



OFFICE OF FAIR TRADING

The Producer Responsibility Obligations
(Packaging Waste) Regulations 1997

Paperpak Limited

**A report by the Director General of Fair Trading to the
Secretary of State for Trade and Industry on the
competition scrutiny of the Paperpak scheme**

February 1998

OFT 213

PAPERPAK

A report by the Director General of Fair Trading to the Secretary of State for Trade and Industry on the competition scrutiny of the Paperpak scheme

CONTENTS

<i>Chapter</i>		<i>Page</i>
1	General summary	3
2	The Paperpak scheme	4
3	Comments received from third parties	6
4	Assessment	7
5	Conclusions and Recommendation	10
 <i>Annex</i>		
A	OFT Notice seeking comments from third parties	11

© Crown Copyright 1998

This material may be freely reproduced except for sale or advertising purposes

1 GENERAL SUMMARY

- 1.1 I am authorised by the Director General of Fair Trading under paragraph 7 of Schedule 1 to the Fair Trading Act 1973 to carry out a competition scrutiny of the Paperpak scheme as required by regulation 31 of the Producer Responsibility Obligations (Packaging Waste) Regulations 1997 (the Regulations). This is my report.
- 1.2 Paperpak is a proposed scheme which is to be set up by the UK paper packaging industry. Paperpak will be operated by Paperpak Limited, a non-profit making company limited by guarantee.
- 1.3 This advice has been prepared on the basis of the current draft membership agreement which will form the basis of the constitution of the Paperpak scheme. This assessment is based on the broad terms of the membership agreement and additional information which has been provided by the scheme operator. The advice is based on a premise of a scheme which has no members at present.
- 1.4 The Office of Fair Trading is content that the Paperpak scheme meets the requirements of the competition scrutiny under the Regulations: that is to say, it does not have, and is not likely to have, the effect of restricting, distorting or preventing competition, and it does not lead, and is not likely to lead, to an abuse of market power.
- 1.5 I therefore recommend that you should advise the Environment Agency, and Paperpak Limited as operator of the draft scheme, in accordance with regulation 31(5), that you are satisfied that the Paperpak scheme meets the requirements of the competition scrutiny.

2 THE PAPERPAK SCHEME

- 2.1 Paperpak is a proposed scheme which is to be set up by the UK paper packaging industry. Paperpak will be operated by Paperpak Limited, a non-profit making company limited by guarantee.
- 2.2 The shareholders of Paperpak Limited will comprise a number of paper industry trade organisations including the Paper Federation, the Corrugated Packaging Association and the British Carton Association. The day to day management of the company will lie with its Board of Directors. A maximum of ten directors will be appointed, one of whom will be the Chief Executive Officer and there will be up to nine nominated by the shareholder organisations (no more than one director may be nominated by each organisation). These directors will together have the right to appoint additional directors up to the maximum number.
- 2.3 Participation in the Paperpak scheme is open to any obligated company whose producer responsibility obligations derive principally from its handling of paper packaging, provided that its obligations can be discharged by the scheme operator.
- 2.4 Members of the Paperpak scheme will send to Paperpak Limited similar information as would be required by the Environment Agency had they opted for individual compliance. Paperpak Limited will aggregate the obligations of all scheme members and supply details of the resultant overall obligation to the Environment Agency. In each year that Paperpak is registered as a scheme, the scheme operator will acquire evidence of recovery and recycling and will provide information to the Environment Agency as may be required in order to show that it has discharged the recovery and recycling obligations of the scheme's members.
- 2.7 Each scheme member's obligation will be met firstly by any evidence of compliance which members provide to the operator of the scheme, which they may have as a result of their normal business activities. The scheme operator will then, through arranged contracts with the reprocessing industry, purchase sufficient evidence of compliance in order to meet the overall obligations of its members. Scheme members will each be charged the same amount for recycling of each material and for recovery. This charge will be the overall cost of recycling or recovery divided by the total tonnage of evidence which the scheme has had to purchase in respect of the obligations of the member in question.
- 2.8 Paperpak Limited states that it intends to take measures to increase the UK's paper recovery and recycling levels to the extent that funds are available. Such measures will include encouraging charities and voluntary organisations to set up collection

points and the funding of pilot schemes to demonstrate the viability of collecting and reprocessing additional paper packaging materials. It is also intended that scheme members will explore with their customers means of encouraging waste holders, consumers and local authorities to segregate packaging waste by material in order to facilitate more economic recovery. Paperpak Limited states that it will also establish relationships with trade associations and groups such as the National Recycling Forum, the Local Authority Recycling Advisory Committee and the Resource Recovery Forum, to facilitate recycling and recovery systems.

