producers, located just next to the Dutch border.

6.19 In addition, once differences in the product mix (e.g. lacquer type, open or tight-head, painted or not) are accounted for and delivery costs are taken into account, it is clear that imports from Germany are profitable, and so would act as a constraint on Greif's prices post-merger. Indeed, Cognis UK currently imports Sulo open-head drums from Germany. Table shows that for each type of drum, the UK delivered price of a steel drum from Germany is within the range required to be competitive with UK suppliers. For tight-head plain drums the UK delivered price is £**[…..]**, which is the same as the German delivered price using the lowest transport cost from Germany. For tight-head lacquered the UK delivered price is £**[….]**, which is at the higher end of the range for German delivered price. For open-head lacquered drums the UK delivered price is at about mid range of the German delivered price. Finally, for open-head plain drums the UK delivered price of £**[….]**is comfortably above the German delivered price regardless of which transport cost measure is used.

6.20 As these figures are averages, this data shows that there will be in all cases a considerable segment of customers for whom German suppliers will be competitive.[38] This evidence shows that steel drums sourced from German suppliers can be cost effectively supplied to the UK in the event of a 5 per cent price increase and therefore should be included in the relevant market.

[38] The delivery costs listed from Europe are to a range of locations in the UK but typically in the north west of England including Manchester, Warrington, and Staffordshire (see Appendix E, Table 2). The UK delivery cost is the average across all of Greif's customers and some customers will be above, and others below this level.

6.21 In relation to French prices, we find that the prices charged by **[ ]** for plain Open Head and Tight Head drums in 2006 were competitive on a UK delivered basis with UK suppliers if prices were to increase by 5% post-merger. Using this data set, suppliers from France are able to supply the UK cost effectively, which is consistent with Greif's experience. Although Greif's French prices were somewhat higher than those of Blagden, Greif has been competing with imports from French factories. Indeed, one UK customer, **[……….]**, has recently threatened Greif that it will switch all its orders to **[……..]** in Northern France unless Greif reduces its average drum price by around £**[….]**.[39] This would be a loss of approximately **[…..]** drums per annum.

Tapered Drums

6.22 Finally, as identified by the Competition Commission, transport costs would be lower for open head "tapered drums" since they can be stacked inside similar drums. (Appendix E, §12) However despite this Competition Commission seems to downplay the significance of this by noting that:

> *tapered drums are only imported in small quantities and are open headed. Open-head account for fewer than* **[…..]** *per cent of drums used in Great Britain… (Appendix E, §12)*[40]

6.23 This statement by the Competition Commission seems to suggest that it accepts that 'tapered' drums are a constraint on the prices of open-head drums. Supply-side substitution means that a constraint on one type of drum also acts as a constraint on other types of drums. It appears from this that the Competition Commission has failed to understand the implications of supply-side substitution for market definition. If two products are supply-side substitutes, it is not possible for a manufacturer to profitably increase prices for one product, *even if* there is no demand-side substitution.[41]

6.24 Even under the Competition Commission's own approach, **[…..]**% is not an insignificant amount. This would reduce the potential pool of candidates who could possibly suffer an SLC post-merger. It should also be noted that **[…………………..]**, which clearly demonstrates that tapered drums can constitute a demand-side substitute.

Conclusion

6.25 In the Provisional Findings the Commission considers the geographic market to be Great Britain. This conclusion was based on responses from the survey and an analysis of transport costs and delivered prices. We have shown that these findings are flawed:

- the survey responses suggest that customers do not view barriers to importing as being significant. This is evidenced by Table 15 and the written responses to Q34 of the survey, and appears to be confirmed by the Commission in § 18 of Appendix E;

[39] See Annex H.
[40] We note that the wording of this has changed from the Appendix Put-back document, which read "tapered drums … would be a direct constraint only on the price of open head drums" (§7) [Emphasis added].
[41] See for example, Motta. 2004, "Competition Policy: Theory and Practice", *Cambridge Press,* 103.

- using factory gate prices for each different type of drum, the evidence suggests that new steel drums could be economically transported from Belgium, the Netherlands, Germany and France.

