CMA
Competition & Markets Authority

COMPLETED ACQUISITION BY PORK FARMS GROUP LIMITED OF THE CHILLED SAVOURY PASTRY BUSINESS OF KERRY FOODS LIMITED

Statement of issues

6 February 2015

The reference

1. On 5 January 2015, the Competition and Markets Authority (CMA), in exercise of its duty under section 22(1) of the Enterprise Act 2002 (the Act), referred the completed acquisition by Pork Farms Group Limited (PFGL, formerly named Poppy Acquisition Limited), acting through its wholly owned and newly incorporated subsidiary Pork Farms Caspian Limited (Caspian), of the chilled savoury pastry (CSP) business of Kerry Foods Limited (KFL) (the Target) for further investigation and report by a group of CMA panel members (the inquiry group).

2. The CMA must decide:

   (a) whether a relevant merger situation has been created; and

   (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

3. In this statement, we set out the main issues we are likely to consider in reaching our decisions, having had regard to all the evidence gathered to date including evidence set out in the phase 1 decision of 17 December 2014 (the reference decision). This does not preclude the consideration of any other issues which may be identified during the course of our investigation.

4. We are publishing this issues statement in order to assist parties submitting evidence to focus on the issues we currently envisage being relevant to our inquiry and to invite parties to notify us if there are any additional relevant issues which they believe we should consider.

5. Throughout this document, where appropriate, we refer to PFGL and the Target collectively as ‘the Parties’.

Background

6. Pork Farms Limited (Pork Farms, controlled by PFGL) operates a CSP business supplying the food retail sector under brands and retailers' own label in the United Kingdom (UK). Prior to the transaction (see paragraph 8), PFGL was ultimately controlled by Vision Capital Partners VI L.P. and Vision Capital Partners VI E L.P. (both parts of the Vision Capital Group). The Vision Capital Group is a private equity firm with offices in London and New York.

7. KFL is controlled by Kerry Group plc. Kerry Group plc (with its group of companies referred to as Kerry) is an international food corporation comprising a wide range of businesses involved in ingredients, agriculture and consumer food products. KFL operates 13 manufacturing facilities throughout the Republic of Ireland and the UK. The Target has two sites in the UK and supplies CSP products into the food retail sector under brands and retailers' own label in the UK.

8. The transaction involves the acquisition by PFGL, through Caspian, of the Target. Simultaneously, KFL acquired ordinary and preference shares in PFGL. The transaction completed on 17 August 2014. KFL's ordinary shares grant it voting rights in PFGL (less than 25% of the total) and the right to appoint up to two (out of a total of eight) directors to PFGL's board of directors.

9. The Parties overlap in the manufacture and supply of CSP products in the UK within the following categories: hot pies, cold pies, sausage rolls, pasties, and slices.

10. Kerry (through other group companies) retains a small presence in the supply of CSP products in the UK leading to a post-merger overlap with PFGL in:

    (a) in Northern Ireland, all CSPs but in particular sausage rolls; and

    (b) scotch and savoury eggs.

11. A description of the products, markets, and the various participants in those markets is set out in the reference decision (see particularly the considerations by product in paragraphs 102 to 173).

Market definition

12. Market definition is a useful analytical tool, but not an end in itself, and identifying the relevant market involves an element of judgement. The boundaries of the market do not determine the outcome of the CMA's analysis of the competitive effects of the merger in any mechanistic way. In assessing

whether a merger may give rise to an SLC, the CMA may take into account constraints outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[1]

13. The Parties overlap in the supply of various CSP products, some branded and some own label, to a variety of customers. These include (1) the large grocery retailers (which operate both supermarkets and convenience stores), and (2) other customers, such as wholesalers, convenience store groups, and other smaller retailers.

14. As set out at paragraph 35 of the reference decision, Pork Farms submitted that it was appropriate to consider a wider market covering all CSP products as all types of CSP products are similar.[2] Pork Farms submitted that, intuitively, and from the perspective of consumers, there was a high degree of substitutability between the different CSP product categories, as all types of CSP products provide the same utility to consumers (ie a fast and convenient pastry-based meal).

