

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Commissioner of Competition for a consent order pursuant to sections 92 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34;

AND IN THE MATTER OF the acquisition by Abitibi-Consolidated Inc. of all of the outstanding shares of Donohue Inc.

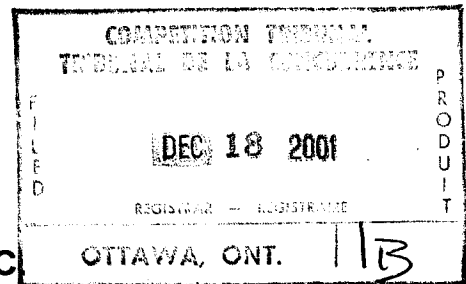
BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

ABITIBI-CONSOLIDATED INC.



Respondent

STATEMENT OF GROUNDS AND MATERIAL FACTS

I. INTRODUCTION

1. The Commissioner of Competition (the "Commissioner") brings this application for a consent order on the grounds that the acquisition by Abitibi-Consolidated Inc. ("ACI") of all of the outstanding shares of Donohue Inc. (the "Merger") prevents or

2. The Commissioner, with the consent of ACI, respectfully submits for approval a draft consent order (“DCO”) that, if implemented, will eliminate the likelihood of a substantial lessening or prevention of competition resulting from the Merger.

3. ACI does not accept the facts, submissions or conclusions of law set out herein, but does not contest them for the purposes of this application only. Further, nothing in this Statement of Grounds and Material Facts or in the Commissioner’s application for the DCO, shall be taken as an admission by ACI of any facts, submissions or conclusions of law which would support the allegation that the Merger prevents or lessens, or is likely to prevent or lessen, competition substantially in any market.

II. THE PARTIES

(a) The Commissioner

4. The applicant is the Commissioner appointed under section 7 of the *Competition Act*, R.S.C. 1985, c. C-34 (the “Act”) and as such, is the sole person authorized to make this application.

(b) Abitibi-Consolidated Inc.

5. The respondent, ACI, is a corporation incorporated pursuant to the *Canada Business Corporations Act* and was formed from the amalgamation of Abitibi-Price Inc.

and Stone-Consolidated Corporation by articles of amalgamation effective as of May 30, 1997. The principal executive office and the registered office of the company are located at 1155 Metcalfe Street, Suite 800, Montréal, Québec.

6. ACI manufactures and supplies newsprint, value-added papers, wood products and pulp. Prior to the Merger, ACI owned and operated a total of twelve newsprint mills in North America, with eight in Canada and four in the United States. Of ACI's eight Canadian mills, four were located in Québec,¹ two in Ontario and two in Newfoundland. In the United States, ACI had mills in Steilacoom, Washington and Snowflake, Arizona, as well as a 50% partnership interest in mills in Augusta, Georgia and Claiborne, Alabama. ACI also has an agreement to market all of the newsprint produced from Boise Cascade's mill in De Ridder, Louisiana.

7. In February 1999, ACI, Norske Skog of Norway and Hansol of South Korea entered into a joint venture to create a newsprint and groundwood paper company serving the Asia-Pacific region. The joint venture is named Pan Asia Paper Co. and consists of four newsprint mills, two in Korea, one in China, and one in Thailand. ACI also owns a newsprint mill in the United Kingdom operating as Bridgewater Paper Company Ltd.

8. The shares of ACI are publicly traded on the Toronto and New York Stock Exchanges.

(c) Donohue Inc.

¹ In 2000, ACI sold its newsprint mill located in Chandler, Québec.

9. Donohue Inc. (“Donohue”) was incorporated by letters patent dated March 30, 1920 issued under Part 1 of the *Companies Act (Québec)* and continued on September 2, 1983. Donohue’s head office was located at 500 Sherbrooke Street West, Suite 800, Montréal, Québec.

10. Donohue was an integrated forest products company engaged in forest management and timber harvesting, and in the manufacture and sale of newsprint, value-added papers, market pulp and wood products. Donohue operated a total of seven newsprint mills in North America, consisting of five mills in Canada and two in the United States. Of Donohue’s five Canadian mills, three were located in Québec, one in Ontario and one in British Columbia. In the United States, Donohue had two newsprint mills in Texas.

11. The shares of Donohue traded on the Toronto Stock Exchange. Prior to the Merger, Quebecor Inc. (“Quebecor”), the largest commercial printer in the world, held approximately 65% of the voting shares of Donohue.

III. THE MERGER

12. Effective as of June 22, 2000, ACI acquired all of the issued and outstanding Class “A” Subordinate Voting Shares and Class “B” Shares of Donohue. As consideration, ACI paid \$42 per share, payable by \$12 in cash and 1.8462 ACI common shares per Donohue share, for total consideration of approximately \$7.1 billion, including assumed debt.²

² Unless otherwise indicated, all amounts are shown in Canadian dollars.