6.26 These findings show that the relevant geographic market should include Belgium, Netherlands, Germany and France.

7. COMPETITIVE CONSTRAINTS

7.1 The Commission appears to have completely disregarded the very real competitive constraint imposed on new steel drum suppliers by the threat of customers switching to alternative products. This is despite the Commission itself recognising in its working paper on market definition that the fall in UK steel drum volumes over the past decade was driven by the development of plastic and IBC technology.[42]

7.2 Competitive constraints (irrespective of whether they are result from within or outside the market definition) include the following:

- IBCs
- Plastic drums
- Imports
- Bulk shipments
- Countervailing buyer power
- Entry or expansion by competitors (including competitors of alternative products)

7.3 The competitive constraint imposed on the merged parties' business from IBCs and plastic drums is clearly identified by the evidence discussed in section 5 on the product market definition above.

7.4 The competitive constraint imposed on the merged parties' business from imports is clearly identified by the evidence discussed in section 6 on the geographic market definition above.

7.5 It is difficult to quantify the extent of the competitive constraint imposed on the merged parties by migration to bulk shipments, although the Commission recognises that there has in fact been migration to bulk.[43]

7.6 20% of tight-head drum customers in the Customer Survey considered bulk to be a 'realistic alternative' to steel drums. As many customers already transport some products in bulk form, the switching of incremental volumes to bulk may not be difficult. The threat of the loss of such incremental volumes would, together with the threat of substitution to other forms of industrial packaging, constrain Greif's behaviour post-merger.

Countervailing buyer power

7.7 The Commission dismisses countervailing buyer power as an effective constraint on the basis that there would not be sufficient buyer power to constrain the merged entity in its dealings with all customers. This conclusion, which appears to be reached in isolation from any aggregated impact of all the competitive constraints taken together, is based on the following:

- customers *'did not mention'* (§ 8.22) the option of taking large steel drum manufacture in-house;

[42] Working Paper on Market Definition, paragraph 89.
[43] See Annex J.

- it was not apparent that the merged entity would necessarily and consistently sacrifice profits *in the UK* to protect global business;

- a Continental European or international presence was not a determining factor in choice of supplier (§ 8.23);

- even if larger customers could exert sufficient countervailing buyer power to obtain lower prices, it is not clear that smaller customers would have the same ability; and

- although some buyers may have outside options, this would not constrain prices to other buyers because contracts are negotiated individually.

7.8 It is credible that Greif's largest customers would consider manufacturing steel drums in-house, particularly in view of the fact that Ineos Chlor has operated such a facility in the past. Greif does however accept that this is the least likely means of entry or expansion and considers that larger customers would simply switch to the 'significant spare capacity' (§8.2) available at alternative manufacturers or if needed sponsor expansion. Sponsored expansion, for example the award of a long-tern contract, reduces any financial risk to a supplier adding an additional shift.

7.9 Whether or not the merged entity would necessarily and consistently sacrifice profits *in the UK* to protect global business does not in any way diminish the power that pan-European or international customers could bring to bear on the merged parties to reduce prices in the UK. Analysis of new large steel drum sales from Greif UK over the last 12 months show that **[….]**% by volume and **[….]**% by revenue is attributable to customers who buy steel drums on a multi-national basis. Moreover, the imposition of any unjustified price increase in the UK could lead to serious ramifications for Greif's business in Continental Europe. Although pan-European customers may choose national suppliers in each country rather than pan-European suppliers for their total volumes across Europe, this in no way negates the leverage these very large customers enjoy over suppliers contracted on a pan-European or worldwide basis.

7.10 Approximately **[ ]**% of Greif's turnover is accounted for by 40 large customers. The Commission has not advanced any evidence whatsoever to suggest that these customers do not enjoy significant countervailing buyer power**,** whereas Greif has supplied evidence of the increasing practice of e-bid negotiations, evidence of profits sacrificed in the UK to secure global business and evidence of contractual terms which are heavily weighted in the customers' favour. Even if smaller customers do not have the same leverage as larger customers, due to their low volumes they are best placed to switch volumes at short notice to alternative UK-based manufacturers of new or reconditioned large steel drums.

7.11 It is Greif's contention that **all** buyers have some outside options and it is therefore irrelevant that contracts are negotiated individually. This contention has been well documented and supported by Greif's previous submissions, as well as the arguments advanced in this document.

