Buyer power in the Korsnäs/AD Cartonboard merger

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The Korsnäs/AD Cartonboard case – key facts

- **In May 2006 the Commission cleared the purchase of AD Cartonboard by Korsnäs after extensive pre-notification discussions, but without opening a Phase-II investigation.**
- **The transaction combined the # 2 and # 3 players in the liquid packaging board (“LPB”) market in the EEA (“3 to 2” merger).**
- **LPB is used as an input by converters such as Tetra Pak who produce cartons used by sellers of liquid drinks (in particular milk and juice).**
- **There was a very stylised market structure pre-merger: <u>three</u> actual LPB suppliers in the EEA and <u>six</u> customers only (a very large one, two large ones and three very small ones).**

The Korsnäs/AD Cartonboard case – key facts

- There was general agreement between the Commission and the Parties on market definition (which had been analysed extensively on a previous case in the industry in 1999 – Enso Stora).
- The case therefore turned almost exclusively on buyer power, efficiencies and concerns about possible unilateral and coordinated effects in the market.
- Most of the relevant market “parameters” and market “outcomes” where observable to the merging Parties (and the Commission): historic prices charged by the two merging suppliers to each customer over time, volumes sold, other contractual characteristics, actual costs over time and available capacity.
- The Commission could have asked for the same information from Stora Enso and it would have had a full picture of the market history (the merging Parties had to rely on imperfect estimates).

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The Parties' submission on buyer power - Overview

- **KEY STATEMENT - The three large buyers of LPB in the EEA (Tetra Pak, Combibloc and Elopak) have countervailing buyer power.**
- **THEORETICAL FRAMEWORK – Bargaining game between three suppliers and three customers (pre-merger) and between two suppliers and three customers (post-merger): analysis of the alternative options available to each, analysis of the actual outcomes in the past and the threats made by each during the negotiations, and analysis of the cost to each parties of the lack of an agreement (see for instance Inderst and Shaffer, 2006).**
- **ANALYSIS OF THE EVIDENCE USED TO SUPPORT THE STATEMENT (SOME CONFIDENTIAL)**

Evidence submitted by the Parties (1/6) – TETRA PAK

- **These three buyers are large multi-national companies signing world-wide supply agreements for all their converting facilities. [Demand-side link between EEA supply and supply outside the EEA.]**

- **Tetra Pak (the largest of the three) accounts for more than [50-70]% of the total LPB demand in the EEA.**

- **Tetra Pak accounted for more than [80-100%] of the Parties' combined LPB deliveries world-wide in 2004 and more than [80-100%] in 2005.**

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Evidence submitted by the Parties (2/6) - TETRA PAK

- **The merging parties are more dependent on Tetra Pak than Tetra Pak is on them since:**
  - If Tetra Pak did not renew its supply contract with the merging parties, they would find it <u>impossible</u> to replace the lost volumes and given the high fixed costs of running a paper mill, they would incur large losses *[this could be analysed in detail and quantified (including an analysis of the "mitigation" strategies available to the suppliers]*;
  - On the contrary, Tetra Pak would be able to: (a) switch volume between Stora Enso and the merging parties, (b) sponsor a new entrant by offering technical assistance and a significant volume commitment, and (c) sponsor expansion at an existing producer outside the EEA (such as Klabin) by signing a long-term supply contract. *[Each of these statements could be analysed and quantified, and there was a history of these strategies in the industry.]*

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Evidence submitted by the Parties (3/6) - TETRA PAK

- **The existing (and historical) contracts between the merging parties and Tetra Pak could be analysed to assess whether some of the contractual clauses reveal who had more bargaining power during the negotiations:**
  - What is the length of the contract and are there clauses for price adjustments?
  - Is there a cost pass-through provision for large and unexpected cost shocks to the supplier (i.e., increase in energy costs or in the cost of other raw materials)?
  - Is there a clause to pass-through cost decreases (and is there a way for the customer to monitor if cost decreases have occurred)?
  - Are there specific partnerships to reduce costs and how are these benefits being allocated?

- **In this case there was also a signed (forward looking) agreement between the merging parties and Tetra Pak detailing (among other things) how the merger synergies would be shared between the parties and Tetra Pak that contained very useful information on the relative bargaining power.**

Evidence submitted by the Parties (4/6) - TETRA PAK

- **Detailed analysis of the actual outcomes and threats during the previous years:**
  - Simple comparison of the prices charged to different customers (once other factors are controlled for)
  - Extent to which cost variations were passed through to Tetra Pak (is there any asymmetry here whereby Tetra Pak appropriates most of the cost reductions but suffers only part of the cost increases)? *[Historic analysis of profitability for the supplier and the customer using exogenous cost shocks to reveal demand elasticities.]*
  - Actual switches of volumes (or threats of switching volumes) between suppliers by Tetra Pak
  - Actual examples of "sponsored" entry and/or expansion of competing suppliers by Tetra Pak (or threats along these lines).

Evidence submitted by the Parties (5/6) – COMBIBLOC AND ELOPAK

- **Same theoretical framework as for Tetra Pak.**
- **Combibloc and Elopak are the 2nd and 3rd largest buyers of LPB in the EEA: each with a share of consumption between [10-30]%**
- **Both Combibloc and Elopak enjoy buyer power vis-à-vis LPB suppliers as they place orders large enough to fill the capacity of a board machine.**
- **If the merging parties lost Combibloc or Elopak as a customer they would find it <u>very difficult</u> to replace the lost volumes, and because of the high fixed costs they would find this very costly.**

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Evidence submitted by the Parties (6/6) - COMBIBLOC AND ELOPAK

- **Combibloc and Elopak each purchase sufficiently large volumes so as to enable them to:**
  - Sponsor new entry
  - Sponsor significant new capacity *[role of efficient producers located outside the EEA]*
- **Detailed analysis of the existing contracts (to the extent actual supplies take place/took place)**
- **Analysis of the volume switched by Combibloc and Elopak in the past**

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Commission's conclusions on this case

- **Commission checked whether the inferences made by the merging parties on the "observables" were correct.**
- **Commission also checked with the customers: (a) whether the "observables" submitted by the Parties were factually correct, and (b) whether the inferences made by the merging parties were appropriate (in this case the customers agreed with the arguments made by the merging parties). The Commission could also get access to additional "observables" through the market investigation.**
- **Conclusions - the Commission agreed with the merging parties' case that Tetra Pak, Combibloc and Elopak had countervailing buyer power. This was one of the key factors that allowed the Commission to conclude that the merger was unlikely to lead to higher prices.**

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Lessons for future cases

- Need for a clear analytical framework to discuss “buyer power” in the specific industry.
- Need for a detailed assessment of the key “observables” to credibly support a buyer power argument (e.g., analysis of the alternative options available to each of the key market participants, analysis of the profits from the different strategies and analysis of the historic outcomes).
- Commission is then able to (a) check the accuracy of the facts and inferences made by the merging parties with the customers, and (b) collect additional relevant information to reach its conclusions.