

**CASE ME/5294/11**

**ANTICIPATED ACQUISITION BY LINERGY LIMITED OF ULSTER FARM BY-PRODUCTS  
LIMITED**

**DECISION OF THE OFFICE OF FAIR TRADING PURSUANT TO SECTION 33  
ENTERPRISE ACT 2002**

15 March 2012

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

## Contents

|  |    |
|--|----|
| PARTIES.....   | 4  |
| TRANSACTION .....  | 4  |
| JURISDICTION .....   | 4  |
| BACKGROUND AND COUNTERFACTUAL.....                                   | 5  |
| Exiting firm .....   | 7  |
| FRAME OF REFERENCE .....   | 8  |
| Product scope – input side.....                                      | 8  |
| <i>Segmentation by type of plant</i> .....                           | 8  |
| <i>Segmentation by category of material</i> .....                    | 9  |
| <i>Segmentation by customer group</i> .....                          | 10 |
| Product scope – output side .....                                    | 12 |
| Conclusion on product scope .....                                    | 12 |
| Geographic scope – input side.....                                   | 13 |
| <i>Geographic scope for non-fallen stock</i> .....                   | 13 |
| <i>Geographic scope for fallen stock</i> .....                       | 19 |
| Geographic scope – output side .....                                 | 20 |
| Conclusion on geographic scope.....                                  | 20 |
| HORIZONTAL ISSUES FOR NON-FALLEN STOCK .....                         | 21 |
| Number of plants .....   | 21 |
| Number of customers.....   | 22 |
| Pricing.....   | 22 |
| Closeness of competition.....  | 23 |
| Strength of competitive constraint from the Republic of Ireland..... | 24 |
| Buyer power .....  | 25 |
| Barriers to entry and expansion .....                                | 26 |
| Conclusion on horizontal effects for non-fallen stock.....           | 27 |
| HORIZONTAL ISSUES FOR FALLEN STOCK .....                             | 27 |
| Competitive position .....   | 28 |
| Closeness of competition.....  | 29 |
| Conclusion on horizontal effects for fallen stock.....               | 29 |
| HORIZONTAL ISSUES ON THE OUTPUT SIDE .....                           | 30 |
| VERTICAL ISSUES .....  | 30 |
| COORDINATED EFFECTS.....   | 31 |
| Fallen stock .....   | 31 |
| Non-fallen stock .....   | 32 |
| Conclusion on coordinated effects .....                              | 32 |
| THIRD PARTY COMMENTS.....  | 33 |
| ASSESSMENT .....   | 33 |

UNDERTAKINGS IN LIEU ..... 34  
DECISION ..... 36

## **PARTIES**

1. Linergy Limited (**Linergy**) is one of three animal waste renderers in Northern Ireland, located in Dungannon, County Tyrone. It was established by two abattoir operators, Fane Valley/Linden Group and Dunbia, commencing operations in 2007. It is active in the processing of Category 1 animal by-products, Category 3 animal by-products and fallen stock. Its turnover for the financial year ended 30 September 2010 was £6.1 million.
2. Ulster Farm By-Products Limited (**Ulster Farm**) is also one of three animal waste renderers in Northern Ireland, located in Glenavy, County Antrim. It was established in 1953, by Glenfarm Holdings Limited, which is a farmers' co-operative of around 3,895 farmers. It is active in the processing of Category 1 animal by-products, Category 3 animal by-products and fallen stock. Its turnover for the financial year ended 31 December 2010 was £6.8 million.

## **TRANSACTION**

3. This transaction concerns the acquisition by Linergy of the entire issued and to be issued share capital of Ulster Farm. The transaction was signed on 23 November 2011 and its completion is conditional, amongst other things, upon merger clearance by the Office of Fair Trading (**OFT**) under section 33 of the Enterprise Act 2002 (the **Act**). The purchase price agreed by the parties is £[ ] million (after deductions).

## **JURISDICTION**

4. As a result of this transaction, Linergy and Ulster Farm would cease to be distinct.
5. Ulster Farm's turnover in its most recent financial year was £6.8 million. Accordingly, the turnover test in section 23(1)(b) of the Act is not met.
6. Linergy and Ulster Farm both process fallen stock in Northern Ireland. On figures supplied by the parties based on six-week periods in both 2010 and 2011, the parties account for [90-100] per cent of the processing of fallen stock aged over 48 months in Northern Ireland. The parties have told the OFT that these figures should be seen as representative of the parties' position for all fallen stock.
7. Accordingly, the OFT believes that the parties would, after the merger, supply 25 per cent or more of the processing of fallen stock in Northern Ireland, a

substantial part of the UK. The parties therefore satisfy the share of supply test in section 23(2)(b) of the Act.

8. It seems likely that the parties also satisfy the share of supply test in relation to the processing of both Category 1 animal by-products and Category 3 animal by-products in Northern Ireland.
9. The transaction therefore qualifies for the OFT's jurisdiction under the merger control provisions of the Act.

## **BACKGROUND AND COUNTERFACTUAL**

10. The phrase 'fallen stock' refers to animals that have died on farms and therefore need to be disposed of by the farmer. The phrase 'animal by-products' (also referred to as 'non-fallen stock') refers to what remains of an animal after meat and offal for human consumption, and other uses, has been removed. The disposal and processing of fallen stock and animal by-products is heavily regulated and disposal must be in accordance with UK and European law.
11. The relevant regulations categorise animal by-products according to their risk of transmitting bovine spongiform encephalopathy (**BSE**), and require the different categories to be treated differently at all stages. There are three categories of mammalian material (Category 1, Category 2 and Category 3), each requiring a separate licence. In Northern Ireland, the relevant licences are granted by the Northern Ireland Department of Agriculture and Rural Development (**DARD**).<sup>1</sup>
12. Category 1 is the highest risk material and Category 3 is the lowest risk (the parties do not operate any Category 2 plants and the OFT believes there are no Category 2 rendering plants operated in Northern Ireland). The regulations allow for Category 3 materials to be processed in a Category 1 plant (although the outputs would all be treated as Category 1), but not for Category 1 materials to be processed in a Category 3 plant.
13. Category 3 materials attract a lower 'gate fee' (the price paid to the renderer by the supplier of the material) than Category 1 materials - primarily because the products that are produced at the end of the process can be put to a greater number of uses (for example, pet consumption and cosmetics) and are therefore more valuable. For some Category 3 animal by-products, the parties pay the

