

**THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

UNITED STATES OF AMERICA,

Plaintiff,

v.

ABITIBI-CONSOLIDATED INC. and
BOWATER INCORPORATED,

Defendants.

CASE NO.:

Case: 1:07-cv-01912

Assigned To : Collyer, Rosemary M.

Assign. Date : 10/23/2007

Description: Antitrust

COMPETITIVE IMPACT STATEMENT

Plaintiff United States of America (“United States”), pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act (“APPA” or “Tunney Act”), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I. NATURE AND PURPOSE OF THE PROCEEDING

Defendants Abitibi-Consolidated Inc. (“Abitibi”) and Bowater Incorporated (“Bowater”) entered into a merger agreement, dated January 29, 2007, pursuant to which Defendants would merge to create a new company, AbitibiBowater Inc. The United States filed a civil antitrust complaint on October 23, 2007, seeking to enjoin the proposed merger. The Complaint alleges that the likely effect of the merger would be to lessen competition substantially in the production and distribution of newsprint in North America in violation of Section 7 of the Clayton Act, 15 U.S.C. § 18. This loss of competition likely would result in higher newsprint prices in the United

States. At the same time the Complaint was filed, the United States also filed an Asset Preservation Stipulation and Order (“Stipulation”) and a proposed Final Judgment, which are designed to eliminate the anticompetitive effects of the merger.

Under the proposed Final Judgment, which is explained more fully in Section III, Defendants are required to divest Abitibi’s Snowflake, Arizona, newsprint mill, which has approximately 375,000 metric tonnes of newsprint manufacturing capacity. Until the mill is sold and operated under the new ownership, Defendants must take certain steps to ensure that the mill and its accompanying assets, as defined in the proposed Final Judgment (hereafter, the “Divestiture Assets”), are operated as ongoing, economically viable, and competitive assets.

The United States and Defendants have stipulated that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the proposed Final Judgment would terminate this action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgment and to punish violations thereof.

II. DESCRIPTION OF THE EVENTS GIVING RISE TO THE ALLEGED VIOLATION

A. Defendants and the Proposed Transaction

Abitibi and Bowater both produce, distribute, and sell newsprint and other groundwood paper throughout the world. Defendants also produce other pulp and wood-related products, operate sawmills, and own or lease timberlands throughout the United States and Canada.

Abitibi is a Canadian company with its headquarters in Montréal, Quebec, Canada. In 2006, Abitibi reported total sales of approximately \$4.85 billion. Its North American newsprint

sales were approximately \$1.7 billion. Abitibi is the largest newsprint producer in North America. It owns approximately 25 percent of North American capacity.

Bowater is incorporated in Delaware, and has its headquarters in Greenville, South Carolina. In 2006, Bowater reported total sales of approximately \$3.53 billion. Its North American newsprint sales were approximately \$1.1 billion. Bowater is the second largest newsprint producer in North America. It owns approximately 16 percent of North American capacity.

Defendants publicly announced their proposed transaction on January 29, 2007. The new company, AbitibiBowater Inc., will be headquartered in Montréal, Quebec, Canada, but it will be incorporated in Delaware and listed on both the NYSE and Toronto stock exchanges.

B. The Competitive Effects of the Transaction on the Newsprint Market

1. Newsprint is the Relevant Product Market

The Complaint alleges that the production, distribution, and sale of newsprint is a relevant product market within the meaning of Section 7 of the Clayton Act. Newspapers are printed on newsprint. Newsprint is an uncoated groundwood paper made by a mechanical pulping process without the use of chemical additives, such as bleach. Newsprint can also be made, partly or entirely, from recovered fiber, such as old newsprint and old magazines. Because of the production process and lack of additives, newsprint is the lowest quality and generally least expensive grade of groundwood paper.²

² There are two primary newsprint basis weights, 30 pound (48.8 gsm) and 27.7 pound (45 gsm), the lighter of which has a higher yield. The differences between the two weights are not material to product market definition because prices for each basis weight track each other, newspaper publishers can use either weight in their presses, and newsprint

Newspaper publishers, who buy more than 80 percent of all newsprint sold in the United States, have no close substitutes to use for printing newspapers because of newsprint's price and physical characteristics, such as its strength and opacity. In addition, because publishers' newsprint presses are optimized to use newsprint, switching to another grade of paper would be costly.

Newsprint used for other purposes, primarily the production of direct mail and newspaper inserts, constitutes only a small share of total newsprint sales. If newsprint prices were to increase by a small but significant amount, some customers for these other uses might switch to other grades of groundwood paper or otherwise reduce their consumption of newsprint. Those losses, however, would not be sufficient to make such a price increase unprofitable.³ For these reasons, demand for newsprint is highly inelastic to changes in price. Accordingly, the production, distribution, and sale of newsprint is a line of commerce and a relevant product market.