Closeness of competition

7.12 The Commission's conclusion that the parties were each other's closest competitor pre-merger in terms of switching and market shares is highly questionable, in light of the available evidence, which is detailed below in Table 7.

Table 7

EVIDENCE FOR	EVIDENCE AGAINST
PRE-MERGER LEVEL OF RIVALRY	
Competition Commission's Customer Survey: **36%** of respondents agreed that customers played off Greif and Blagden The data provided by Greif showed losses to other types of packaging of between **[ ]** per cent a year from 2003 to 2006. Greif's losses to other types of materials were lower than Greif's total losses to other new large steel drum manufacturers for the period 2004 to 2006. The data provided by Blagden showed that gains and losses to other materials were limited and most business was lost to, or gained from, competing steel drum suppliers. Comment from the Provisional Findings: 'We note that, even for the period 2004 to 2006 (which was the period during which steel drum prices increased most relative to plastic drum prices), Blagden remained the largest single competitor in terms of the amount of switching' (paragraph 7.12)	**Competition Commission's Customer Survey:** **47%** of respondents disagreed (the majority of whom **<u>strongly</u>** disagreed) that they played off Greif against Blagden and **17%** were neutral on this question, i.e. **64% in total** Greif provided the following data for the period 2004 to 2006: • **[….]%** of lost large customer business went to **alternative packaging** • **[….]%** of lost large customer business went to **Blagden** • **[….]%** of lost large customer business went to **Ramsden & Whale** • There has been a year on year consistent reduction in gains by Blagden from Greif. In 2005, Blagden only gained **[….]%** of Greif's business N.B. The data on losses from Greif to Blagden is absolute. Data on losses to other competitors (including alternative packaging competitors) only includes losses of which Greif is aware. The percentage volume lost to other competitors is the **minimum** percentage lost and undoubtedly **underestimates** the true percentage lost. **BP's submission dated 20 March 2007 states:** 'In BP's experience, Greif and Blagden did not compete aggressively with each other pre-merger for large accounts such as BP'. It should be noted that **[ ]%** of Greif's turnover is accounted for by large accounts. **Comments made by Company X to the Commission dated 27 March 2007:** 'Company X had switched a proportion of its purchases away from new steel drums because of the aggressive market behaviour of Greif, <u>coupled with Blagden's failure to compete for their business.'</u> *(Emphasis added)*

7.13 In the Provisional Findings the Commission considers that the merger would result in the loss of Greif's strongest competitor. (§12) In support of this, the Competition Commission has presented evidence to illustrate the degree of competition that existed pre-merger between Greif and Blagden. (§7.9-7.15) The principal reasons as far as we can see are.

- Evidence on "market shares and on changes in market shares" show that Blagden and Greif were each other's closest competitors. (§7.15)

- In the period from 2002 to 2006 the data appears to show that Greif accounted for a large portion of the customers that were won from and lost to Blagden (Figure 3);

- Blagden was the single largest competitor to Greif, based on lost customers (Figure 4);

- One-third of respondents reported that they had played off Greif against Blagden.

7.14 The Commission also makes an assessment of competition from other steel drum manufacturers: Metal Drums, Ramsden and Whale (R&W), and AW Stokes (together 'rival suppliers'). It concludes that Blagden was the main constraint on Greif's pricing prior to the merger, and (by dint of its finding of an SLC) that the rival suppliers do not provide the same competitive constraint. (§11) However we do not believe that this position is supported by the evidence. In what follows we discuss the evidence to support these arguments.

Gains and losses between Greif and Blagden

7.15 The Commission has presented data in Figure 3 to show the amount of gains and losses by Blagden in the period 2002-2006. This seems to show that over the period the majority of Blagden's gains and losses were**[……]**. However, we believe that the manner in which this data has been presented does not reflect how competition between Blagden and Greif has evolved in recent years. In fact, presenting the data as we have below shows that Blagden has progressively become a substantially weaker competitor in the market.

Figure 3 presents Blagden's major gains since 2002. This uses the same data as that for Figure 3 in the Provisional Findings but separates the gains out year-by-year. Visual inspection of the graph shows a strong trend that is not apparent in Figure 3. The graph below shows that the success that Blagden has had in winning contracts from rival suppliers has **[…………..]**, suggesting it was becoming a progressively weaker competitor.