<sup>1</sup> Source: [www.dardni.gov.uk/index/animal-health/animal-by-products.htm](http://www.dardni.gov.uk/index/animal-health/animal-by-products.htm) and <http://online.businesslink.gov.uk/bdotg/action/licenceLanding?type=LICENCE&itemId=1084033266>.

supplier for the raw materials (that is, a negative gate fee). The end products are meat and bone meal (**MBM**)<sup>2</sup> and tallow.<sup>3</sup>

14. Linergy currently operates a Category 1 plant, but not a Category 3 plant. The Category 3 material it receives is therefore processed in its Category 1 plant. The gate fee charged for the Category 3 material is lower than for Category 1 material, but as any end products must be categorised as Category 1 on exit (because of the risk of contamination), the value of the end products is much lower than if they were processed in a Category 3 plant.
15. As stated in the Merger Assessment Guidelines,<sup>4</sup> 'the OFT considers the merger compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect.' In most cases this would be the prevailing conditions before the merger, but in some cases evidence may exist such that it is appropriate for the OFT to assess the merger against an alternative counterfactual.
16. In this case, the parties have provided minutes of board meetings during 2011, which show that Linergy intended to construct a Category 3 plant. Board approval was granted for this construction in May 2011. The parties have told the OFT that the necessary licensing and planning approvals are in place as is sufficient bank funding (around £[ ] million). The build and commission period was forecast to last around [ ]. Therefore, in the absence of the merger, the OFT considers that there is strong evidence to show that Linergy would have constructed a Category 3 rendering plant.
17. Linergy has told the OFT that the opportunity arose to buy Ulster Farm, which operates separate Category 1 and Category 3 plants, and that Linergy chose to follow this course of action instead of building its own new Category 3 plant.
18. The purchase price agreed by the parties for Ulster Farm was £[ ] million (after deductions) and Linergy estimates that it would need to spend a further £[ ] million on upgrading Ulster Farm's plants. Therefore, based on Linergy's estimates, purchasing Ulster Farms would be over £[ ] million cheaper than building its own new Category 3 plant.
19. The evidence therefore shows that Linergy's reason for acquiring Ulster Farm is to acquire its Category 3 plant more quickly and more cheaply than it would

<sup>2</sup> MBM is typically about 48-52 per cent protein, 33-35% ash, eight to 12 per cent fat, and four to seven per cent moisture.

<sup>3</sup> Tallow is a rendered form of beef or mutton fat, processed from suet.

<sup>4</sup> OFT/CC Joint Merger Assessment Guidelines, paragraphs 4.3.5 to 4.3.7.

have been able to build its own Category 3 plant. The evidence indicates that absent the merger there was a realistic prospect that Linergy would have built its own Category 3 plant, which would have competed with that of Ulster Farm.

20. On the basis of the above, the OFT considers that there is strong evidence to support an assessment of this transaction against an alternative counterfactual. That alternative counterfactual would involve Linergy proceeding with its plans to build its own Category 3 plant and thus becoming a more effective competitor in relation to Category 3 material, whilst continuing to operate its existing Category 1 plant. This counterfactual is particularly relevant to the OFT's assessment of non-fallen stock set out below, although as will be apparent from the assessment below, the OFT's Decision would remain the same whether this counterfactual or the prevailing conditions of competition are used.

### **Exiting firm**

21. [ ].

22. In order for an exiting firm argument to be successful, the OFT requires sufficiently compelling evidence on each of the following three limbs:

- a. the exit from the market of the target business in the near future is inevitable absent the merger
- b. there is no realistic and substantially less anti-competitive alternative to the merger (for example, there must not be other realistic purchasers whose acquisition would produce a substantially better outcome for competition), and
- c. what would have happened to the sales of the firm in the event of its exit.<sup>5</sup>

23. However, the parties have confirmed that they do not believe the three limbs set out above are satisfied. First, no evidence has been provided that Ulster Farm would have exited the market absent the merger. Secondly, no evidence has been provided to show that there is no realistic and substantially less anti-competitive alternative to the merger, for example that no tenderer in the Republic of Ireland or in Britain (or indeed a company active in neighbouring markets), which does not overlap with the parties, would purchase Ulster Farm. Thirdly, no evidence has been provided to show what would have happened to the sales of Ulster Farm in the event of its exit.

<sup>5</sup> OFT/CC Joint Merger Assessment Guidelines, paragraphs 4.3.8 to 4.3.18.

24. Accordingly, there is insufficient evidence for the exiting firm argument to be taken into account in the relevant counterfactual for this transaction.

## **FRAME OF REFERENCE**

25. It is important to remember that market definition is a useful tool, but not an end in itself. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of a merger, as it is recognised that there can be constraints on merging parties from outside the relevant market.<sup>6</sup>
26. The parties source animal by-products primarily from slaughter houses and deboning plants, but also from retail food waste and dead farm animals. Suppliers of raw materials generally pay for disposal (known as a 'gate fee') and are generally treated as customers rather than suppliers. The OFT has framed this aspect of the market as the 'input side'.
27. As discussed above, the parties sell the rendered materials at the end of the process as MBM and tallow. The OFT has framed this aspect of the market as the 'output side'.

### **Product scope – input side**

28. As a result of the regulatory environment, all fallen stock and animal by-products must be processed by licensed processing plants to ensure the risk of disease transmission is reduced as far as practically possible. This section assesses whether it is appropriate for the competitive analysis to segment fallen stock and animal by-products.