13. In connection with the Merger, ACI entered into agreements with Quebecor and Donohue whereby Quebecor agreed to tender all of the shares it held in favour of ACI's offer and Donohue agreed to recommend ACI's offer to its shareholders. As a result of the Merger, Quebecor is the largest single shareholder of ACI, with approximately 11% of the voting shares of ACI.

IV. THE COMMISSIONER'S INQUIRY

14. On February 14, 2000, ACI submitted a short form pre-notification filing pursuant to section 114 of the *Act*, along with a request for an Advanced Ruling Certificate under section 102 of the *Act*. On February 24, 2000, the Bureau requested a long form filing pursuant to section 114 of the *Act* and classified the Merger as very complex.

15. On March 20, 2000, the Commissioner commenced a formal inquiry (the "Inquiry") into the proposed Merger pursuant to subparagraph 10(1)(b)(ii) of the *Act*. During the course of the Inquiry, the Commissioner obtained a number of Orders pursuant to section 11 of the *Act* requiring the production of relevant records and written returns from the parties and other industry participants, such as Irving Paper Ltd., Kruger Inc., Pacifica Papers Ltd., Papier Masson Ltd., Daishowa Inc., Atlantic Packaging Products, and StoraEnso Port Hawkesbury Limited.

16. On April 14, 2000, the Commissioner and ACI reached an agreement to voluntarily hold ACI and Donohue separate until the close of business on May 9, 2000 to afford the Commissioner additional time to review the Merger. At that time, the parties were advised that the Inquiry would continue notwithstanding the closing of the Merger and that the *Act* provided a three-year period pursuant to section 97 during which the Commissioner may bring the matter before the Tribunal.

17. On April 18, 2000, ACI announced that it had acquired 95% of the Class A Subordinate Voting Shares and approximately 92% of the Class B Shares of Donohue.

18. On June 5, 2000, ACI agreed to hold the Port-Alfred and Thunder Bay mills separate from the remaining assets. On June 22, 2000, ACI announced that it had exercised its rights to acquire all Class "A" Subordinate Voting Shares and Class "B" Shares of Donohue that were not previously tendered under its offers. ACI now held all of the issued and outstanding Donohue shares.

19. On September 8, 2000, ACI delivered the final information required by the Commissioner to complete the review of the Merger.

20. After a series of negotiations, the Commissioner and ACI agreed upon an undertaking to resolve the Commissioner's concerns in respect of the Merger (the "Undertaking"). The Undertaking provided for the voluntary divestiture of the Port-Alfred Mill to a third party purchaser. In the event that the Mill was not divested within the period specified in the Undertaking, the parties agreed to the sale of the Mill by an independent agent pursuant to an order issued by the Tribunal, on consent.

21. ACI has not been able to divest the Port-Alfred Mill and other related assets. Pursuant to the terms of the Undertaking, therefore, the Commissioner seeks an order, with the consent of ACI, appointing an independent agent to carry out the divestiture of the Port-Alfred Mill and other related assets in accordance with the provisions of the DCO filed.

V. DESCRIPTION OF THE INDUSTRY

22. As noted above, both ACI and Donohue were engaged in the manufacture and sale of newsprint, market pulp, wood products and value-added papers. A brief description of each of these products and the Commissioner's conclusions in respect of each product is set out below.

(a) Newsprint

23. Newsprint is a printing paper that is predominantly used in newspapers, but is also used in a number of other applications, including flyers, advertising inserts and directories. The most common form of newsprint is referred to as "standard" newsprint and has a weight of 48.8 grams per cubic metre. Newsprint is the least expensive and lowest grade of paper produced from wood pulp.

24. Newsprint may be manufactured from "virgin" or recycled fibre or any combination thereof. Virgin fibre is a form of wood fibre that has not previously been processed into paper. Recycled fibre is fibre derived from old newsprint or old magazines that has been de-inked to make it suitable for use in paper manufacturing.

25. Newsprint is delivered to users in rolls through shipments by rail, sea and/or truck. Some printers operate on a just-in-time delivery basis, receiving only the quantity of newsprint necessary for their short-term needs. In addition, commercial printers, who use newsprint to produce advertising inserts and flyers, often require an expeditious supply of newsprint to satisfy short deadlines imposed by their customers.

26. Newsprint may not be stockpiled by customers for mid-to-long term future use as it is a bulky product which retains its optimal brightness and moisture for a limited time.

As such, commercial printers and other customers of newsprint mills require a reliable supplier who can deliver the correct amount of quality newsprint in a timely manner.

27. Newsprint quality is evaluated based on a number of factors, including runnability,³ printability⁴ and brightness. The quality of the newsprint used has a significant effect on the efficiency of the printing process. A roll of newsprint with several breaks per roll may result in downtime and increased expense, particularly for publishers of daily newspapers where undue delays in printing can result in additional costs due to the late delivery of the newspapers.