- 2.9 Initial working capital to cover start-up costs will be secured from the Paperpak Limited's shareholders. Such funds are to be repaid "within a reasonable time". The funds are to cover the registration of Paperpak as a scheme, and the provision of premises, staff and administrative systems to operate Paperpak.
- 2.10 Each member of the Paperpak scheme will be charged a proportionate amount of the fees payable to the Environment Agency in respect of registration of the scheme, an amount equal to the cost of compliance with the member's obligation, and a joining fee or, in subsequent years, an annual membership fee. These amounts will cover administration of the system for providing evidence to the Environment Agency, payment of fees to the Environment Agency, the cost of contracts with waste collectors and/or reprocessors to undertake recovery and recycling to meet a member's specific obligations, providing funds for specified activities designed to increase the amount of recovery and recycling carried out in the UK and repayment of the start-up loans referred to at 2.9 above.
- 2.11 Each scheme member must enter into a separate membership agreement with Paperpak Limited as operator of the scheme. From 1 January 1999, members may leave the scheme on giving one month's notice. Until then, Paperpak's members may only leave the scheme giving one month's notice if Paperpak increases the level of fees or alters the terms and conditions of the membership agreement.

Relevant markets

- 2.12 Further information on the paper industry and the markets for the other waste streams covered by the Regulations is given in the Director General's July 1997 report on his competition scrutiny of the Valpak compliance scheme. Background information on the waste management sector is provided in the August 1997 report on the Jempac compliance scheme.

3 COMMENTS RECEIVED FROM THIRD PARTIES

- 3.1 Consultation notices were placed in the week ending 21 November 1997 in *Packaging Week* and *Materials Recycling Week* (see Annex A). The views of respondents are summarised below.
- 3.2 Some suggested that the arrival of a further specialised scheme usefully provides another choice for obligated companies seeking to discharge their obligations, and that the Paperpak scheme offers a genuine alternative to the other schemes available to the paper industry.
- 3.3 There was some concern that the existence of Paperpak could mean that paper PRNs would not be easily available to other schemes and obligated parties, and that this could increase the costs of compliance for those outside the Paperpak scheme. Some concern was expressed about the potential monopsony position of a scheme based on a materials organisation, and that there must be clearly defined mechanisms to avoid the development of a monopolistic situation where materials organisations form schemes.
- 3.4 Concern was also raised about whether Paperpak would be able to obtain PRNs as many reprocessors will already have contractual obligations with previously established schemes. It was suggested that a situation where it was able to obtain PRNs only in the open market would be likely to drive up the cost of PRNs.
- 3.5 It was noted that the terms of entry to and departure from Paperpak are straightforward and not onerous and that members should have good control of the scheme when it is operating.

4 ASSESSMENT

- 4.1 The Office has considered the level of competition Paperpak is likely to face and whether the scheme is likely to restrict, distort or prevent competition.

Competition

- 4.2 Eight compliance schemes have so far been registered with the Environment Agencies. Four are described as national cross-sectoral schemes (Biffpack, Recycle UK, Valpak and Wastepack), one is a scheme mainly specific to the dairy industry (Difpak) and three are best described as regional schemes (Jempac, S.W.S. Compak and Wespack). Obligated companies have the choice of joining these schemes or of registering individually with the Environment Agencies. It is therefore true to say that a competitive market exists in the industry created by the Regulations, and the ability of any one scheme to dominate is lessened by this competitiveness. Obligated companies also have the option of arranging to discharge their obligations themselves or they may be able to arrange for a waste management company to obtain PRNs on their behalf.