#### *Segmentation by type of plant*

29. The OFT understands that there are a number of small scale incinerators in Northern Ireland,<sup>7</sup> which mainly cater for the poultry industry and which do not operate on the same scale as rendering plants. The parties do not operate any such incinerators.
30. The parties state that there are different licensing requirements for mammalian and poultry remains. Some small scale incinerators may have a licence to process

<sup>6</sup> See for example OFT/CC Joint Merger Assessment Guidelines, paragraph 5.2.2. In this case, for example, the extent to which a competitive constraint is exerted on the parties by renderers located in the Republic of Ireland is analysed as part of the market definition discussion and also as part of the assessment of horizontal unilateral effects.

<sup>7</sup> For a full list see [www.dardni.gov.uk](http://www.dardni.gov.uk) section\_iii\_incineration\_coincineration\_plants13092011-2.pdf.

mammalian remains, but the parties state that they do not exert competitive pressure on the parties.

31. The OFT believes that it is appropriate to treat small scale incinerators as operating in a discrete market from facilities that process mammalian material.

*Segmentation by category of material*

32. As discussed above, a renderer wishing to process both Category 1 and Category 3 animal by-products requires two separate plants and two separate licences from DARD (unless the renderer is willing to process all material as if it were Category 1 material, in which case the outputs are less valuable). A Category 3 plant cannot process Category 1 (or indeed Category 2) materials so it exerts no competitive constraint on the activities of a Category 1 plant.
33. As stated above, Category 1 and 3 materials are subject to different levels of gate fee. The gate fee for Category 3 materials is significantly lower than the gate fee for Category 1 materials, and the OFT's investigation has confirmed that a supplier would not accept a Category 1 gate fee charge for Category 3 materials. A negative gate fee sometimes applies to Category 3 materials (and was applied by Ulster Farm until January 2012), but not since the BSE outbreak to Category 1 materials.
34. The output resulting from the processing of Category 1 and 3 materials has different values. Category 3 output is more valuable than Category 1 output and in most respects the two are not substitutable. For example:
  - a. Category 3 MBM can be used for pet consumption, where as Category 1 MBM cannot, and
  - b. Category 3 tallow can be used in soaps, lubricants, cosmetics and animal feeds, whereas Category 1 tallow cannot. Although, both Category 1 and Category 3 tallow can be used as a fuel.
35. Category 3 materials can be processed in a Category 1 plant, but the output would then be classified as Category 1, so its sale would generate lower revenue for the renderer. Therefore, although a Category 1 plant can be used to process Category 3 material, this minimises the value of the output (without raising the gate fee). This is an important reason why Linergy wishes to acquire (or build) a separate Category 3 plant to complement its existing Category 1 plant.
36. The OFT has therefore found some important differences between Category 1 and Category 3 processing. However, despite these differences, there is also

evidence that customers (such as slaughter houses) might value the ability to send both Category 1 and Category 3 materials to the same renderer. The extent to which this is an important factor is unclear, but it seems possible that bundling makes the transportation of the materials, and the negotiation of prices, simpler. The OFT has not received evidence confirming this, but the OFT notes that it might explain why customers have been sending a significant quantity of Category 3 material to Linergy even though Linergy does not have a Category 3 plant and charges a different level of gate fee to Ulster Farm (which does operate a Category 3 plant).

37. In its competitive assessment below, the OFT has treated Category 1 and Category 3 separately. However, the OFT has also considered the extent to which the bundling of Category 1 and Category 3 services by renderers may be a relevant factor.

*Segmentation by customer group*

38. The OFT has considered whether different demand characteristics between different customer groups mean that the market should be segmented by customer group.
39. The parties derive their input materials from three main sources (the first two of which are referred to as 'non-fallen stock' and the third as 'fallen stock'):
- a. slaughter houses and deboning plants
  - b. retail food waste,<sup>8</sup> and
  - c. dead farm animals from farmers.
40. The great majority of farmers in Northern Ireland are members of the National Fallen Stock Scheme (**NFS Scheme**), which is operated by the National Fallen Stock Company (**NFS Company**). Under the NFS Scheme, registered collectors, who may or may not have direct contractual relations with a renderer, collect the dead animals (fallen stock) and transport them to a renderer where they are processed. Tenders covering the whole of Northern Ireland are submitted on an annual basis (although there are plans to make this more frequent). These prices are then published by the NFS Company.
41. Farmers who are not members of the NFS Scheme also dispose of fallen stock through renderers, and farmers can also choose to deliver animals directly to the renderer outside of the scheme. However, the data supplied by the parties seems

<sup>8</sup> This represents a small proportion of the total.

to suggest that the same prices are charged whether or not the NFS Scheme is formally used, although lower prices are charged where the farmer delivers the carcass.

42. Fallen stock is more expensive to process than non-fallen stock and the pricing structure is different for non-fallen and fallen stock customers. Non-fallen stock customers negotiate a price paid per tonne directly with the renderer, which has been around £[ ] per tonne for Category 1 products and has been a credit of up to £[ ] per tonne for Category 3 products. In contrast, fallen stock customers do not tend to negotiate on price. Most farmers are members of the NFS Scheme, which lists its prices on a per animal basis and there is little or no further negotiation. For example, the disposal charge for a fallen cow is currently around £80.<sup>9</sup>
43. Third party enquiries have indicated that non-fallen stock customers send large quantities of materials to rendering plants on a regular basis. In contrast, farmers generally want to dispose of any fallen stock relatively quickly, so will tend to send small quantities at a time to renderers on an ad hoc basis. The quantity and regularity of fallen stock supply is therefore less predictable, though the parties say there are seasonal patterns that make it predictable to some extent.
44. Although both fallen stock and non-fallen stock can be processed in the same plant, different regulatory requirements (such as the need to sample over 48 month fallen bovine material), different pricing structure, and different customer demands lead the OFT to believe that the market should be segmented by non-fallen stock and fallen stock customers.
45. The OFT has considered whether the processing of fallen stock should be further segmented between cattle aged over 48 months and cattle aged under 48 months, because their collection is subject to different regulations. For example, the parties have told the OFT that under 48 month fallen stock can be taken outside Northern Ireland for processing (though the OFT has seen no evidence of this happening in practice), and that sampling of over 48 month fallen stock must be undertaken by the renderer. The parties have submitted that they do not treat the two types of cattle separately, and their shares of supply are similar for both types. Linergy uses the same prices and collectors for both types. The parties submit, therefore, that fallen stock should not be segmented into more than one economic market.

