CHAPTER 9

Conclusions

The 'monopoly situation'

227. We are required to determine first whether a monopoly situation as defined in the Fair Trading Act 1973 exists and, if so, by virtue of which provisions of sections 6 to 8 of the Act and in favour of what person or persons it exists.

228. Section 6(1)(*a*) of the Act provides that a monopoly situation shall be taken to exist if at least one-quarter of all the diazo copying materials which are supplied in the United Kingdom are supplied by or to one and the same person. As stated in paragraph 30 Ozalid supplied 54 per cent by value in 1973–74 and 52 per cent in 1974–75 and no other supplier supplied as much as 25 per cent. We conclude that by virtue of section 6(1)(*a*) of the Act a monopoly situation exists in favour of Ozalid.

229. Section 6(1)(*c*) and (2) of the Act provide that a monopoly situation shall be taken to exist if at least one-quarter of all the diazo materials which are supplied in the United Kingdom are supplied by members of one and the same group consisting of two or more persons who whether voluntarily or not, and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict or distort competition in connection with the production or supply of diazo materials. Under section 11 of the Act a monopoly situation of this kind is a 'complex monopoly situation'.

230. It appeared to us that a complex monopoly situation might exist by virtue of the identity or near identity at the time when the reference was made to us of list prices and published discounts for diazo materials supplied by Ozalid, GAF, AM and H & T. However, section 10(2) of the 1973 Act provides that, for the purpose of establishing whether a monopoly situation exists, no account shall be taken of any provisions of any agreement in so far as they are provisions by virtue of which it is an agreement to which Part I of the Restrictive Trade Practices Act 1956 applies. As a result of information given to us some four months after the reference had been made it seemed likely that there were or had been such agreements concerning prices and discounts. We sought further information from the companies, but in view of their difficulty in providing it and in order to avoid delay we informed them that it was our provisional conclusion that a complex monopoly existed in favour of all four companies because together they supplied at least one-quarter of all the diazo copying materials which were supplied in the United Kingdom and they so conducted their respective affairs as to restrict or distort competition in that (*a*) they charged the same or similar list prices, and (*b*) they allowed the same or similar discounts.

231. In the event all of the four companies accepted that there had been agreements (or arrangements) concerning prices and discounts which were registrable under the 1956 Act, and we were informed that they were taking steps to furnish the Office of Fair Trading with particulars. Such agreements, which under the 1956 Act are presumed to be against the public interest unless the contrary can be shown, must be notified to the Director General of Fair Trading (formerly the Registrar of Restrictive Trading Agreements). We regret to record that the existence of these agreements was not notified within the statutory period allowed and that details were not notified to us for a considerable time (see paragraphs 5 and 6).

232. Although there was lack of agreement among the companies about the relevant facts, the provisional conclusion set out in paragraph 230 was challenged on the ground that it was untenable in the face of section 10(2) of the 1973 Act because of registrable agreements; it was also challenged on certain other grounds, particularly that the uniformity of list prices and published discounts did not imply any restriction of competition. We have set out in paragraphs 185 to 188 the grounds on which it was argued that there was no complex monopoly situation.

233. What is not in dispute is that, following the end of what the industry refers to as the price war of the late 1960s, list prices and published discounts became uniform as the result of adoption by the suppliers of a new price list and of a system of quantity discounts (see paragraphs 145 and 149). Although some customers were not put on the new discount scale, efforts were made to keep the number of such customers to a minimum. For some time list prices and published discounts continued to be approximately uniform at any rate partly as a result of discussions and consultations before changes were made. However, it was not long before there began to be some increase in the use of special discounts; from about the end of 1974 the increase became particularly marked and special discounts became one of the principal forms of competition in the industry, though at around this time there also began to be less uniformity in list prices and published discounts.

234. It is thus clear that the uniform list prices and published discounts which emerged at the end of the price war in 1968 were the result of discussions between the suppliers, in which registrable agreements were reached. However, although registrable agreements were certainly made at this point, at the time of our inquiry there was no unanimity between the suppliers about the precise terms of the agreements. In the years following the end of the price war, discussions about prices and discounts continued between the suppliers. It was common ground among the principal manufacturers at the time of our inquiry that further agreements were made between 1968 and early 1971, but there was uncertainty about the precise terms of those agreements and whether H & T was a party to them. As regards the period between then and the date of the reference, GAF and AM considered that each of them made agreements with Ozalid, though Ozalid did not accept this.