Barriers to entry

- 4.3 As stated in previous reports, regulatory barriers to entry to setting up a properly constituted scheme are not considered to be significant; there are unlikely to be any significant sunk costs involved in setting up a scheme. A potentially more significant barrier to entry relates to exclusive contracts, in particular, contracts with the reprocessing industry. All schemes so far approved have assured this Office that they are unlikely to enter into such contracts, and Paperpak Limited has similarly said that it does not envisage entering into any exclusive arrangements with reprocessors on behalf of the scheme.
- 4.4 Another possible barrier to entry to the scheme market is the difficulty which members may have in leaving existing schemes. If the Paperpak scheme is registered in 1998, members will have to remain in it until the end of this year. From 1 January 1999, members may leave the scheme on giving one month's notice. The Office considers it unlikely that competition between schemes for new members will be restricted by Paperpak in this way.

Competition in the paper industry

- 4.5 It is possible that as an industry-based scheme Paperpak may be able to capture a membership which accounts for a high proportion of the market for the supply of

paper. It may then be possible for Paperpak to distort this market if it were to discriminate between the scheme's members. However, we have been assured that in respect of matters such as membership fees and tonnage levies all members will be treated on an equal basis. It is noted that membership of the scheme may be limited if it appears that the scheme operator may have difficulty in meeting any additional obligations. The Office has been assured that membership will be offered firstly to those who have already expressed an interest in joining, and then to other companies with a principal obligation in paper packaging, in order of application.

- 4.6 As an industry specific scheme, Paperpak may be able to provide benefits to its members which other schemes are less able to provide. Paperpak has said that it intends to provide advice on the calculation of its members' obligations (for example by providing ready reckoners for use in calculating obligations) as well as setting up working groups to consider how members may reduce their obligations and increase their recovery levels. There may therefore be advantages for a company in the paper industry in joining Paperpak but it is not clear that these advantages will necessarily prove to be significant. Other schemes may be able to provide different benefits which Paperpak is less able to provide. The Office is therefore of the opinion that, even if some paper industry companies are unable to join the scheme, the operation of the scheme will not necessarily lead to distortion of competition in the paper industry.

Competition in the supply of PRNs

- 4.7 The Office might have concerns if the scheme were able to tie up a significant proportion of paper reprocessing PRNs. Such a concentration could be detrimental to other companies trying to meet their obligations. We have been informed that, initially at least, the scheme's members are expected to be drawn predominately from the raw material manufacture and converting sectors of the paper packaging industry, so their own waste arisings (defined as a by-product of a company's normal activities) are estimated to be less than 1% of packaging handled. It does not therefore appear that the scheme will have access to large amounts of waste paper and board materials from members' own waste arisings.
- 4.8 It is the case, however, that a number of Paperpak members will be accredited reprocessors and / or collectors of waste paper. It would therefore be possible for scheme members to have access to amounts of PRNs which they have retained after reprocessing the waste of third parties. The Office has been informed by Paperpak Limited that PRNs can be used to offset a member's obligation whether they arise specifically from the own waste of members or whether they have been retained by members after reprocessing the waste of third parties.

- 4.9 The Director General of Fair Trading is of the view that, where waste is accepted by a reprocessor, the reprocessor should be required to issue a PRN to the deliverer of the waste if one is requested - at present there is no such requirement in the Regulations or Statutory Guidance. Whether they are inside or outside a scheme, reprocessors may well find themselves in the advantageous position of possessing evidence of compliance, unrelated to their own waste arisings, which can be used to offset their own obligation (they may, of course, have had to pay the deliverer of the waste to retain the PRNs). The Office regards this as inequitable and unfair on other members of the packaging chain who do not have such easy access to the evidence which is required to meet their obligations. We do not, however, consider it appropriate to object to the Paperpak scheme for this reason because, as we have said, such reprocessors would benefit either inside or outside of the scheme. The problem, as we see it, lies with the Regulations and / or the Statutory Guidance. The Office will continue to press for the Regulations and / or the Statutory Guidance to be altered in such a way as to meet our concerns.
- 4.10 The Office would have concerns about the Paperpak scheme if members with excess amounts of evidence (ie. over and above their own obligation) were to sell such PRNs to Paperpak Limited on preferential or beneficial terms. These PRNs could then be used by Paperpak Limited to offset other members' obligations. The Office has been informed, however, that if the scheme operator wishes to purchase such PRNs from its members, then it can do so, but on a normal commercial basis which will be unrelated to the fact that the company concerned happens to be in membership of Paperpak.