<sup>9</sup> There are some 'hide discounts' offered for fresh dead animals, and there are different prices charged for delivery and collection, but these are part of the pricing structure rather than a negotiation over the price.

## **Product scope – output side**

46. The parties submit that the outputs of the rendering process (tallow and MBM) have different uses, depending on whether the input material was Category 1 or Category 3. This is principally the result of the tighter regulation of Category 1 outputs. Category 1 tallow is used as boiler fuel and a feedstock for biodiesel production, whereas Category 3 tallow can also be used in the oleo chemical industry and in animal feeds. Similarly, Category 1 MBM is used in large scale power and heat generators, whereas Category 3 MBM can also be used in the pet food industry, in fertilisers and in animal feeds.
47. Third parties have indicated to the OFT that there are various alternatives to using rendered products such as vegetable based products and heavy oil. As a result, the outputs of the rendering process are interchangeable with other commodities for many uses.

## **Conclusion on product scope**

48. A supplier wishing to dispose of animal waste must use a renderer with the relevant licence. On the input side, the OFT believes there are important distinctions between non-fallen stock and fallen stock, and between Category 1 and Category 3 by-products.
49. Therefore, the OFT has assessed the transaction using the following product frames of reference on the input side):
- a. The processing of Category 1 animal by-products (non-fallen stock)
  - b. The processing of Category 3 animal by-products (non-fallen stock), and
  - c. The processing of fallen stock.
50. As will be apparent from the competitive assessment section below, it is not necessary for the OFT to form a definitive view on whether the processing of Category 1 and Category 3 materials should be treated as two separate markets.
51. In addition, it is not necessary for the OFT to form a definitive view on whether the fallen stock market should be further segmented between cattle aged over 48 months and cattle aged under 48 months.
52. On the output side, it is not necessary for the OFT to form a definitive view on the product market since the transaction does not give rise to a realistic prospect of a substantial lessening of competition under any plausible market definition.

## Geographic scope – input side

53. This section considers the geographic frames of reference for non-fallen stock (Category 1 and Category 3 materials), followed by the geographic frame of reference for fallen stock. The geographic scope for the output side is then discussed in the next section.

### *Geographic scope for non-fallen stock*

54. The parties have argued that the catchment area for non-fallen stock should either be 150 miles or the whole of the island of Ireland. The parties submit that since HGV legislation allows drivers to drive for nine hours a day, if 30 minutes were allowed for loading and unloading they would be able to drive for four hours each way in a day. The parties submit that based on the assumption that the HGV can travel at an average of 50 mph, it would be able to drive 200 miles in each direction in a day. Therefore, to be conservative they submit that the appropriate catchment area should be 150 miles.
55. The parties have not provided evidence that travelling distances of this order would be an efficient course of action given the associated transport costs (in fact, as will be discussed below, their data shows the opposite). The parties have instead provided evidence showing that a small number of customers do in practice travel distances of this order to some renderers. However, these examples can be explained by the fact that all (or nearly all) of these customers are linked to the relevant renderer by common ownership or other links through shareholdings.<sup>10</sup>
56. The OFT defines the geographic market with reference to the hypothetical monopolist test.<sup>11</sup> In cases such as this one, the OFT generally examines the geographic catchment area within which the great majority of customers are located (normally 80 per cent). Catchment areas are a pragmatic approximation for a candidate market to which the hypothetical monopolist test can be applied.<sup>12</sup> To define a geographic market a narrow catchment area should be taken, the hypothetical monopolist test performed and the market widened if the price rise would not be profitable. A geographic market should not be based on a small number of examples or on the maximum possible travel distance in one day.

<sup>10</sup> In this Decision, suppliers of animal by-products who own shareholdings in a renderer, or who share common shareholders with a renderer, are referred to as 'shareholder customers'.

<sup>11</sup> Merger Assessment Guidelines, paragraph 5.2.21.

<sup>12</sup> Merger Assessment Guidelines, paragraph 5.2.25.

57. The OFT therefore requested information on customer location to test to what extent a catchment area of 150 miles from the parties' rendering plants, or a catchment area of the island of Ireland, is appropriate. The parties provided data on sales volumes. Linergy's data shows that over 80 per cent of customers for non-fallen stock were located within [70-80] miles of its plant in 2011. For Category 1 materials, Linergy's 80 per cent catchment area is [160-170] miles; for Category 3 materials, Linergy's 80 per cent catchment area is [40-50] miles.<sup>13</sup> However, these figures are greatly affected by the presence of shareholder customers who seem to be transporting non-fallen stock over large distances. In particular, Linergy has two large shareholder customers in the south of the Republic of Ireland in County Wexford. If shareholder customers are excluded from the data, the 80 per cent catchment area for all non-fallen stock is [40-50] miles, with no customers located outside of Northern Ireland.
58. It is not entirely clear why shareholder customers might be willing to transport their non-fallen stock substantially further than other customers. One possible reason might be that meat plants prefer to keep their rendering activities in-house, or at least they might prefer not to deal with plants that are vertically integrated with upstream meat plant competitors. Another possible reason might be that there are large fixed costs associated with running a rendering plant and therefore that volume can be important and so it can be worth spending more on extra transport costs in order to put more volume through the system. What seems clear, however, is that the long distances travelled by shareholder customers in some cases are not reflected in the behaviour of other (third party) customers.
59. The parties have not provided a detailed breakdown of sales volumes for Ulster Farm, but have indicated that over 90 per cent of its sales by volume came from Northern Ireland in 2011. The OFT notes the parties' claim that Ulster Farm's catchment area is 'untypically low'. However, it is not clear that Ulster Farm's catchment area is narrower than that of other renderers or that it is narrower than the catchment area for Linergy's non-shareholder customers.
60. Linergy's data show that it derived over 50 per cent of its volume (in 2011) from customers located less than three miles from its plant. However, Linergy's plant was constructed on the same industrial estate as two large shareholder customers, presumably partly to minimise transport costs.