28. Although there are differences in quality, newsprint is produced to meet certain common industry standards. Newsprint is therefore considered to be a relatively homogenous product.

29. A significant proportion of Canadian produced newsprint is destined for export markets. In 1999, approximately 86.5% of all newsprint produced in Canada was sold into the United States and abroad. In 1999, 96% of ACI's newsprint production was supplied to export markets and 89.8% of Donohue's newsprint production was supplied to export markets. In both cases, these exports were predominantly to customers located in the United States.

30. Canadian consumption of newsprint was approximately 1,240,000 tonnes of newsprint in 2000 and 1,250,000 tonnes in 1999. As of January 1, 2001, the average

³ Runnability refers to the number of defects within a roll of newsprint that cause an interruption in an automated printing process. Such defects are commonly referred to as "breaks".

⁴ Printability refers to the consistency of the paper and the absence of hills, valleys or other changes in consistency.

price of newsprint was US\$610 per tonne. As a result, the Canadian market for newsprint represents an approximately C\$1.1 billion per year industry. As outlined in greater detail below, the most significant concern to the Commissioner is the effect of the Merger on the supply of newsprint to customers located in Eastern Canada.

(b) Market Pulp

31. Pulp is one of the components required for paper production. It is a fibrous material that is produced by mechanically or chemically reducing wood. Pulp can be produced through a variety of processes, including cooking wood in solutions of various chemicals (chemical pulp), mechanically grinding logs (groundwood) or from de-inking old newspapers or magazines (recycled pulp).

32. ACI produces pulp for its own consumption and also for sale to third parties (referred to as “market pulp”). Prior to the Merger, ACI had the capacity to produce 170,000 tonnes of pulp through its mill located in Fort Frances, Ontario. Of this total production capacity, 120,000 tonnes were required for ACI’s own use, leaving 50,000 tonnes for sale to third parties. However, virtually all of ACI’s market pulp is sold to a single customer, Boise Cascade, through a long term supply contract.

33. Donohue had an annual production capacity of 481,000 tonnes of market pulp produced in mills located at Saint-Félicien and Matane, Québec and Sheldon, Texas.

34. Following the Merger, there remain a substantial number of major suppliers of market pulp within Eastern Canada that may be relied upon to constrain any price increase by the merged entity, such as Bowater Pulp and Paper Canada Inc. (“Bowater”) in Thunder Bay, Ontario, Tembec Inc. in New-Brunswick, Québec and

Ontario and Kimberley Clark in Nova-Scotia. As a result, the Commissioner has concluded that the Merger does not raise sufficient concern to warrant a remedy in respect of the supply of market pulp.

(c) Wood Products

35. Prior to the Merger, ACI operated three fully owned sawmills in Roberval, La Tuque and St-Fulgence, Québec, and four partially-owned sawmills in La Tuque, St-Ludger-de-Milot, La Baie and St-Raymond, Québec, with a combined annual capacity of 536 million board feet of lumber. Such lumber is used in a variety of applications, including construction and carpentry.

36. Donohue operated twelve sawmills and two re-manufacturing facilities in the Province of Québec, with a total annual capacity of 1.3 billion board feet of lumber. Donohue also participated in a joint venture in respect of a sawmill located north of Montreal through which Donohue was entitled to 10.8 million board feet per year. In addition, Donohue operated two sawmills located in British Columbia, with a combined annual capacity of 360 million board feet.

37. Following the Merger, there remain a substantial number of competitors that may be relied upon to constrain any price increase by the merged entity in respect of wood products, such as Kruger Inc. in Ontario and Québec, Domtar Inc. in Québec and Ontario, Tembec Inc. in New-Brunswick, Québec and Ontario and Alliance Forest Products Inc. in Québec and New-Brunswick. As a result, the Commissioner has concluded that the Merger does not raise sufficient concern to warrant a remedy in respect of the supply of wood products.

(d) Value-Added Papers

38. Value-added papers are made largely from groundwood or mechanical pulp and also contain varying amounts or proportions of filler. Value-added papers are used in a wide variety of products. For example, supercalendered paper is a clay-filled groundwood paper having a smooth finish and high opacity, used primarily for catalogues, magazines and inserts. Uncoated freesheet is a grade of paper consisting of essentially only chemical pulp and without any coating that is used for printing and writing.

39. Prior to the Merger, ACI's aggregate annual production capacity of value-added papers was 1.5 million tonnes produced through a number of mills located in Canada and the United States, representing approximately 30% of the total North American capacity for the production of value-added papers.

40. Donohue was not a significant producer of value-added papers with an aggregate annual production capacity of only 0.2 million tonnes produced through mills located in Canada and the United States. Donohue's capacity represents only approximately 4% of the total North American capacity for the supply of value-added papers.