Figure 3: Blagden total market gains

[………………………………………………….]
Source: Table 9 of Blagden Market Definition Put-back

This trend is also observed when comparing only Blagden's gains against Greif. These are set out in Figure 4 below.

Figure 4: Blagden market gains from Greif

[……………………………………………………………………..]
Source: Table 9 of Blagden Market Definition Put-back

7.16 The graph above shows the same trend as Figure 3. There is a clear **[………………………………….]**. Its most successful year against Greif was in **[…..]** and then **[…..]**. However gains fell substantially in **[…..]** and were **[….]**in **[…]**. To put these figures in context, if you assume a total market supply for Greif of around **[……….]**drums then **[….]** drums represents a paltry **[..]**% in**[…]**. In **[…]**, the figure is **[..]**%. These figures cast significant doubt on the theory that Blagden was a strong and aggressive competitor to Greif pre-merger.

7.17 When the losses of contracts to Blagden are compared to other sources of competition, it is clear that Blagden represents just one source of competition. Losses for Greif from all sources (rather than just steel drum suppliers) are shown in Figure 4 of the Provisional Findings for the period 2004 to 2006. Greif's losses on major contracts to Blagden represented around **[….]**% of total losses.[44] Greif's losses to R&W represented **[….]**% and the remainder of around **[….]**% were lost to alternative packaging. That is, **[….]**% of the current competitive constraint on Greif will remain post-merger.[45]

7.18 Table 8 below shows the proportion of Greif's total losses of major contracts accounted by each competitor on a year-by-bear basis. The only year out of the three that Blagden was a strong competitive force compared to other suppliers was in 2005 when it accounted for **[….]**% of Greif major contracts losses. In other years Blagden played a comparatively minor role. In 2004 it accounted for just **[….]**% of Greif's major contract losses, and **[…..]** in 2006. This data shows that Blagden was just one constraint on Greif's pricing, and typically a fairly minor constraint.

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[44] This would equate to **[…..]**% of Greif's total volumes if you assume that volumes were **[………..]** for each of the three years.
[45] These figures differ slightly from the figures in §7.12 of **[….]**% (Blagden), **[….]**% (R&W), and **[….]**% (alternative packaging). This is due to the error noted previously that losses to alternative packaging were understated in previous submissions. The correct figures for losses are: Blagden **[…...]**, R&W **[…...]** and alternative packaging **[……]**. These can be calculated by summing each constraint for the period 2004-2006 in Annex I.

Table 8: Greif’ s year-on-year losses […………………..….]

7.19 To further illustrate the wide degree of constraints imposed on both Greif and Blagden by competitors other than each other, we present below a graph illustrating the combined losses by both Greif and Blagden.[46] This graph simply combines the major contract losses for both Greif and Blagden to see where the majority of competitive constraint is coming from.

Figure 5: Combined major contract losses by Greif and Blagden 2004-2006

[……………………………………………………………………..]

Notes: ‘Other’ includes ‘New business’, ‘European supply’ and ‘Plant closure’
Source: Table 9, Blagden Market Definition Put-back, Greif Market Information Response Q52(b)-(c)

7.20 The figure shows that around a **[…..]** of Blagden and Greif’s major contract losses were between each other. In terms of single suppliers, R&W was the next largest beneficiary of contract losses. However, comfortably the largest was losses to alternative packaging accounting for **[…..]** % of all major contract losses. This is further evidence that Blagden and Greif were just one source of competition on each other; there also exists a wide range of other sources of competition including new steel drum suppliers (especially R&W) and alternative industrial packaging.

7.21 Although the Commission’s careful wording that “Blagden remained the largest single competitor in terms of amount of switching” (§7.12) over the period 2004-2006 is factually correct, it says little about the actual degree of constraint provided by sources other than Blagden. The way the Commission has worded §7.12 is another example of its compartmentalised approach to assess the effect of the merger. The relevant test should not be whether any given competitor on its own would prevent an SLC, as the Commission seems to suggest. The relevant test should be whether all constraints in combination would prevent an SLC.