<sup>13</sup> Linergy submits that its catchment area for Category 3 materials is [ ] miles. However, its figures include a potential shareholder customer which is not currently a customer of Linergy and which should therefore not be included. As Linergy only currently operates a Category 1 plant, it is not clear to what extent this split is useful in any case.

61. Third parties have indicated that price and distance are important factors in deciding which render to use (and that distance affects price to a significant degree as a result of transportation costs). It therefore seems that Republic of Ireland renderers such as College Proteins, which are fairly close to Northern Ireland, may compete to some extent for some customers who are in the far west (for example, County Fermanagh) or south (for example, the area around Newry) of Northern Ireland, but for the majority of customers in Northern Ireland, renderers in the Republic of Ireland are likely to be a less viable option. It may be relevant that renderers in the Republic are prohibited from co-locating Category 1 and Category 3 processing facilities. Therefore, for a customer wishing to send both Category 1 and Category 3 materials to the same plant, renderers in the Republic may not be a viable option.
62. The OFT contacted third parties to ascertain the most appropriate catchment area for non-fallen stock. The evidence on this issue is mixed, but no third party (including third parties based in Northern Ireland and in the Republic of Ireland) stated that the majority of their customers came from more than 100 miles, and most stated 40 to 50 miles, although some said that a minority of customers are located further afield. Two renderers in the Republic of Ireland who responded to the OFT's enquiries stated that they do not derive any business from Northern Ireland. Another renderer in the Republic of Ireland only derives five per cent of its Category 1 materials and ten per cent of its Category 3 materials from Northern Ireland customers, despite the fact that it is located near to Northern Ireland. The other renderers in the Republic of Ireland did not respond to the OFT's questions.
63. The parties have provided information on the destination of animal by-products from meat plants, covering the whole of the island of Ireland. This shows that of the 14 Northern Ireland based meat plants, only three use a renderer located outside of Northern Ireland. Only one of these three uses a renderer located in the Republic of Ireland, although for that customer, the Republic of Ireland renderer is closer to its plant than any of the Northern Irish renderers. The other two use a [ ] plant in Great Britain despite needing to transport the animal by-products across the Irish Sea. The OFT understands the relevant transport costs are in the region of £[ ] per tonne, so the reasons for this course of action are not clear. Of the 11 customers who use renderers in Northern Ireland, the parties state that nine are shareholder customers. However, the OFT understands that only six of these shareholder customers have plant(s) in Northern Ireland and process their entire volume in these plant(s).
64. The OFT used data on transportation costs to analyse how far it would be profitable to transport animal by-products in response to small but significant

non-transitory increase in price (the gate fee) of five per cent (SSNIP).<sup>14</sup> The parties have submitted that prices are determined by [ ]. Therefore, the OFT believes that transportation costs are, indirectly, an important factor in determining the gate fee.

65. The OFT has produced a number of different estimates of the additional transportation distance that would be profitable in response to a SSNIP, using data from different sources, all of which give a similar estimate of the additional distance. The parties provided an estimate of transportation costs for moving materials 190 miles, to a plant in the Republic of Ireland, of £[ ] per tonne. This equates to a cost of [ ] pence per tonne per mile. The following table shows Linergy’s current average prices by species type, what a five per cent price rise would represent for each species type and, based on the parties’ estimate of transport costs, how far it would be economical to transport goods in response to a SSNIP.

| <b>Species</b> | <b>Average price per tonne</b> | <b>5% price rise</b> | <b>Economic additional transportation distance (miles) in response to 5% price rise</b> |
|----------------|--------------------------------|----------------------|---|
| Bovine         | [ ]                            | [ ]                  | [10-20]   |
| Ovine          | [ ]                            | [ ]                  | [10-20]   |
| Porcine        | [ ]                            | [ ]                  | [0-10]  |
| Poultry        | [ ]                            | [ ]                  | [10-20]   |

66. Therefore, based on Linergy’s figures it is only cost-effective on average to transport animal by-products up to an additional [10-20] miles in response to a SSNIP.
67. The OFT used data on prices for a major customer of Ulster Farm, and from a third party located in the Republic of Ireland to check the robustness of the above estimate. Ulster Farm’s data were combined with data on transportation costs,<sup>15</sup> which show that the cost per tonne per mile of transporting goods by an 18 tonne trailer are around 16.7 pence.<sup>16</sup> Based on these figures transportation of an additional 15-18 miles would be profitable in response to a SSNIP. The OFT has also requested information on transportation costs from a renderer based in the Republic of Ireland. This renderer uses trailers with a capacity of around 20 tonnes, and it estimates that haulage costs at around €2.40 per mile

<sup>14</sup> This ‘hypothetical monopolist test’ is frequently used by competition authorities as an indicator of the relevant market. Five per cent is the usual level of price rise used for the hypothetical monopolist test and hence for market definition.

<sup>15</sup> Figures compiled for the Road Haulage Association by DFF International: <http://costs.dffintl.co.uk/Otherctp.pdf>.