41. As outlined in greater detail below, value-added papers and newsprint are functionally distinct. Due to the higher value of value-added papers compared to newsprint, suppliers are able to economically ship value-added papers over larger distances than newsprint, resulting in a broader geographic market for value-added papers. In fact, value-added papers have been imported from both the United States and Europe into Canada. As a result, the Commissioner has concluded that the relevant geographic market for value-added papers is likely larger than Eastern Canada.

42. Unlike newsprint, capacity for the production of value-added papers is increasing. A number of producers have recently converted newsprint mills to produce higher revenue generating value-added papers.

43. The merged entity holds 34% of the North American capacity for the supply of value-added papers. The Commissioner has concluded that in light of the combined market share of the merged entity, the fact that Donohue was not a large or effective competitor in respect of the supply of value-added papers prior to the Merger, the increasing capacity for the production of value-added papers and the presence of foreign competition from the United States and overseas as described above, the Merger does not raise sufficient concern to warrant a remedy in respect of the supply of value-added papers.

VI. COMPETITIVE ANALYSIS

(a) Product Market

44. The Commissioner has concluded that newsprint constitutes a separate product market for the purpose of assessing the impact on competition of the Merger. As outlined in greater detail below, there are no economically viable substitutes for newsprint.

45. Value-added papers, such as uncoated groundwood paper, are of a higher grade and are sold at a modest to substantial premium over newsprint. As of January 1, 2001, the average price for newsprint was US\$ 610 per tonne, while value-added papers ranged in price from US\$ 630 to US\$ 900 per tonne.

46. In addition, value-added papers and newsprint have different end-uses. Value-added papers are predominantly used for catalogues, advertisements and books, while the predominant use of newsprint is for newspaper production. Also, for certain customers, value-added papers are not functionally interchangeable with newsprint due to differences in brightness, glossiness or thickness.

47. The conclusion that there are no economically viable substitutes for newsprint is supported by customers of ACI and Donohue as well as other suppliers of newsprint which have provided information to the Competition Bureau.

48. In terms of the supply of newsprint, the Commissioner has concluded that producers currently producing value-added papers or other higher value papers are unlikely to shift production to lower value newsprint. Value-added paper is produced in at least ten different grades using machines that are dedicated to the production of that specific grade. With the exception of switching from uncoated groundwood paper production to newsprint, these machines cannot be altered to produce other grades of papers.

49. The costs of shifting production from value-added papers or other higher value papers to newsprint are significant and may result in substantial downtime. Such costs are unlikely to be recovered through the sale of lower value newsprint. Further, even though producers are operating at full or near full capacity in newsprint, there is a trend to shift production capacity away from newsprint towards value-added papers.

50. Based on the factors as described above, newsprint constitutes a separate relevant product market for the purpose of assessing the competitive impact of this Merger.

(b) Geographic Market

51. As described in further detail below, the Commissioner has concluded that the relevant geographic market is Eastern Canada. This market includes all provinces located east of Manitoba, with the exception of Newfoundland.

52. Although newsprint producers located in Eastern Canada do export newsprint internationally, newsprint producers located in the United States or offshore locations are not able to effectively compete in respect of the supply of newsprint within Eastern Canada for the reasons set out below.

53. Transportation costs are a significant component of the price of newsprint, comprising on average 10% of the total price. As a result, newsprint suppliers have a cost advantage for customers that are located in close proximity to their mills. For example, ACI and Donohue mills are mainly concentrated in Eastern Canada which gives the merged entity an advantage in serving customers in Eastern Canada.

54. In addition, Eastern Canada is a low-cost operating region given the availability of inexpensive pulp and electricity. As a result, suppliers located outside of Eastern Canada would find it difficult to effectively compete in respect of the supply of newsprint within the relevant market.

55. For customers who operate on a just-in-time delivery basis, such as some large daily newspaper publishers, receiving newsprint from a mill which is proximate to their operations considerably reduces the risk of disruptions in supply and facilitates such just-in-time delivery.

56. Commercial printers use newsprint to produce a number of products, such as advertisements and flyers. The size and other characteristics of newsprint required by the printer varies depending upon the type of flyer or advertisement to be produced. Therefore, commercial printers are unable to effectively stockpile newsprint for anticipated future use. In addition, as customers of commercial printers commonly require printing to be completed on short notice, commercial printers are normally unable to place orders for newsprint well in advance. To meet such short deadlines, commercial printers prefer their newsprint to be supplied from local mills.

57. Further, the automated printing process for which the majority of newsprint is used is subject to very narrow tolerances and requires frequent adjustment to ensure efficient operation. To assist in this process, customers commonly require on-site technical support from mill representatives. In addition, customers occasionally require emergency support from mill representatives on extremely short notice. Local mills are better positioned to provide customers with such technical support.