7.22 To conclude, this section considers the Commission’s approach to assessing the closeness of competition between Greif and Blagden. Aggregating the data as the Commission has done does not illustrate the trends in the data, and runs the risk of presenting a misleading picture of the market dynamic. On this occasion Figure 3 of the Provisional Findings suffers from placing too much weight on historical data.

7.23 Looking at the year-on-year data it becomes clear that Blagden was becoming a progressively weaker competitor, and this is also true when looking at Blagden’s year-on-year gains from Greif. In 2006 it gained **[………………..]** from Greif. An analysis of the period 2004-2006 shows Blagden was only one source of competition, with R&W and alternative industrial packaging together account for **[ ]**% of the drum volumes lost by Greif. Looking at the collective losses of Greif and Blagden, it is clear that they each represent just one competitive constraint on each other; competitive constraint also comes from other suppliers of new steel drums and alternative industrial packaging.

[46] See Annex I for the data used in the graph.

Extent to which customers played Greif and Blagden off against each other

7.24 In respect of the customer survey the Commission describes the results as "mixed". (§7.13) We are not quite sure how the Commission reached this conclusion since from our reading the survey results show no evidence of Blagden as a strong competitive rival. In particular the survey identified that:

- Only 27% agreed or strongly agreed that Blagden made frequent sales calls;
- Only 1% agreed or strongly agreed that Blagden had frequent promotions; and
- Only 36% agreed or strongly agreed that they had played off Greif and Blagden.

This evidence does not suggest that Blagden was aggressively trying to win market share from Greif.

7.25 If Blagden were indeed a strong competitive constraint on Greif, then one would expect to observe that customers who actively played Greif and Blagden against each other obtained lower prices than those that did not. In fact, there is no evidence that this was the case.

7.26 In the Competitive Effects Putback (Table 4, §29) the Commission included a calculation of average pocket margins for those customers who dual sourced compared to those that did not. The upper and lower confidence intervals overlapped therefore, as shown by the Commission, there was no statistically significant difference in the prices paid by each type of customer. We note that this analysis is omitted from the Provisional Findings. This analysis confirms that Blagden was not the only competitive constraint on Greif.

7.27 Aside from relying heavily on the idea that Blagden was Greif's closest competitor, the Commission also seems to downplay the constraint imposed by the remaining rival suppliers of new steel drums, including Metal Drum, R&W, and Stokes. This is despite strong and compelling evidence to show these rival suppliers would constrain Greif's behaviour post-merger. This evidence is as follows:

- Rival suppliers make a comparable product range to Greif and Blagden. (Appendix F, §5)
- There is no suggestion of any difference in quality between Greif and Blagden and smaller suppliers.
- There is a low cost of switching to rival suppliers. (Appendix F, §9)
- These suppliers have 'significant excess capacity' which exceeds the volume necessary to switch for a price increase to be unprofitable.
- Rival suppliers have lower fixed costs than Greif and Blagden, therefore could have lower prices for some production runs. (§7.29) (Note that an average pricing comparison, as done by the Commission, would be ambiguous for this reason – we discuss further below).
- Rival suppliers are operating effectively in the market, despite the apparent concerns of the Commission over their variable costs compared to Blagden and Greif.

- Results of the customer survey showed that customers are highly price-sensitive and are prepared to switch to rival suppliers in the event of even small increases in price:[47]
  - o 17% of customers would switch to alternative suppliers if Greif raised prices by 4-5%, a further 22% would look for alternatives (Table 19). 10% of customers would switch for 2-3% price increase by Greif post-merger, while a further 8% would look for alternatives;
  - o 35% of customers could switch over 50% of their volume to other suppliers (Table 18); and
  - o 23% of customers by value could be switched to other suppliers (Table 18).
- Rival suppliers have spare capacity of 600,000 drums at current shift levels. (Appendix F, §15). Rival suppliers could increase capacity by 830,000 drums by adding an extra shift (Appendix F, §31). The Commission has assessed that there are no risks in doing so. See for example the evidence of Metal Drum.[48]

7.28 This evidence shows that rival suppliers would constrain Greif post-merger, and so present a substantial lessening of competition. Despite this, the Commission has some concerns that rival suppliers would not provide a sufficiently strong constraint. We discuss its reasons why in the next section.