<sup>16</sup> The OFT has been told by a meat processor that 18 tonne trailers are generally used.

for both Category 1 and Category 3 materials. This equates to just under 10 pence per tonne per mile, which makes transportation of an additional 25 miles cost-effective in response to a SSNIP. Therefore, based on transportation costs alone, it seems that for the great majority of Northern Irish customers it would not be profitable to switch to a supplier in the Republic of Ireland in response to a SSNIP.

68. For Category 3 animal by-products that require a gate fee to cover costs, the cost-effective travel distance is likely to be even smaller because a SSNIP on this lower fee is even smaller relative to transport costs. Using the same calculation as for Category 1 shows that only an extra 7.5 miles' travel would be cost-effective.
69. In any case, the above assessment shows that it is not cost effective to transport non-fallen stock more than 25 miles at most in response to a SSNIP for either category of material.
70. The OFT has used the above information to analyse whether Northern Ireland based meat plants would switch to a renderer outside of Northern Ireland in response to a five per cent price rise by a hypothetical monopolist of all Northern Ireland plants. The OFT believes that there are 16 sites in Northern Ireland that produce over 1,000 tonnes of animal by-products per year (there may be some other smaller producers). If a hypothetical monopolist of Northern Ireland rendering plants implemented a SSNIP, transport costs are such that 14 of these 16 plants would not be expected to switch to a renderer in the Republic of Ireland.
71. Of the two which would be expected to switch:
  - a. One is located in County Fermanagh and a Republic of Ireland renderer is closer to such an extent that (other things being equal) it would not be expected to switch to a Northern Ireland renderer in the case of a five per cent price rise from Republic of Ireland based renderers.
  - b. One is near Newry, which would only have to transport goods an extra two miles to reach a Republic of Ireland renderer, and which would therefore be expected (other things being equal) to switch to a Republic of Ireland based renderer in response to a five per cent price rise throughout Northern Ireland.

72. Critical loss analysis<sup>17</sup> using actual volumes where known, or average volumes where actual volumes are not known, shows that the geographic market for non-fallen stock is likely to be one of the following three alternatives:
- a. Northern Ireland, based on Linergy's current estimated profitability per tonne<sup>18</sup>
  - b. Northern Ireland minus County Fermanagh, if renderers' profitability is greater than £29 per tonne but less than £55 per tonne, or
  - c. Northern Ireland minus County Fermanagh and the area around Newry, if renderers' profitability is greater than £55 per tonne.<sup>19</sup>
73. The above analysis of transport costs is not consistent with a geographic market covering a 150 mile radius or a geographic market covering the whole of the island of Ireland. In all possible cases outlined above, the market can be no wider than Northern Ireland.
74. The OFT also notes that there may be other costs (other than transport costs) associated with moving animal by-products between Northern Ireland and the Republic of Ireland, such as currency exchange costs and other transaction costs.
75. As discussed above, the parties have shown that some shareholder customers do in practice travel large distances from the Republic of Ireland to Northern Ireland, but the reasons for this are not clear given the transport costs involved. This behaviour does, though, seem to be anomalous, and when shareholder customers are excluded from the data, catchment areas become smaller than Northern Ireland.
76. The OFT also notes that the constraint of Northern Ireland renderers on Republic of Ireland renderers is of less importance to the OFT's review than the opposite constraint (of Republic of Ireland renderers on Northern Ireland renderers). The OFT's remit covers Northern Ireland customers but not Republic of Ireland customers.
77. The parties have also argued that since the renderer generally pays for transport costs, they are not relevant to the customer's decision regarding which renderer

<sup>17</sup> Critical loss analysis is an empirical tool for analysing the boundaries of the market. Generally speaking, the critical loss is defined as the maximum sales loss that could be sustained as a result of the five per cent price increase without making the price increase unprofitable. Where the likely loss of sales to the hypothetical monopolist is less than the critical loss, then a five per cent price increase would be profitable and the market is defined.

<sup>18</sup> [ ].

<sup>19</sup> The OFT does not have sufficient information to assess which of the three alternatives is most appropriate.

to choose. The OFT does not accept this argument and it is not supported by the parties' own data. For example, the parties supplied two case studies setting out the cost breakdowns for customers, which show that transport costs are the only changeable costs between different customers, and that these feed directly into the gate fees charged.

#### *Geographic scope for fallen stock*

78. Under current DARD regulations, renderers outside Northern Ireland are not permitted to process Northern Irish fallen stock aged over 48 months. In addition, information received by the OFT in relation to the NFS Scheme suggests that no Republic of Ireland renderers have expressed an interest in tendering as part of the NFS Scheme, and no Republic of Ireland renderers are registered by the NFS Company.
79. The higher prices in the Republic of Ireland compared with Northern Ireland for the processing of fallen stock do not suggest a high degree of competition between the two areas.
80. The OFT has examined Linergy's volume data and has found that the 80 per cent catchment area for fallen stock was [50-60] miles in 2010 and in 2011, with only one fallen stock customer based outside Northern Ireland. The OFT has also separated the data by fallen stock that was collected by the renderer (or a collector on its behalf) and that which was delivered by the farmer in these two years, and found that the 80 per cent catchment area for collected stock was [50-60] miles and for delivered stock was [20-30] miles. It therefore seems that farmers located further from the rendering plant tend to have their fallen stock collected rather than deliver it themselves.
81. A catchment area of this size for fallen stock is consistent with third party comments, with a collector stating that they do not consider it cost effective to use Foyle Proteins (the parties' only competitor in Northern Ireland), even though Foyle Proteins offers cheaper prices, because Foyle Proteins is located 80 miles away.
82. Under the NFS Scheme, the parties have stated that they both submit one tender price for the whole of Northern Ireland. This suggests that they believe the conditions of competition to be relatively homogenous for the whole of Northern Ireland.

### **Geographic scope – output side**

83. The parties submit that their tallow and MBM is sold throughout the UK and in some cases to other European countries. The majority of Linery's tallow is supplied to Scotland and all its MBM is supplied to England. Substitutable products sometimes originate from outside the EEA.