15. Further, Pork Farms submitted (paragraph 46 of the reference decision) that all CSP categories should be considered to be in the same product market based on supply-side substitution as all CSP manufacturers supplied across most, or all, of the different categories of CSP products and were capable of switching production between the different CSP categories. In particular, the ingredients used for all types of CSP were broadly similar and the costs of switching production between different types of CSP could be relatively low.

16. Pork Farms also stated that there were no barriers to switching supply between branded and own-label products, or between supplying large grocery retailers and other customers. It also believed there was close demand-side substitutability for consumers between branded and own-label products, and that all retailers could readily switch between CSP product suppliers.

17. The CMA will investigate the extent to which different CSP products, labels and distribution channels can be aggregated on the basis of demand-side and/or supply-side substitution. In particular, we will consider:

    (a) the extent to which different CSP products may be in separate markets;

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[1] *Merger Assessment Guidelines* (CC2/OFT1254), September 2010), paragraph 5.2.2.
[2] In that they use a similar range of ingredients.

(b) the extent to which there may be different markets for the supply of CSP products to (1) the large grocery retailers and (2) other customers (see paragraph 13);

(c) the extent to which there may be different markets for own-label and branded products; and

(d) the extent to which there may be segmentation within a CSP category, such as between economy, standard and premium tier products.

18. We will also consider the scope of the relevant geographic markets.

Assessment of the competitive effects of the merger

Counterfactual

19. We will assess the possible effects of the merger on competition compared with the competitive conditions in the counterfactual situation (ie the competitive situation absent the merger). We will therefore consider what would have been likely to have happened if the merger had not taken place, and in particular whether:

    (a) KFL would have retained ownership of the Target and continued to operate it as before or have taken actions which would have changed for example the Target's scale, range of products, or efficiency; or

    (b) KFL would not have retained ownership, and if so whether there would have been other likely buyers for all or part of the Target business; and

    (c) absent the merger, PFGL would have continued to operate Pork Farms as before or whether actions such as expansion, restructuring or sale would have occurred.

20. In making our assessment we will consider possible alternative scenarios and decide upon the appropriate counterfactual situation based on the facts available to us and the extent of foreseeable future developments.

Theories of harm

21. Theories of harm describe the possible ways in which an SLC could arise as a result of the merger and provide the framework for our analysis of the competitive effects of the merger. We have set out below the theories of harm which we intend to investigate. However, we may revise our theories of harm as our inquiry progresses. Also, the identification of a theory of harm does not preclude an SLC being identified on another basis following further work by

us, or the receipt of additional evidence. We welcome views on all the theories of harm set out below.

Theory of harm 1: horizontal unilateral effects

22. The concern under this theory of harm is that, as a result of the merger, PFGL would face competition from one fewer credible supplier in negotiating with customers for the provision of own-label products and/or branded products. In consequence it would have the ability to increase the prices of its products (or decrease service levels or quality) and/or would have a lesser incentive to innovate. Ultimately, higher prices, lower quality of product or service level or reduced innovation may be passed on to end consumers.

23. Different effects may arise depending on the product, label, whether own-label products are economy/standard/premium tier, and on the distribution channel. We therefore propose to analyse the merger effects for each combination of product/label/tier/distribution channel separately where these distinctions appear potentially significant, although we will consider any competitive interaction between different segments.

24. For this theory of harm to hold we will need to address whether the Parties are close competitors and whether competitive constraints from inside the market (existing competitors), or other relevant countervailing factors (discussed in paragraphs 31 to 35) are likely to prevent or mitigate any SLC that we may find.