Competition in the PRN purchasing market

- 4.11 Although the overall recovery obligation under the Regulations may be met by recovery or recycling of any material, part of the obligation will be material specific. Consequently, it may be possible for a material specific scheme to dominate the market for the purchase of PRNs in that material. Paperpak members will mainly come from the manufacturing and converting end of the packaging chain (which have a lesser % obligation than the packing, filling or selling ends of the chain), and from Paperpak Limited's estimate of its scheme membership provided to the Office, it appears that the scheme operator will be responsible for approximately 10% of the UK's entire paper and board obligation under the Regulations in 1998. It is therefore unlikely that Paperpak Limited will find itself in a dominant position regarding the purchasing of paper PRNs.

5 CONCLUSIONS AND RECOMMENDATION

Conclusions

- 5.1 Of particular concern to this Office has been the interrelation between scheme membership and access to reprocessing capacity. As highlighted at 4.9, the Director General is of the view that where waste is accepted by a reprocessor, the reprocessor should be required to issue a PRN to the deliverer of waste if one is requested. In this report, we have not sought to punish the scheme due to what we regard as a shortcoming of the Regulations and / or Statutory Guidance. The overall view taken is that the Office has not objected to any part of the scheme which simply allows the member to operate in the same way as he would do outside of the scheme.
- 5.2 The Office would object, however, if the scheme were able to exert control over the overall paper PRN market. This it would be able to do if it were to have preferential or beneficial access to the excess PRNs of its members. The Office has, however, been assured that normal commercial arrangements would apply to the sale of PRNs which a member possesses over and above its own individual obligation. The Director General has a continuing duty to monitor the operation of registered schemes, and the Office will take a particular interest in the availability and pricing of PRNs in the paper market.
- 5.3 Having investigated the issues, this Office is satisfied that the Paperpak scheme does not have, and is not likely to have, the effect of restricting, distorting or preventing competition, and nor will it lead, or be likely to lead, to an abuse of market power.

Recommendation

- 5.4 I therefore recommend that you should advise the Environment Agency, and Paperpak Limited as operator of the draft scheme, in accordance with regulation 31(5), that you are satisfied that the Paperpak scheme meets the requirements of the competition scrutiny.

February 1998

Henry L Emden
Assistant Director, Competition Policy Division
For the Director General of Fair Trading

A OFT NOTICE SEEKING COMMENTS FROM THIRD PARTIES

The following notice was placed in *Packaging Week* dated 20 November 1997 and *Materials Recycling Week* dated 21 November 1997.

OFFICE OF FAIR TRADING

Paperpak - notification of a compliance scheme

The Producer Responsibility Obligations (Packaging Waste) Regulations 1997 ('the Regulations')

Under the Regulations, certain businesses have obligations regarding the recovery and recycling of packaging. They can either act alone to meet the requirements of the Regulations, or join a registered compliance scheme which will assume this responsibility for its members.

The Director General of Fair Trading has a duty to undertake a competition scrutiny of all compliance schemes prior to their registration.

The Director General has received a submission concerning the operation of a new compliance scheme set up by the UK paper packaging industry, to be known as Paperpak. The Paperpak scheme will be operated by Paperpak Limited and will be open to any company in the packaging chain with a principal obligation in paper packaging.

The Director General invites comments from interested third parties in relation to the scheme to be operated by Paperpak Ltd. They should be addressed to:

David Blocksidge
Office of Fair Trading
Competition Policy Division
Field House
15-25 Bream's Buildings
London EC4A 1PR

Please contact Mr Blocksidge if you require a summary of the proposed scheme. To be considered as part of this consultation, comments must be received by 12 December 1997.