58. Also, all of the suppliers located in the United States contacted by the Competition Bureau advised that they were reluctant to supply newsprint into Canada due to cost disadvantages resulting from currency exchange rate differentials.

59. Although the published price for newsprint is generally set in U.S. dollars, transactions between Canadian mills, such as those operated by the merged entity, and Canadian customers are generally denominated in Canadian dollars, thereby minimizing the consequences of exchange rate fluctuations.

60. Suppliers of newsprint located outside of Eastern Canada do not export a material quantity of newsprint into Eastern Canada. In 2000, only 13,000 tonnes or 1% of

newsprint consumed in Canada was supplied from outside of Canada, with the majority of this supply being shipped into Western Canada. Moreover, Canadian Pulp and Paper Association data indicates that as of July, 2000, U.S. mills were operating at full capacity. This data is supported by the fact that all of the U.S. suppliers contacted by the Competition Bureau expressed no interest in shipping to Eastern Canada, even in response to a significant price increase.

61. Despite the homogeneous nature of newsprint, there is a significant price difference between Eastern Canada and the United States that is not explained by transportation costs. Canadian Pulp and Paper Association data indicates that in 1998, average mill net per tonne of newsprint (i.e. sales price minus transportation costs to the customer) for shipments in the United States was significantly higher when compared to average mill nets for shipments in Canada.

62. Similar to their counterparts in the United States, newsprint suppliers located in Western Canada are unable to competitively ship newsprint into Eastern Canada given the significant transportation costs. The cost of shipping a tonne of newsprint from British Columbia into Eastern Canada is significantly greater than the cost of shipping from the relevant market.

63. Also, the increased transportation time to ship into Eastern Canada is unacceptable for those commercial printers and other customers who require a timely supply of newsprint to meet short production deadlines. In addition, newsprint is a freight sensitive product that may degrade easily if not properly packaged. Transporting newsprint over large distances increases the risk of such damage or degradation.

64. Producers located in Newfoundland produce newsprint solely for use within Newfoundland or export to U.S. or overseas customers accessible through marine shipments from ports in Newfoundland. In particular, although ACI and Kruger Inc. operate newsprint mills in Newfoundland, neither of these producers supply newsprint into Eastern Canada from these mills.

65. The consistent view of the customers of ACI, Donohue and other newsprint suppliers contacted by the Competition Bureau is that suppliers located outside of Eastern Canada are not viable alternatives, even in response to a significant increase in the price of newsprint, due to the increased transportation costs, the need for timely delivery, the benefit of receiving technical support, the need for a secure source of supply from a local mill and the uncertainty of foreign currency exchange rates.

66. In addition, limiting the relevant geographic market to Eastern Canada is supported by the actual shipment patterns for newsprint. As noted above, shipments of newsprint from the United States are virtually nonexistent. In addition, suppliers do not currently ship newsprint from either Newfoundland or Western Canada into the relevant market.

67. The conclusion that the relevant product market is Eastern Canada is also supported by certain internal business documents created by the parties and other industry participants that identify relevant competitors on a regional basis, as opposed to on a broader geographic market, such as North America.

68. Based on the above, the relevant geographic market is Eastern Canada, excluding Newfoundland.

(c) Market Concentration

69. Prior to the Merger, the Relevant Market was relatively concentrated due to significant consolidation among various suppliers over the past five years. The following is a listing of the Eastern Canadian acquisitions over that time period:

- (a) In 1996, Donohue acquired two newsprint mills in Thorold, Ont. and Baie-Comeau, Que. from QUNO Corp.;
- (b) In 1997, Abitibi-Price Inc. acquired Stone Consolidated Corp. which was amalgamated to form ACI;
- (c) Also in 1997, Tembec purchased the Spruce Falls, Ont. mill from Spruce Falls Acquisition Corp.;
- (d) In 1998, Bowater acquired Avenor Inc., a large newsprint producer in Eastern Canada; and
- (e) Also in 1998, Papier Masson Ltée purchased the Masson, Québec mill from Nexfor Inc.

70. The ACI-Donohue merger in 2000 involved the largest and third largest producers of newsprint within Eastern Canada. Through the Merger, ACI strengthened its position as the world's largest producer of newsprint with a total capacity of 6.3 million tonnes per year, representing approximately 16% of the total worldwide supply of newsprint.

71. The other large competitors remaining in the Relevant Market are: Bowater and Kruger. In addition, there are a number of smaller producers, including Daishowa

Forest Products Ltd. (“Daishowa”), Alliance Forest Products Inc., Papier Masson Ltd., F. F. Soucy Inc., Irving Paper Ltd., StoraEnso Port Hawkesbury Ltd., Atlantic Packaging Products Ltd. and Tembec Inc.