Arguments against constraint from rival suppliers

7.29 It is noticeably difficult to find the Commission's actual conclusions in the Provisional Findings on the extent to which Metal Drums, R&W, and AW Stokes would constrain Greif post-merger. As far as we can tell the Commission has instead merely noted that "Blagden was the main constraint on Greif's pricing prior to the merger" (§11), although by dint of its final conclusion of an SLC, rival suppliers are obviously not considered a strong enough constraint. The different reasons discussed by the Commission are:

- Greif could block sponsorship by pricing low to customers large enough to sponsor entry;
- some small competitors are reluctant to expand; and
- Smaller competitors operate at higher variable costs.

Greif could block sponsorship by pricing low to customers large enough to sponsor entry

7.30 The Commission claims that Greif could price low to suppliers that are big enough to sponsor or encourage entry or expansion to block that threat. We make one comment.

7.31 If Greif did block sponsorship or expansion by pricing low, this implies that larger purchasers, who account for a significant share of the market, will not face the

[47] Note that all these values are above the **[….]**% critical loss for a 5% price increase to be unprofitable.
[48] See §13, Summary of hearing with Metal Drum Company Ltd held on 27 March 2007.

possibility of a price increase post-merger. This obviously reduces the potential pool of targets for price discrimination.[49]

7.32 We would add that it is the largest customers that would have most difficulty switching for two reasons. First, due to their volumes it might be difficult for smaller rival suppliers to accept all their orders. Second, the largest customers typically are those that make dangerous products, therefore are less able to switch to alternative industrial packaging. These factors make large customers the most obvious candidates for price discrimination. However, these customers are protected from price discrimination by the threat of sponsoring/encouraging entry or expansion as BP did with R&W.

Some small competitors are reluctant to expand

7.33 The Provisional Findings of the Commission notes that rival suppliers have spare capacity of 600,000 drums at current shift levels (Appendix F, §15), although could increase capacity by 830,000 drums by adding an extra shift (Appendix F, §31). This is very high and amounts to between **[ ]**% of the volume Greif gains in acquiring Blagden. Despite this, the Commission has claimed that some small competitors are reluctant to expand, even though they would have to make no investments to do so.

7.34 The redactions unfortunately do not allow us to see which rivals are prepared to expand and who would not. We do know that Metal Drum has stated that it would “welcome the opportunity” to expand (see Metal Drum, third party hearing, §13), while the evidence from the hearing with Ramdsen & Whale also suggests that it would be interested in expanding its output further. So there are clearly some rivals who would be interested in expanding.

7.35 We note that rivals would need to increase output by only around **[ ]** of their unutilised capacity to defeat a price increase by Greif. Greif would have to lose just **[ ]**% of volume to render a general price increase unprofitable, and even less to defeat price discrimination.

7.36 To put this in context, suppose that Greif’s post-merger volumes were **[……….]** drums per year. If so, then this would mean that volume losses of **[……………..]** would defeat a general price increase. We note, according to the Commission’s assessment, these volumes could be covered by the capacity rival suppliers at current shift levels. That is, rival suppliers could meet these volumes with <u>no</u> additional investment and <u>no</u> risk.

7.37 Furthermore, as Table 19 of the customer survey showed, rival suppliers would not have to exert much effort in advertising their services. The results of Table 19 showed that customers would actively look for alternatives for relatively small increases in price. It is difficult to see why these rival suppliers would not be interested in taking advantage of this opportunity to fill under-utilised production lines.

7.38 Moreover, the loss of sales to other new steel drum drums suppliers is just one way through which either general price increase or price discrimination would be unprofitable. Greif would also lose customers to alternative packaging, imports, or

[49] We estimated in the section on price discrimination that the required volume loss required for price discrimination to be unprofitable is 4%. In light of this ‘buyer power’, the volume required to defeat price discrimination would be lower than 4%.

reconditioned drums. A general price increase or price discrimination would be defeated by a combination of volumes losses to all of these constraints. The Commission seems to compartmentalise each type of constraint and assesses the degree to which each of these could constraint the merger entity on its own. The relevant assessment should take into consideration the combined influence of all constraints.

Smaller competitors operate at higher variable costs

7.39 As far as we can tell, the main reason why the Commission dismisses the constraint from Ramsden and Whale, Metal Drum Company and Stokes is because they have higher variable costs. It notes that "smaller suppliers produce on a higher cost-per-drum basis, therefore this additional capacity would only constrain Greif's ability to raise prices above those of the remaining small suppliers". (§13(b)) We have several problems with this analysis.