2. Relevant Geographic Market: North America

The Complaint alleges that the relevant geographic market is no smaller than the United States and Canada ("North America").⁴ Newsprint can be transported within the United States

manufacturers can produce either weight on the same newsprint machines without incurring switching costs.

³ Defendants also produce higher-grade groundwood paper and would be able to recapture some of the revenue lost from newsprint in these other groundwood grades.

⁴ The United States did not fully investigate whether Mexico should be included in the North American market because the inclusion or exclusion of Mexico does not change the analysis. Mexico is not a significant producer of newsprint, it does not export significant amounts of newsprint to the United States, and the industry does not consider Mexico to be part of the North

and Canada at a sufficiently low cost and in such a timely and reliable manner that an attempt to increase price in any smaller region of the United States or North America would prove unprofitable. In the event of such an attempted price increase, customers could readily and economically shift their purchases to newsprint producers throughout North America. In addition, national newspaper buying groups, which account for over 70 percent of all newsprint purchases throughout the United States, create a North American pricing structure. Price differences across regions within the United States have been small and short-lived, as supply has shifted rapidly to restore parity marketwide.

The Complaint also alleges that the relevant geographic market is no broader than North America. Newsprint mills located in Canada and the United States account for approximately 98 percent of North American newsprint consumption. Transportation costs of importing newsprint are high, and customers are concerned about the reliability of foreign newsprint supply. Consequently, a small but significant increase in the price of newsprint will not likely cause customers to purchase sufficient volumes of additional newsprint from outside North America to make such a price increase unprofitable. Accordingly, North America is a relevant geographic market.

3. Anticompetitive Effects of the Merger

The Complaint alleges that the proposed merger likely will substantially reduce competition to supply newsprint in the United States. Abitibi and Bowater are the two largest North American newsprint producers, and they directly compete against one another to produce and sell newsprint. Abitibi and Bowater currently own approximately 25 percent and 16 percent

American market.

of North American newsprint capacity, respectively, which will result in a post-merger share of over 40 percent.⁵

North American newsprint demand has declined over the last several years at a rate of approximately 5 to 10 percent per year because of a significant decline in demand for newspapers. As a result, North American newsprint producers have closed or idled capacity and converted some of their newsprint machines to produce other grades of paper. This decline in demand for newsprint is projected to continue, and the resulting excess newsprint capacity likely will lead Defendants and their competitors to close, idle, or convert more newsprint mills.

But for the merger, neither Defendant acting alone would be of sufficient size to profitably increase the price of newsprint by reducing its own output through strategically closing, idling, or converting its capacity.

The combination enhances Defendants' incentives to exercise market power because the merged firm will control a greater base of capacity over which the merged firm would benefit from an increase in newsprint prices after strategically closing, idling, or converting some of its capacity. Without Snowflake's capacity, the merged firm would not be of sufficient size to be able to recoup the losses from such strategic closures through increases in prices on its remaining newsprint production. The divestiture of Snowflake would adequately address the likelihood that the proposed merger substantially would reduce competition for newsprint in the United States.

⁵ The 40 percent market share represents the merged firm's newsprint capacity over which it would be able to profit from an anticompetitive price increase. This share does not include approximately nine percent of North American newsprint capacity attributable to Abitibi and Bowater through joint-venture relationships and a sales management contract. This volume is not relevant to the competitive effects analysis because, under the structure of these arrangements, Defendants would not be able to benefit from a price increase on this capacity.

4. Neither Supply Responses Nor Entry Will Defeat the Exercise of Market Power

Neither the combined firm's North American producers, nor competitors from outside of the North American market, can, individually or collectively, increase their newsprint sales to North American customers to make a price increase by the merged firm unprofitable. Entry by a new competitor would not be timely, likely, or sufficient to defeat an exercise of market power by the merged firm. The merged firm will therefore have both the incentive and the ability to impose an anticompetitive price increase.

While North American newsprint competitors currently have some limited excess capacity, that capacity will be reduced by the closure or conversion of unprofitable newsprint mills or machines in response to falling demand for newsprint. Once this capacity exits the market, the merged firm then will be able profitably to exercise market power.

North American newsprint competitors would not defeat an anticompetitive price increase by restarting their closed or idled capacity. The increased revenue from restarting a closed mill or machine would not outweigh the start-up costs, particularly in a declining market.

North American producers with the capacity to make higher-grade groundwood paper are not likely to switch production from those grades into newsprint production in response to a price increase. Declining demand for newsprint has caused several producers to invest substantial capital to convert newsprint machines to produce more profitable value-added grades of paper. These producers would not find it profitable to switch from producing higher grades back to newsprint to defeat an exercise of market power by the merged firm.