235. It is to the Director General of Fair Trading that particulars of registrable agreements have to be given, and it is his duty to register particulars of the agreements. When our report was almost completed, we received a copy of a

memorandum of registrable agreements submitted jointly by the suppliers to the Director General. This memorandum included transactions covering the whole period since the end of the price war; but it left many points about them uncertain, and nothing has yet been placed on the register.

236. In these circumstances, the present case raises a peculiar difficulty. Section 10(2) of the Act precludes us from relying on provisions of an agreement by virtue of which that agreement is registrable, for the purpose of identifying a complex monopoly situation. Registrable agreements dealing with prices and discounts were undoubtedly made, but it is doubtful what their terms were and who were the parties to them and we are therefore unable to say what their effects were. Consequently we do not know to what extent the behaviour of the parties in fixing their individual list prices and discounts represented the performance or effects of provisions of agreements falling under section 10(2), or to what extent it was attributable to other factors. What this means is that we cannot tell how much of the material before us is material which we are allowed to consider in reaching a decision about a complex monopoly situation. It is therefore impossible for us to reach a conclusion whether a complex monopoly situation exists now or did exist at the time the reference was made.

237. Our only conclusion on the monopoly situation is therefore that stated in paragraph 228, namely that by virtue of section 6(1)(*a*) of the Act a monopoly situation exists in favour of Ozalid.

The public interest

238. Ozalid has always been the largest supplier of diazo materials in the United Kingdom. In 1968 and 1969, after several years of price war, Ozalid acquired two diazo manufacturing companies, Mason (which was in financial difficulties) and Nig, and the number of suppliers was thereby reduced. These acquisitions of diazo manufacturing companies, by increasing Ozalid's share of the market from about a third to rather more than a half, established it even more firmly as the leading supplier of diazo materials in the United Kingdom. The main purpose of these acquisitions was, we were told, to rescue the industry from the damaging effects of the price war and to provide financial support to two companies, at least one of which still had a good business. It is also clear that Ozalid believed that the acquisitions would strengthen its position as price leader in the industry. They substantially increased Ozalid's share of the market and at the same time presented it with some opportunities for concentration of production and cost savings.

239. During the early 1970s Ozalid acquired interests in a number of important trade houses which it already supplied with diazo materials (see paragraph 56). Ozalid claims that it does not participate in the management of these trade houses and does not attempt to influence the manner in which they do their business or purchase their supplies. However, Ozalid obligated itself to giving preferential terms to its associated trade houses as one of the terms of the purchase contracts under which it acquired interests in them. It would not be expected therefore that the level of these preferential terms would be fully justified by the extra distributing and marketing functions agreed to be carried out in addition to those performed by independent trade houses (see paragraph 210); we think that they would naturally be a continuing factor in encouraging the houses concerned to look more favourably in general on purchases from

Ozalid and would have thereby contributed to its strength and that the acquisition of these interests would have led to a wider and more effective distribution of its goods, some of which has been at the expense of its competitors. One of the manufacturers and one trade house expressed some concern about the acquisitions (see paragraph 181) but Ozalid's associated trade houses have continued to trade in diazo materials from Ozalid's competitors. In any case, only about one-fifth of the diazo materials business in the United Kingdom is done through trade houses and it is the usual practice for the largest and, from the manufacturers' point of view, the most important users to buy direct from the manufacturers. The total effect of the acquisitions of trade houses by Ozalid appears not to have been significant; Ozalid estimates that the result has been to increase its overall share of the market by less than 2 per cent. However, if Ozalid were to make further similar acquisitions on a substantial scale competition might be seriously affected in the particular districts concerned.

240. At present Ozalid supplies slightly more than half of all the diazo materials, including imports, supplied in the United Kingdom. We do not think that in this industry the economies available to a supplier of Ozalid's size, or with Ozalid's market share, are likely to give the company any very significant advantage over its competitors or that such economies are a substantial barrier to the entry of new competitors. The successful entry of Regma into the United Kingdom market supports this view. Large scale manufacture offers limited economies derived mainly from longer runs, but there appears to be more scope for economies of scale in distribution than in manufacture although this is affected by the general practice of distributing diazo materials in conjunction with other drawing office supplies.

241. The present state of technology in the diazo industry appears to be such that size of manufacturer does not appear to be of very special advantage in research and development. Moreover, although Ozalid's competitors in the United Kingdom are substantially smaller as suppliers of diazo materials, three of them (GAF, AM and Regma) are parts of much larger, multinational organisations capable of devoting substantial resources to the diazo industry and to the wider reprographic field as a whole.