7.40 In terms of the elements of variable costs (other than steel costs), it is unclear that Greif has any significant cost advantage. The cost of labour, utilities etc can all be expected to be reasonably constant between steel drum manufacturers. Transport is an exception as although Greif has no particular advantage, transport costs will vary from manufacturer to manufacturer depending largely on their distance from their customers.

7.41 Greif believes that any advantage it may have due to lower steel costs is offset by the higher fixed costs it pays due to having more maintenance and overheads costs than smaller manufacturers. We note that the Commission's analysis confirms that Greif's fixed costs are higher (§7.29) and that the Commission draws no conclusions as to how total costs differ between manufacturers. From the Commission's provisional findings it is consequently possible that all steel drum manufacturers have similar average costs.

7.42 The Commission has not actually claimed that Greif is cheaper than small drum manufacturers for a similar type of customer. As the Commission notes in §7.30,

"prices vary (for a given type of drum) depending on the location and size of customers … for these reasons price comparisons between manufacturers are indicative at best"

7.43 Greif understands that it has more of the large volume customers than smaller manufacturers, and tends to have a larger average order size. When comparing prices of plain steel drums between manufacturers, Greif urges the Commission to ask competitors for their average order size to show that its price comparison is not overly influenced by the buyer power of larger customers.

7.44 In addition, we note that it appears from the Commission's drafting in §7.31-2, **[…………………………………..]**. If this is correct, then it appears that the evidence on the pricing comparison is at best mixed – that **[………………………………..]**. If this understanding is correct, then it appears that there is no evidence that the parties are in fact consistently the two cheapest drum suppliers.

7.45 Further, the Commission assumes that because rival supplier's variable costs are higher, their prices will also be higher. Aside from the problem that marginal cost is not equal to variable cost (but merely an approximation)[50], the Commission's assumption would only be true if the market operated as a simplistic version of the Bertrand model of oligopoly, where firms set price equal to marginal cost. However there is no evidence whatsoever that this market is characterised by Bertrand competition.

7.46 Businesses set prices in order to recover their overall costs. The Bertrand model where price is equal to marginal cost requires some extremely strong assumptions which do not apply to the supply of steel drums . These include no fixed costs, a homogeneous product, and any firm can produce as much as it wants at constant marginal costs.[51] If any of these are relaxed, the price will be above marginal cost.

7.47 Simple observation of the data tells us that the Bertrand model is not a good characterisation of the market and that there is no reason to expect firms in this market to price at marginal or even variable costs. The data provided in the Provisional Findings and Q11 of the Market Information request shows Greif's prices are **[ ]** than its variable costs. Indeed, if price were determined based on variable costs alone, then the entire market would already be captured by the firm with the lowest marginal costs (presumably Greif or Blagden). Given that rival suppliers compete in the market and are able to win business from Greif and Blagden, there is more competitive dynamic at play than a simple application of the Bertrand model.

7.48 The Commission could actually test whether its theory applies in practice in a straightforward manner. The Commission has Greif's pocket margin database available at its disposal to verify whether price has any relationship to variable cost. The relevant measure in the database of mark-up over variable costs is the 'contribution margin' field. The 'contribution margin' takes into account all variable costs; what remains is available as a contribution against Greif's fixed costs. If the Commission's theory on variable costs were correct you would expect to see the contribution margin to be constant. A quick look at the database shows that this is not the case.

7.49 The database shows the contribution margin for each customer varies widely. The contribution margin varies from -**[….]**% to **[….]**%, has a median of **[….]**%, and a standard deviation **[….]**%. The wide distribution of the contribution margin is shown in Figure 6 below. Visual inspection of the graph below shows the Commission's theory that price is based on the variable cost of serving each customer has no basis.

Figure 6: Contribution margin distribution

[………………………………..]

7.50 As Greif's price to individual customers bears little relation to the variable costs of supply, the Commission cannot assume that Greif's rivals will be more or less competitive on price. The evidence is simply not consistent with the Commission's theory. We once again urge the Commission to avoid making assumptions that are not backed by the evidence.