### **Conclusion on geographic scope**

84. For both Category 1 and Category 3 non-fallen stock, although a small amount of business is inevitably conducted over a larger area (often not for economic reasons), the weight of evidence indicates that the geographic market is no wider than Northern Ireland. Transportation costs (and possibly currency and other transaction costs) are likely to make a five per cent price rise by a Northern Ireland hypothetical monopolist profitable.
85. Based on the geographic location of most meat plants in Northern Ireland, the nearest Republic of Ireland renderers are unlikely to exert a significant constraint on the parties. In any case, Republic of Ireland renderers do not have significant activities in Northern Ireland.
86. The OFT has therefore treated the whole of Northern Ireland as its geographic frame of reference for the Category 1 and Category 3 processing of non-fallen stock. In its competitive assessment below, the OFT has also considered the effect (if any) of Republic of Ireland renderers in Northern Ireland.
87. For fallen stock, due to the regulatory environment and the competitive structure of the sector, the OFT has found that the relevant geographic market is no wider than Northern Ireland, and the data submitted by the parties regarding their 80 per cent catchment areas suggests that it may be a radius of just over 50 miles from the relevant processing plant. However, as will be apparent from the competitive assessment below, it is not necessary to form a definitive view between these two alternatives.
88. On the output side, it is not necessary for the OFT to form a definitive view on the geographic market since the transaction does not have a realistic prospect of resulting in a substantial lessening of competition under any plausible market definition.

## **HORIZONTAL ISSUES FOR NON-FALLEN STOCK**

89. This section considers whether the transaction may be expected to result in a substantial lessening of competition as a result of horizontal unilateral effects in relation to the processing of Category 1 and Category 3 animal by-products.
90. As explained above, the OFT believes that the processing of Category 1 and Category 3 animal by-products belong in discrete product markets. However, much of the information provided to the OFT relates to both types of material, Linergy does not currently operate a separate Category 3 plant, and there is evidence of some bundling of the two services, so the two relevant markets will be considered together in this section.

### **Number of plants**

91. If the merger goes ahead, the parties would operate two Category 1 plants and one Category 3 plant (with Linergy expected to abandon its plans to build a new Category 3 plant), all of which are in Northern Ireland.
92. For Category 1 animal by-products, the parties would operate two of the three plants in Northern Ireland post-merger. The only remaining competitor would be Foyle Proteins, and the OFT has been provided with evidence that Foyle Proteins would not have sufficient spare capacity to deal with a significant increase in customers.
93. For Category 3 animal by-products, the parties would operate the only plant currently existing in Northern Ireland post-merger (although all Category 1 plants are capable of processing Category 3 materials). Moy Park also operates two Category 3 plants, but as it has no customers other than its own upstream business, it should not in reality be regarded as a competitive constraint on the parties. Indeed, it seems that it does not even have sufficient capacity for the needs of its own upstream business because it sends a proportion of its animal by-products to other renderers each week.
94. As the relevant counterfactual is that Linergy would build its own Category 3 plant, the transaction therefore represents a merger to monopoly for Category 3 plants within the relevant geographic market. The OFT notes the parties representations that it would also be relatively straightforward for Foyle Proteins to start operating a Category 3 plant from its existing premises.

## Number of customers

95. The parties have stated that there are 14 meat plants in Northern Ireland. Until mid-January 2012 (when Ulster Farm significantly changed its pricing structure), three were Linergy customers and five were Ulster Farm customers. This would give the parties a combined share of customers of [50-60] per cent within the relevant geographic market of Northern Ireland.
96. The parties have also provided information on the share of non-fallen stock customers within Linergy's catchment area. The parties have stated that there are 28 meat processing plants within [70-80] miles of Linergy. Until mid-January 2012 (when Ulster Farm changed its pricing), [ ] of these were Linergy customers and [ ] were Ulster Farm customers. This would give the parties a [30-40] per cent share of these customers. As the [70-80] mile radius includes part of the Republic of Ireland, which is outside the relevant geographic market in this case, one would expect their share of customers to be lower on this measure.
97. These figures show that the parties are both significant competitors in Northern Ireland, providing rendering services to over half of meat plant customers. The parties have not provided any evidence showing that this measure overestimates the parties' competitive position or their share of supply by volume or value. However, the OFT notes that this evidence does not take account of the sizes of these large customers and it excludes smaller customers. Nor does it take account of whether these customers are Category 1 or Category 3 customers.

## Pricing

98. [ ].
99. On 16 January 2012, Ulster Farm changed the prices it charged to [ ] animal by-product customers. For Category 1 material, their gate fees were raised by [ ] per cent. For Category 3 material, Ulster Farm moved from offering a credit of £[ ] per tonne (that is, a negative gate fee) to [ ]. The OFT understands that these price rises were imposed without negotiation. The OFT notes, however, the parties' submission that this change should not be seen as a price rise, but rather a reversion to the price levels that existed in 2010. It seems that the 2011 price levels were loss making, so it is not clear why Ulster Farm would have agreed to the previous prices with its customers. This may mean that there were other relevant factors of which the OFT is not aware.

100. The price change resulted in only two of the three customers switching their supply. Of the two customers:
- a. one switched to a plant it owns in the Republic of Ireland, partly because it was unable to switch to either of the other two Northern Ireland renderers, and
  - b. the other initially continued to supply animal by-products to Ulster Farm but it has now switched to a renderer in the Republic of Ireland.
101. The customers knew about the impending merger with Linergy when choosing an alternative renderer so they may have been reluctant to switch to Linergy. Both customers who switched to Republic of Ireland renderers seem to have been unable to find a suitable alternative renderer in Northern Ireland, although the OFT has received conflicting information on this issue and the facts are unclear.
102. The parties have provided minutes of a board meeting of Glenfarm Holdings Limited (the owner of Ulster Farm) at which the price rise was discussed. The 13 December 2011 board minute (the transaction was signed on 23 November 2011) states that the price increase was [ ]. The minutes from the board meeting on 3 January 2012 suggest [ ].
103. Therefore, based on the information available, this price rise may arguably be seen as a demonstration of how the proposed merger altered the incentives of Ulster Farm, and as such may be seen as merger specific. The OFT notes the uncertainty over the reasons for Ulster Farm's pricing levels and the parties' explanation of the price rise as being intended to stem the losses being incurred by Ulster Farm and to reinstate the level of prices previously being charged.