242. Ozalid does not appear to enjoy any significant advantages on account of its size in the purchasing of paper or chemicals used in diazo manufacture. It has an agreement with ICI regarding the supply of polyester film, under which, because it has committed itself to large purchases of film, it has been able to obtain a price more favourable than that charged by ICI to other diazo manufacturers. There is no evidence that competitors of Ozalid have been placed in any difficulty regarding the supply of polyester base film, in which there is an active international market, and we accept the evidence of ICI that the price advantage enjoyed by Ozalid is a reflection of the scale of its purchases relative to its competitors. Ozalid also has a technical collaboration agreement with ICI (see paragraph 66), and it was suggested to us that this might give Ozalid a substantial advantage over its competitors if as a result of collaboration some material or process were developed which would be available only to Ozalid. The agreement does not, however, contain any provision which would have this effect; in fact pre-treated polyester film (which was developed as a result of collaboration) is readily available from ICI to Ozalid's competitors, and we see no reason to suppose that any future developments resulting from the technical collaboration agreement would not also be readily available.

243. Brand loyalty among users of diazo materials is weak and does not appear to confer any advantage on Ozalid over other manufacturers. Nearly all large users prefer to have more than one supplier. There is some tendency for users of diazo materials to buy their materials from the supplier from whom they have obtained diazo machines; but Ozalid's size does not appear to give it any particular advantage in this respect, since almost all suppliers of diazo materials in the United Kingdom supply diazo machines either of their own manufacture or imported, or both. (We consider the supply of diazo machines further in paragraphs 259 and 260.)

244. We note the measures which Ozalid took after the acquisition of E N Mason and Nig to concentrate its production facilities and to improve the productivity of coating and converting (see paragraph 221). Ozalid has also, though only recently, implemented proposals from which significant cost savings are expected for reorganising the distribution and marketing of the group's diazo products.

245. We were concerned about the effects upon costs of two features of the diazo industry, namely excess capacity and the wide variety of the industry's products. Ozalid has suffered persistent excess capacity since the acquisitions of 1968 and 1969, mainly in aqueous coating, and the excess has increased sharply in the present recession. However, the company explained that the excess capacity was in machines only and that the cost of retaining idle machines was small.

246. Ozalid and other manufacturers have in the last few years reduced the range of their diazo materials by reducing the numbers of coatings and standard sizes and have also reduced the weight of base paper (see paragraphs 24 to 27). So far as the first point is concerned some of the manufacturers consider that the range is greater than is really needed by users of diazo materials and we agree that this affects their costs. For several reasons, including the introduction of metrication and the fall in demand, the industry as a whole has reduced the range by eliminating a number of items although at the same time, for competitive reasons and in response to demand, some manufacturers have added other items to their range. The reduction in the weight of the paper was undertaken partly to offset the substantial increase in the price of base paper, though it involved some additional research and development in connection with necessary changes in coating techniques; in these respects the British industry was acting in line with what was happening abroad.

247. In line with the rest of the industry Ozalid has achieved substantial success in the exporting of diazo materials; in 1974 the company's overseas sales of materials totalled £2·6m, or about a fifth of its total sales of materials. We were informed that the British diazo materials industry is as advanced technically as any in the world and, in view of the success of the British industry in exporting and until recently the virtual absence of imports, we have no reason to doubt this. Indeed Ozalid appears to have been responsible for the principal innovation in diazo materials in recent years, namely the development of diazo film. We received no adverse comments on the technical progressiveness of the industry from the substantial number of users of diazo materials whose views we invited during the course of the inquiry. Ozalid maintained, we think with justification, that the diazo industry now has a well developed technology with little scope for further dramatic progress.

248. Ozalid's profits are considered in some detail in Chapter 6. The company's rates of return on capital employed on an historic cost basis since 1966 are set out in the table below. These figures are in respect of strictly reference business (ie United Kingdom sales of diazo materials).

Ozalid: return on capital employed (historic cost basis) diazo materials only

	Percentage
1966	27·5
1969	25·9
1972	43·0
1973	29·1
1974	32·5
1975	29·6

It was urged on us that since it was the practice in the industry for diazo machines to be sold at little or no profit (see paragraph 212) it was unrealistic to isolate the profits on materials, and that it was appropriate to consider the profits on materials and machines together. Ozalid's rates of return on capital employed on United Kingdom sales of materials and machines together on an historic cost basis have been as follows:

Ozalid: return on capital employed (historic cost basis) diazo materials and machines

	Percentage
1966	22·2
1969	20·3
1972	33·7
1973	22·4
1974	23·4
1975	16·0

When adjustment is made for the effects of inflation by adopting a current cost accounting basis the average returns on capital employed for the last two years are 15 per cent for materials alone and 7 per cent for materials and machines together.