72. Market shares for newsprint are commonly measured on the basis of capacity. Prior to the Merger, the estimated market share of newsprint production capacity based on 1998 figures for producers within the Relevant Market was as follows:

Firm	Annual Capacity (tonnes)	Market Share
ACI	2,205,000	27.9%
Bowater	1,464,000	18.5%
Donohue	1,419,000	18%
Kruger	961,000	12.2%
Daishowa	386,000	4.9%

73. Following the Merger, ACI-Donohue’s combined market share within the Relevant Market, based on the 1998 estimates set out above, equals 45.9%.

74. As a result of the Merger, the post-merger four-firm concentration ratio (CR4) in Eastern Canada increases from 76.6% to 81.5%. The post-merger Herfindahl-

Herschman Index (“HHI”)⁵ is 2,672, compared to a pre-merger HHI of 1,668, an increase of 1,004 points.

75. The post-merger three-firm concentration ratio (CR3) in the Relevant Market increases from 64.4% to 76.6%. and the two-firm concentration ratio (CR2) increases from 46.4% to 64.4%.

76. As outlined below,⁶ the Commissioner has concluded that the high level of concentration within the market for the supply of newsprint in the Relevant Market and other factors as described herein increase the likelihood that interdependence will be effectively acted upon by suppliers within the Relevant Market.

(d) Section 93 Factors

(i) Foreign Competition

77. Shipments of newsprint into Eastern Canada from producers located in the United States or other foreign sources are insignificant. As noted above, in 2000, only 13,000 tonnes or 1% of newsprint consumed in all of Canada was imported, with the majority of these imports being supplied into Western Canada.

⁵ HHI is a measure of the degree of concentration in a market. HHI is calculated by summing the squares of the individual market shares of all participants. The U.S. Department of Justice and Federal Trade Commission Joint Revised Merger Guidelines (1992) state that where the post-merger HHI is greater than 1800 in any market, such a market is considered to be “highly concentrated”. Also, where the post-merger HHI exceeds 1800 and the merger produces an increase in HHI of more than 100 points, such a merger is likely to create or enhance market power or facilitate its exercise.

⁶ Please see section (e) entitled “Interdependence” beginning at paragraph 103.

78. Newsprint mills located in the United States, including the Northeastern United States, are currently operating at or near full capacity levels, with sufficient demand for newsprint from customers located within close proximity to these mills. In fact, Canadian Pulp and Paper Association data indicates that as of July, 2000, U.S. mills were operating at 100% capacity. As a result, U.S. mills do not have any excess capacity that could be directed to the Eastern Canadian market. Similarly, mills located in Europe focus primarily upon domestic markets.

79. Even if such capacity existed, foreign suppliers would find it difficult to competitively supply newsprint into the Relevant Market due to the cost and logistics of transporting newsprint into Eastern Canada. Also, the Commissioner has been advised by foreign suppliers that they are not able to provide secure or just-in-time delivery of newsprint over larger distances into Eastern Canada. As noted above, all of the U.S. newsprint suppliers contacted by the Competition Bureau advised that they were dissuaded from selling into Canada due to the cost disadvantages resulting from currency exchange rate differentials.

80. Customers have also expressed to the Competition Bureau a preference to continue to purchase newsprint from established local sources. When questioned, U.S. and Europe based suppliers expressed their reluctance to enter the Canadian market, even in the face of a hypothetical significant non-transitory price increase. In fact, at least until December 2000, despite significant increases in the price of newsprint, no foreign supplier had entered the relevant market since the Merger.

81. Based on the factors set out above, the Commissioner has concluded that foreign suppliers do not offer a potential source of competition within the Relevant Market.

(ii) Acceptable Substitutes

82. As outlined above, there are no economically viable substitutes for newsprint.

(iii) Effective Remaining Competition

83. The remaining large competitors within the Relevant Market are Bowater and Kruger. The Merger makes it less likely that these competitors will effectively compete for the supply of newsprint within Eastern Canada.

84. Bowater is the second largest producer of newsprint into Eastern Canada with mills located in Gatineau, Québec; Thunder Bay, Ontario; Dalhousie, New Brunswick; and, Liverpool, Nova Scotia. While Kruger is the next-largest producer of newsprint, it has considerably less production capacity than Bowater, with only two mills in Eastern Canada: Bromptville and Trois-Rivières, Québec.

85. As with other newsprint producers located in Canada, Bowater and Kruger export the vast majority of their newsprint to customers located in the United States. In addition, Bowater and Kruger, like other Canadian suppliers of newsprint, are currently operating at near-capacity. Canadian Pulp and Paper Association data indicates that on average, Canadian newsprint mills were operating at 98% capacity as of July, 2000. Many of these suppliers have expressed their unwillingness to disrupt long-term relationships with existing customers by shifting a greater portion of their capacity to supply customers located in Eastern Canada.