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[50] As noted by Hausman (1996) "it is well known among economists that estimating true marginal cost from a firm's accounting cost data is, at best, extremely difficult". See Hausman, J., Leonard, G., & Vellturo, C, 1996, "Market definition under price discrimination", *Antitrust Law Journal,* Vol. 64, p. 372.

[51] Carlton, D. & Perloff, J, 2000, *Modern Industrial Organization 3rd Ed,* Addison-Wesley, p. 170.

Entry or expansion by competitors (including competitors of alternative products)

7.51 The Commission accepts that expansion by an existing UK supplier of new large steel drums could occur with relatively low investment and within a short timescale (§ 8.9). Based on existing spare capacity, new large steel drum manufacturers **alone** would constrain Greif post-merger and prevent a substantial lessening of competition. The Commission has not evidenced any relationship between variable costs and price and has no basis for dismissing expansion by an existing UK supplier as a competitive constraint.

7.52 The Commission cannot refute the fact that the award by BP of a long-term contract to Ramsden and Whale constitutes sponsored ***expansion***, among other means by paying a premium for products from this supplier,[52] and merely states that it does not consider this to be an example of past sponsored ***entry*** (§ 8.18). Sponsored expansion of Greif's competitors by its larger customers cannot therefore be dismissed as a competitive constraint.

7.53 The Commission totally ignores the constraint imposed on Greif post-merger by the very recent entry of Mauser into the UK IBC and large plastic drum market and of Schütz into the UK large plastic drum market.

Conclusion

7.54 We disagree that the evidence supports the theory that rival suppliers will not be competitive post-merger. As there is excess capacity and low switching costs, the Commission relies <u>heavily</u> on the theory that rival suppliers have higher variable costs and therefore are not able to provide a competitive constraint against Greif. However, even by its own admission, the comparison of variable costs and prices between suppliers is not robust and may be affected by different treatments of cost. Given the importance of this matter, the Commission has a duty to investigate until it has established the evidence to the requisite standard of proof.

7.55 Moreover, even if it were correct that smaller competitors have higher variable costs than Greif and Blagden, that does not mean that they are not a competitive constraint. If it were the case that these suppliers were consistently more expensive than Greif and Blagden on a like for like basis, without any compensating benefits in terms of service, then it is difficult to see why these firms would currently have any sales. Greif’s prices are already in excess of its variable costs, so there is no suggestion that these firms have to be able to price at variable costs to be able to compete.

7.56 This simplistic application of the Bertrand model does not fit with either the theory or the market evidence. Given that the lack of constraint from rival suppliers seems to be a primary reason for blocking the merger, we urge the Commission to consider very carefully whether its evidence is sufficiently robust.

[52] See §1, Summary of hearing with BP plc held on 29 March 2007.

Conclusion On Competitive Constraints

7.57 In this section we have considered the degree of constraint imposed by Blagden on Greif pre-merger, as well the extent to which rival UK steel drum suppliers will provide post-merger constraint. We make the following observations:

- The evidence suggests Blagden was not a strong rival pre-merger. In the period since 2004 Blagden was winning fewer and fewer contracts off Greif. Indeed, over the period 2004-2006, the combined Greif/Blagden business lost much more business to 'alternative packaging' than to each other.

- The customer survey did not suggest customers typically played Blagden off against Greif.

- The Commission has provided evidence that Greif did not achieve a higher margin on customers who dual sourced from Greif and Blagden compared to those that did not.

- The evidence suggests rival suppliers would be a strong competitive constraint against Greif post-merger. Rival suppliers produce a comparable product range and have 'significant spare capacity' (§8.2) which could be utilised without additional cost and at no risk.

- The Commission's theory that these suppliers are not competitive as they have higher variable costs has no basis in theory or fact. In economics this would require 'Bertrand' competition, but there is no evidence whatsoever that the steel drum market is characterised by Bertrand competition. In addition, we have demonstrated that Greif does not price at a constant mark-up over variable cost.

- Finally, the example of BP and R&W shows that there is potential for smaller rivals to expand on the back of large contracts.

7.58 In conclusion, the combination of a lack of pre-merger constraint from Blagden and post-merger constraint from smaller rivals must lead to the conclusion that there is no SLC.

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