Some North American producers export a portion of their newsprint capacity. Some of these newsprint exports likely would be directed back to the North American market in response to a price increase. However, this repatriation of newsprint will be insufficient, even in combination with other competitive responses, to discipline an exercise of market power by the combined firm. Abitibi and Bowater collectively produce 65 percent of North American newsprint exports, and would have no incentive to repatriate their exports to defeat a price increase. In addition, most of the remaining exports by North American producers are sold pursuant to long-term sales arrangements and relationships and, therefore, are unlikely to be repatriated in response to a price increase.

Greenfield entry is highly unlikely. A new North American newsprint mill or machine would cost in excess of a hundred million dollars. Particularly given that demand for newsprint is declining in North America, a new entrant would not find it profitable to build a new newsprint mill in response to a price increase, and could not do so within two years.

Accordingly, expansion, repatriation, and entry would not be timely, likely, or sufficient to deter an anticompetitive price increase by the merged firm.

III. EXPLANATION OF THE PROPOSED FINAL JUDGMENT

The proposed Final Judgment provides for the divestiture of Abitibi's Snowflake, Arizona, newsprint mill to a buyer acceptable to the United States, in its sole discretion, to preserve competition for newsprint in the United States. Snowflake is located in northeastern Arizona. In 2006, Snowflake produced over 330,000 metric tonnes of newsprint on two machines. Snowflake is one of the most efficient and profitable newsprint mills in North America. Plans to improve the

Snowflake mill's efficiency in coming years with investments in energy and machinery are already underway. Snowflake's size and cost position ensure that its divestiture to a competitor of the merged firm will preserve competition in the North American newsprint market.

As part of its investigation, the United States considered market shares, costs of production, the extent of industry excess capacity, and future reductions in newsprint demand in analyzing whether the merger would cause an anticompetitive increase in newsprint prices. As discussed in Section II.B.3, if Defendants were allowed to merge without a divestiture, the merged firm would be able to close its capacity strategically, allowing the merged firm to raise newsprint prices and recoup its lost profits on its combined output. Divesting Snowflake, however, will reduce the capacity over which the merged firm could profit to a level at which it would not have the ability to close capacity strategically.

Snowflake uses 100 percent recycled fiber and Abitibi currently supplies the Snowflake mill with approximately 25 to 30 percent of its fiber requirements. At the option of the Acquirer, the proposed Final Judgment requires Defendants to enter into a supply contract for up to 25 percent of Snowflake's old newsprint requirements at the prevailing market price for up to three years from the date of the divestiture. Similarly, at the option of the Acquirer, and upon the approval of the United States, the proposed Final Judgment also requires Defendants to provide certain transition services for up to twelve (12) months as part of the divestiture.

In merger cases where the United States seeks a divestiture remedy, it requires completion of the divestiture within the shortest time period reasonable under the circumstances. Section IV of the proposed Final Judgment requires Defendants to complete the divestiture within 120 days

after the filing of the Complaint in this matter. The assets must be divested in such a way as to satisfy the United States in its sole discretion that the operations can and will be operated by the purchaser as a viable, ongoing business that can compete effectively in the relevant market. The United States, in its sole discretion, may grant one or more extensions of time, not to exceed sixty (60) calendar days in total. Defendants must use their best efforts to accomplish the divestiture as expeditiously as possible.

If Defendants do not accomplish the divestiture within the period prescribed in the proposed Final Judgment, a trustee shall be appointed by the Court upon the application of the United States. If a trustee is appointed, the proposed Final Judgment provides that Defendants will pay all costs and expenses of the trustee. The trustee's commission will be structured so as to provide an incentive for the trustee based on the price obtained and the speed with which the divestiture is accomplished. After his or her appointment becomes effective, the trustee will file monthly reports with the Court and the United States setting forth his or her efforts to accomplish the divestiture. If the divestiture has not been accomplished at the end of the six months, the trustee and the United States will make recommendations to the Court, which shall enter such orders as appropriate in order to carry out the purpose of the trust, including extending the trust or the term of the trustee's appointment.

Finally, the proposed Final Judgment sets forth the process for and the circumstances when Defendants must notify the United States of the acquisition of any mill or machine or any interest in a mill or machine, if the value of such exceeds \$2,000,000, that is currently jointly-owned by either Abitibi or Bowater with any third party. This notification requirement applies to

certain transactions not otherwise subject to the reporting and waiting period requirements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and runs for ten years from entry of the Final Judgment. The provision is intended to ensure that any such acquisition does not undermine the benefits that the divestiture of the Snowflake mill will bring to the market.

IV. REMEDIES AVAILABLE TO POTENTIAL PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Final Judgment has no *prima facie* effect in any subsequent private lawsuit that may be brought against the defendants.

V. PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and Defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest.

The APPA provides a period of at least sixty (60) days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within sixty days of the date of publication of this Competitive Impact Statement in the