86. In addition, certain of the mills operated by existing producers may not be suitable for customers in Eastern Canada, due to the lack of recycled content or other technical incompatibilities.

87. As outlined in greater detail below, the increased level of concentration resulting from the Merger increases the likelihood that interdependence will be effectively acted upon by remaining suppliers making it less likely that these competitors will effectively compete within the Relevant Market.

(iv) Removal of a Vigorous and Effective Competitor

88. As noted above, Donohue was the third largest producer of newsprint in Eastern Canada after ACI and Bowater.

89. The newsprint mills operated by Donohue were among the most efficient in North America establishing Donohue as a low cost producer of newsprint. In addition, Donohue had significant goodwill within the market and an overall reputation for high quality, service and commitment to environmental protection.

90. As outlined in greater detail below, the newsprint industry has a history of imperfect interdependence. Donohue occasionally refused to implement price increases implemented by other industry participants and occasionally refused to follow other producers in reducing capacity through voluntary production downtime.

91. The Merger removes a low-cost newsprint producer with significant goodwill established in the Relevant Market. The removal of Donohue as a competitor also increases the likelihood that interdependence will be effectively acted upon by the remaining participants in this Market.

(v) Technological Change

92. Newsprint production is a mature industry and is not characterized by dramatic technological advances, but rather by gradual improvements in mill design, equipment and other systems.

93. The advent of the Internet is anticipated to reduce the demand for newsprint as advertisers and publishers rely upon Internet communications, such as online news services or online classified advertisements, as opposed to newspapers. To date however, the demand for newsprint has remained consistent.

94. Change and innovation are therefore not significant factors in the assessment of this Merger.

(vi) Barriers to Entry

95. There are significant barriers to entry into the Relevant Market. No additional capacity has been added to the Relevant Market for over ten years nor is any additional capacity anticipated within a three year period.

96. *De novo* entry into newsprint production involves complex logistics and significant capital investments, such as the expense of acquiring the necessary equipment and

manufacturing facilities, securing a significant workforce and arranging for the supply of large amounts of electricity, with minimal anticipated returns due to the low revenues generated from the sale of newsprint and high exit costs from significant environmental liabilities resulting from paper mill operations.

97. In addition, newsprint production requires a supply of pulp. For example, an average mill producing 300,000 tonnes of newsprint requires approximately one billion cubic metres of wood. Government imposed restrictions on the use of forest lands limit the available supply of wood needed to manufacture pulp. The licences providing access to such forest lands have already been allocated to the incumbent suppliers within the Relevant Market.

98. As noted above, Eastern Canadian producers are isolated from competition from producers outside of Eastern Canada due to, *inter alia*, the transportation cost advantage held by Eastern Canadian producers in serving the Relevant Market and their ability to provide technical support to customers within the Relevant Market. To be competitive within Eastern Canada, existing competitors must establish a presence within the Relevant Market, through the acquisition or construction of manufacturing facilities. The cost of constructing such a facility may range between \$600,000,000 to \$700,000,000.

99. Further, some newsprint customers are bound by contracts with terms ranging from one year to five years. Moreover, irrespective of any contractual commitments, newsprint suppliers and customers have established long-term relationships. Customers may be reluctant to purchase newsprint from new entrants given the risk of late shipments or a poor quality product. This is particularly true for those newspaper publishers who are dependent upon just-in-time delivery of consistently high quality

newsprint to ensure that newspapers are produced on time. To ensure this supply, these newspaper publishers prefer to deal with suppliers that have well-established reputations and with whom they have a long-standing relationship.

100. Although newsprint may be considered to be a relatively homogeneous product, certain customers have developed a preference for newsprint produced by a certain mill and in some cases, by a specific machine within that mill. These customers have determined that newsprint from a specific source is particularly compatible with their automated printing process.

101. In North America, the newsprint industry is mature with declining or stable levels of demand. The current trend is towards reductions in capacity by either selling newsprint mills or converting newsprint machines for use in the production of higher value papers, such as uncoated groundwood papers. For example, in 1999, ACI converted its mill in Thunder Bay, Ontario from newsprint production to value-added papers.

102. Given the high barriers to entry identified above, the Commissioner has concluded that *de novo* entry or the expansion of existing competitors into the Relevant Market is unlikely.

(e) Interdependence

103. Conditions in the newsprint industry are conducive to interdependent behavior. The Eastern Canadian newsprint industry is characterized by: high levels of seller concentration; relatively inelastic demand; periodic or cyclical periods of limited excess capacity; high barriers to entry; a relatively homogeneous product; relatively stable

demand; transparency of pricing, capacity and capacity utilization information; and, participation in multiple markets.

104. In terms of transparency of pricing information, participants in the Relevant Market announce price increases in advance, thereby permitting competitors to adopt similar price increases. Pricing information is also shared as a result of meeting competition or “most-favoured nation” clauses found in certain customer agreements. In addition, aggregated pricing information is publicly distributed through various industry publications that periodically publish average industry price information.