249. On whatever basis Ozalid's profits are considered the figures show that it has been possible for the company to make profits which we consider to be higher than might have been expected in fully competitive conditions in an industry characterised by excess capacity and declining demand and in a period which included some years of general economic recession. Because of the confusion and uncertainty about registrable agreements, to which we have already referred (see paragraph 236), we are unable to determine how far the level of profits actually achieved by Ozalid has been due to any resulting limitation of price competition or how far (if at all) it has been due to the monopoly position of Ozalid itself.

250. Having regard to all the factors which we have considered in the foregoing paragraphs (238 to 249), we conclude that the monopoly situation which exists in favour of Ozalid because of Ozalid's share of the market does not operate against the public interest. We are unable to say whether it may be expected so to operate in the future (see paragraphs 251 to 254).

Future changes in the industry

251. In paragraphs 42 to 44 we have referred to the growth in competition which the diazo process has encountered from other reprographic systems. We have noted (see paragraph 44) that Ozalid itself intends to market an electrostatic plain paper copier which will compete directly with the diazo process for use in drawing offices. Although the present low level of demand for diazo material is due in part to the current economic recession, it is generally agreed that there is a long-term and continuing decline in demand.

252. The virtual suspension of price competition in 1968 and the immediately following years was undoubtedly due to the active collaboration among manufacturers concerning prices and discounts. In view of the provisions of the 1956 Act, we think it very unlikely that the manufacturers will restrict competition again in this way; indeed, Ozalid said that discussions, and even soundings out, about prices and discounts would not be resumed except under a duly registered agreement. As long as the present high level of excess capacity in the industry persists and there are prospects of further contraction of the market, it also is unlikely that there will emerge a situation in which, as a result of the individual adoption by each manufacturer of an appropriate course of conduct, competition in prices and discounts is eliminated or reduced substantially below its present level.

253. For the near future therefore we foresee a continuation of the competition which now obtains. The manufacturers will continue to compete with one another in respect of quality of materials and more particularly in respect of service to customers. These forms of competition have been prominent throughout the whole period for which we have had information. Further, we have described the development of price competition since about 1974 (see paragraph 233). It has taken the form primarily of unpublished special discounts off published list prices given to selected customers, at present primarily the larger customers and some trade houses. As the effects of registrable agreements become further attenuated it is likely that competition will increase and may conceivably become as severe as we were told it had been during the price war.

254. Looking somewhat further into the future, it seems to us possible that the competitive situation may change, especially if excess capacity were to be reduced substantially with the passage of time, and if one or more manufacturers were to withdraw from the industry. Without there being any registrable agreements or arrangements, changes of this kind may make it possible for price competition, notably but not exclusively on sales to the smaller customers, to be restricted materially by the individual adoption of non-competitive pricing and discount policies by each of the manufacturers, with one or other of them treated as price leader by each of the others. Such a development would be facilitated by the standardised nature of the main diazo products and the absence of brand loyalty.

Discounts

255. In considering the discounts given by Ozalid it is necessary to take into account the fact that similar discounts are given by the other principal manufacturers. Since the end of the price war in about 1968 the main manufacturers of diazo materials have all adopted a system of published discounts under which

the discount varies with the value of deliveries to a single destination against individual orders. Except that standard papers and specialities are considered separately for discount purposes, the rates of discount are not affected by the quantities of particular items in the make-up of an order. The industry saw various benefits from the adoption of this kind of quantity discount system including an encouragement to users to order diazo materials in larger quantities. Since 1968 a number of increases in the value thresholds at which particular discounts begin to operate has provided further incentive to place larger orders (although the effect of continuous inflation has also been a reason for such increases). We consider the encouragement of larger order sizes an important advantage of the quantity discount system in view of the cost of selling and distributing diazo materials.