25. On the basis of the evidence currently available to us, issues which we are likely to consider include:

    (a) the spare production capacity of rivals and the ability to expand output at short notice;

    (b) how final consumers choose products and whether different brands, own-label and economy/standard/premium tier products are perceived as close competitors;

    (c) how suppliers compete and the importance of factors such as pricing, quality, capacity, support for promotions, innovation, service, etc;

    (d) the process through which customers choose suppliers of the relevant products, including through formal bids or bilateral negotiations, and the frequency with which this occurs;

    (e) the factors underlying customers' choice of supplier and the extent of switching between suppliers;

(f) the history of past negotiation/tendering behaviour and what this reveals about the extent of competition between the Parties, and between the Parties and other suppliers, prior to the merger; and

(g) whether behaviours and requirements differ between the large supermarkets and other types of customer.

Theory of harm 2: portfolio effects

26. A competitor has raised concerns that the Parties can sell a large set of CSP products in a bundle and this can make it difficult for smaller suppliers (who operate in a smaller number of segments) to replicate the attractiveness of the Parties' offer.

27. The evidence collected in phase 1 suggests that customers tend to negotiate and buy from suppliers on a product-by-product basis. We received no other evidence suggesting a strong preference for a single supplier/one-stop shopping, and other specialised suppliers contacted in phase 1 were not concerned about the risk of portfolio effects. We note that the merger does not appear to increase the overall set of CSP product categories that PFGL would be able to provide.

28. Therefore, at this stage, it would appear that this merger is unlikely to lead to an SLC because of portfolio effects. However, should any party have reasons to believe that the merger is likely to lead to portfolio effects, it should provide a reasoned submission.

Possible theory of harm: coordinated effects

29. Coordination can occur where potential competitors choose not to actively compete with each other, in the expectation that rivals are likely to respond in a similar way. This reduction in competitive intensity can arise where rivals have similar incentives and can observe what rivals are doing. In consequence there may be an implicit understanding of pricing, market share, not seeking to poach each other's customers and so on, without any form of explicit contact or agreement (ie this theory of harm does not consider explicit collusive conduct).

30. The concern under this theory of harm is that the merger may make coordination more likely if it does not already take place or more effective/stable if it does take place. However, it appears to us unlikely that the conditions for coordination applied pre-merger or that they will be significantly affected by the merger. We are not currently minded to investigate the possibility of the merger increasing the likelihood of coordinated effects. However, should any

party have reason for believing that we should investigate this possible harm, it should tell us and provide a reasoned submission.

Countervailing factors

31. We will consider whether there are countervailing factors which are likely to prevent or mitigate any SLC that we may find. In particular, we intend to consider the following.

32. **Entry and expansion**. We will consider how easy it is to enter and expand the production and supply of branded and own-label CSP products and to supply different types of customers, and whether entry and/or expansion could be expected to be timely, likely and sufficient to prevent any SLC. To do this we will:

    (a) look at the history of actual entry, expansion and exit by the Parties and by their competitors and review any future plans; and

    (b) examine the factors which might inhibit entry or the expansion of existing competitors including spare capacity; and

    (c) consider the cost of expanding or developing new production facilities, and the importance of scale, reputation, brands and other incumbency advantages.

33. **Buyer power**. We will assess whether any customers of PFGL and the Target have countervailing buyer power and whether the buyer power of these customers would be sufficient to protect customers from any effects of an SLC. In this regard, we note that prices tend to be individually negotiated. We would also consider the likely impact of the merger on any pre-existing countervailing buyer power.

34. **Efficiencies**. We will examine any arguments made in relation to efficiencies arising from the merger. In particular, we will examine whether any potential efficiencies are rivalry-enhancing and could be expected to offset any loss of competition.

35. We are not currently aware of any other possible countervailing factors.

Possible remedies and relevant customer benefits

36. Should we decide that the merger has resulted, or may be expected to result, in an SLC in any market(s), we will consider whether, and if so what, remedies might be appropriate, and will issue a further statement.

37. In any consideration of possible remedies, we may have regard to their effect on any relevant customer benefits in relation to the merger and, if so, what these benefits are likely to be and which customers would benefit.

Responses to the issues statement

38. Any party wishing to respond to this issues statement should do so in writing, by no later than 5pm on 20 February 2015. Please email porkfarms.kerry@cma.gsi.gov.uk or write to:

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