105. In terms of transparency of capacity and capacity utilization information, participants in the Relevant Market have regularly reported capacity and publicly announce the permanent or temporary (*i.e.* downtime) withdrawal of capacity in advance, thereby making it possible for competitors to adopt compatible policies.

106. Information concerning mill newsprint production costs, shipments of newsprint, sales of newsprint and other product information is also published and widely distributed through the Canadian Pulp and Paper Association and industry consultant reports.

107. The two largest producers, ACI and Bowater, have multi-market contacts. For example, both operate mills in the Southern United States and in the Western United States.

108. The newsprint industry has a history of imperfect interdependence. In particular, prior to the Merger, price increases and capacity reductions announced by producers within the relevant market were not always implemented or followed by competing producers.

109. In January of 1998, ACI's predecessor, Abitibi-Price Inc., Bowater, Donohue and others announced a price increase of US\$ 40 per tonne to be effective on April 1, 1998. Other producers delayed in implementing any price increase and as such, the price increase was re-scheduled for May 1, 1998. The price increase was not fully implemented on May 1, 1998 or subsequently as certain producers granted price concessions or otherwise refused to implement the price increase.

110. The Merger enhances a key pre-condition to effective interdependence by increasing the level of concentration among suppliers within the relevant market. As such, the Commissioner has concluded that the Merger increases the likelihood that interdependence will be effectively acted upon by ACI, Bowater and other suppliers within the relevant market. In fact, one of the objectives of the Merger was to allow for a rationalization of capacity and a reduction of price volatility.

111. The enhanced likelihood of effective interdependence arising from the Merger has already resulted in greater coordination among competitors within Eastern Canada, such as parallel price increases and increased transparency in respect of the reduction of newsprint production capacity.

112. On January 5, 2000, ACI announced a price increase of US\$50 per tonne of newsprint, effective April 1, 2000. One day later, Bowater announced an identical price increase of US\$50 per tonne of newsprint, also effective April 1, 2000. On January 7, 2000, Donohue announced a price increase of US\$ 50 per tonne, also effective on April 1, 2000.

113. On June 5, 2000, Bowater announced a price increase of US\$ 50 per tonne of newsprint, effective September 1, 2000. On June 15, 2000, ACI announced an identical price increase, also to be effective September 1, 2000.

114. Similarly, on November 30, 2000, ACI announced a further price increase of US\$50 per tonne of newsprint effective March 1, 2001. The following day, Bowater announced the identical price increase to be effective the same date.

115. Also, ACI, Bowater and other suppliers have voluntarily ceased production for short periods of time to remove capacity from the market and reduce price volatility. For example, in 1999, Bowater has announced that it intended to remove 175,000 tonnes of newsprint from its overall capacity through voluntary downtime. ACI removed 450,000 tonnes of newsprint production capacity in 1999. As noted above, ACI also has permanently removed capacity from newsprint production by converting certain newsprint mills to produce value-added papers. In addition, ACI sold its Chandler, Québec newsprint mill in 2000 subject to a restrictive covenant that the mill not be used by the purchaser to produce newsprint. In all cases, these producers have made advance public announcements regarding the amount of downtime they intended to take or the quantity of capacity to be removed.

VII. RELIEF SOUGHT

116. Given the factors described above, including the merged entity's high post-merger market share, the high level of concentration within the relevant market, the high barriers to entry and the increased likelihood that interdependence will be effectively acted upon, the Commissioner has concluded that the Merger prevents or lessens, or is likely to

prevent or lessen, competition substantially in the supply of newsprint within the Relevant Market.

117. The Commissioner therefore respectfully requests, pursuant to sections 92(1)(e) and 105 of the *Competition Act*, that the Tribunal issue the DCO. It is submitted that this likelihood of a substantial lessening or prevention of competition will be eliminated by the implementation of the DCO, as explained more fully in the Consent Order Impact Statement filed.

CT-01/

IN THE MATTER OF an application by the
Commissioner of Competition for a consent
order pursuant to sections 92 and 105 of the
Competition Act, R.S.C. 1985, c. C-34;

AND IN THE MATTER OF the acquisition by
Abitibi-Consolidated Inc. of all of the
outstanding shares of Donohue Inc.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

ABITIBI-CONSOLIDATED INC.

Respondent

**STATEMENT OF GROUNDS
AND MATERIAL FACTS**

JOSEPHINE A.L. PALUMBO

Department of Justice
Competition Law Division
Place du Portage, Phase 1
50 Victoria Street, 22nd Floor
Hull, Quebec K1A 0C9

Tel: (819) 997-3325

Fax: (819) 953-9267

**Counsel to the Commissioner of
Competition**