256. In a discount system of this kind it is possible for the various rates of discount to be set so as to be reasonably closely related to differences in costs derived from supplying orders of different sizes. Although cost savings associated with larger orders have not been quantified with precise accuracy, it is common ground that the higher rates of discount are substantially in excess of cost savings achieved. The top rates of published discount given by the four principal companies are 35 per cent for papers and 25 per cent for films. The order values qualifying for these rates are now not uniform between the suppliers; for consumers they range from £865 to £1,000 on papers and from £600 to £750 on film and for traders from £430 to £500 on papers and from £350 to £400 on film. The effect of these discounts on net prices can be shown by reference to Ozalid's medium paper. The list price for an 841mm x 25m roll of this paper in November 1976 was £3·10; the net price to the consumer was £2·95 at the lowest rate of quantity discount (5 per cent) and £2·02 at the highest rate (35 per cent). The discount structure discriminates in favour of customers (usually larger customers) able to order larger quantities, though we note that the degree of discrimination has narrowed since 1971. However, our consideration of the quantity discount scheme must take into account the fact that it was adopted by an agreement between the principal manufacturers registrable under the 1956 Act, and that subsequently and until recently discount changes were made by registrable agreement to which at least some of the manufacturers were party (see paragraph 231). We are therefore precluded from arriving at any conclusion as to the effects of this quantity discount system on the public interest.

257. In addition to the quantity discounts given in accordance with published scales there are numerous cases of special discounts. These are negotiated with individual customers, usually at fixed rates (in many cases the maximum rate of the published scale) irrespective of the value of orders or the number of destinations. There are a few cases of special discounts at rates higher than the maximum under the scale and there are also isolated cases of retrospective rebates in addition to discounts. A substantial proportion of sales are now made on special terms. The increase in special discounts since 1974 is a reflection of the declining demand for diazo materials resulting partly from increasing competition from other processes and partly from economic recession. Other factors have been the entry of Regma in 1974 and the ending of all agreements and contacts between the manufacturers on prices and discounts. In these circumstances the opportunity for larger customers to extract more favourable terms than the published discounts is much enhanced. We consider that the special

discounts now being offered in the diazo materials industry increase the discrimination between large and small customers that is inherent in the published discount system, and that they conflict with the encouragement of larger orders, which is said to be their principal benefit. Discounts which discriminate between customers may have an effect on competition between those customers; but in this case any effect must be negligible because many customers (eg local authorities) are not in competition with others and because, even where they are in competition, their purchases of diazo materials are a very small part of their total costs.

258. We have found no case of a special discount being related to any specific volume of business and no case of a special discount or a retrospective rebate given in exchange for exclusivity. The discounts therefore have no clear anti-competitive features. Although they discriminate in favour of larger customers we recognise that the suppliers individually have been, and are, under pressure from their larger customers to make price concessions to them. We are satisfied that the granting of special discounts contributes substantially to competition in the diazo materials industry. On balance of all the considerations we do not find that the growth of special discounts granted by Ozalid and the other companies has been against the public interest.

The supply of diazo machines

259. Although diazo machines are not covered by the reference, we considered what effect, if any, the prices and terms at which machines were supplied had on the supply of diazo materials. In considering Ozalid's practice of selling machines at little profit or at a loss (that is at prices which do not cover their full cost including allocated overheads), we need to take into account the fact that the practice of the other major manufacturers in this respect is similar.

260. We considered whether the pricing of machines affects competition in the supply of diazo materials either between established suppliers or by hindering the entry of new suppliers. We concluded that it was not likely to affect competition. Harper and Tunstall, which had been a relatively small manufacturer, encountered no serious difficulty in making and marketing its machines from about 1963. A new entrant, especially one backed by substantial resources, would have little difficulty in obtaining a supply of machines or developing its own. Users tend to buy some or all their requirements of diazo materials from the suppliers of machines they have installed; but each of the main manufacturers of materials also supplies machines, and none is placed at a competitive disadvantage by the prevailing low machine prices. We do not therefore regard Ozalid's pricing of machines as objectionable. However, a small proportion of the diazo machines supplied by Ozalid are hired to customers, and there is a clause in the hiring agreement which requires the hirer to use Ozalid's materials (subject to certain conditions—see paragraph 81). The company told us that it does not enforce this tying clause, and we see no reason why it should continue to be used in hiring agreements.

Conclusion

261. Because of the uncertainty about registrable agreements and their effects (see paragraphs 234, 236 and 249), and the operation of sections 10(2) and 54(5) of the Fair Trading Act 1973, the facts which we are able to consider

in reaching a conclusion about the public interest are limited; within those limitations, we conclude that no facts found by us operate against the public interest. We also conclude that, subject to what is said in paragraph 250 about the monopoly situation, no such facts may be expected to operate against the public interest.

J G Le Quesne (*Chairman*)

Dallas Bernard

Roger Falk

R G Opie

C T H Plant

J S Sadler

B S Yamey

Y Lovat Williams (*Secretary*)

22 November 1976