### **Closeness of competition**

104. The parties are each other's geographically closest competitors and they are the closest renderers to most customers in Northern Ireland. The only other renderer in Northern Ireland, Foyle Proteins, is located in Derry, in the far north-west of Northern Ireland.
105. The OFT has received evidence from one large supplier in Northern Ireland, which indicated that the parties are each other's closest competitor and were the only two options for them to use for processing. For independent customers (that is, suppliers who do not own a downstream rendering plant and are not linked in some other way to a renderer), Foyle Proteins may not be a viable option, because it is a major competitor in other markets (but then, as the parties point

out, so is Linergy). Evidence from the parties' competitors also suggests that they are each other's closest competitor.

106. Although Linergy mostly services its own shareholder customers, it has [ ] spare capacity and could compete for the majority of Ulster Farm's business in a way that the only other competitor, Foyle Proteins, could not. Linergy has spare capacity of around [ ] tonnes per week, whereas Foyle Proteins has [ ] spare capacity. Third parties contacted by the OFT have indicated that Foyle's spare capacity is insufficient to serve Ulster Farm's largest customers if they wished to switch renderer, and it means that over 80 per cent of the merged parties' business would be unconstrained by a Northern Ireland renderer post merger. In addition, a substantial majority of the remaining proportion of the merged parties' business would need to switch to Foyle Proteins in response to a SSNIP in order to make it unprofitable.

107. Linergy notes that some of Foyle Protein's capacity is currently being used by Republic of Ireland customers (often in Donegal in the far north west of the Republic of Ireland, which is near to Foyle Protein's plant) and it could therefore redirect its business to Northern Irish customers if it wished to do so. The OFT does not believe this is a valid argument, as a company's potential ability to stop supplying its existing customers does not equate to spare capacity. Indeed, assuming that a company will only serve profitable customers, prices in Northern Ireland may have to increase by an unknown amount before it would be profitable for Foyle to switch away from its current customers.

108. Based on the evidence available, the OFT believes that the parties are each other's closest competitor.

### **Strength of competitive constraint from the Republic of Ireland**

109. The catchment areas of the parties and of third party respondents show that the great majority of customers are based in quite close proximity to the processing plant. Additionally, the OFT notes that transport costs have been generally increasing, so catchment areas may reduce in size in the future because it may become even less cost-effective to transport animal by-products a large distance.

110. The parties submit that rendering plants in Republic of Ireland exert a competitive constraint on the parties and have provided a small number of examples of customers switching from plants in Northern Ireland to the Republic of Ireland. However, it is not clear what proportion of the total volume or value these customers represent so it is not straightforward to assess how significant this switching activity is. In any case, it should be expected in any industry that there

would be a small number of examples of customers willing to travel much further than most customers, for whatever reason.

111. The parties have presented evidence of customers switching away from Ulster Farm to Republic of Ireland renderers (rather than to Linergy) as a result of the January 2012 price rise. However, the parties state that '[t]here is no logical commercial reason behind their actions', so it is unclear whether the parties believe this is evidence of a competitive constraint from the Republic of Ireland or a recognition that Linergy is a vertically integrated competitor. In any case, the OFT does not believe the two customers' switching to Republic of Ireland renderers is reliable evidence of a competitive constraint from outside Northern Ireland. This is because the reaction of these two specific customers is not necessarily representative of most customers (especially as one of the two switched to its own plant in the Republic of Ireland), the price rise was unusually large.<sup>20</sup> It is also unclear what these customers' (and indeed smaller customers') reactions would have been in response to a smaller percentage price rise rather than a [ ] per cent price rise, but it seems likely that the increased transport costs involved in shipping the animal by-products to the Republic of Ireland would not have made switching in response to a smaller price rise cost-effective.

112. The OFT has received three responses from renderers in the Republic of Ireland, two of whom indicated that none of their supply comes from Northern Ireland and that they are not familiar with the situation in Northern Ireland. The other renderer indicated that five per cent of its Category 1 and ten per cent of its Category 3 supply comes from Northern Ireland, which seems to be a relatively low proportion given its proximity to Northern Ireland.

113. On balance, the OFT believes that the competitive constraint exerted by Republic of Ireland renderers is weak.<sup>21</sup>

### **Buyer power**

114. Animal by-product producers are buying a service from renderers and supplying them with a key input, so might be expected to have some degree of buyer power. However, the regulatory regime dictates where animal by-products must be processed, and there is no option for large customers other than to use renderers (of which there are few). Therefore, any buyer power on the part of animal by-product producers is likely to be offset by power on the part of the renderers.

<sup>20</sup> The price rise was [ ] per cent for Category 1 material, and [ ] for Category 3 material.

<sup>21</sup> See also the discussion above of the relevant geographic frame of reference.

115. The OFT notes that some of Ulster Farm's larger customers secured decreases in gate fees in 2010 and 2011 (which were reversed in January 2012). The reasons why Ulster Farm would agree to such prices for a prolonged period, which seem to have made its business loss making, are unclear. The uncertainty over the details of the price negotiations, and the resulting possibility that there were other relevant factors that the OFT is not aware of, leads the OFT not to place weight on this as evidence of countervailing buyer power. The OFT has not treated this issue as a material factor in its competitive assessment.

### **Barriers to entry and expansion**

116. The parties state that the rendering industry has a high potential for adverse environmental impact and is subject to a lengthy planning process. Additionally, construction of a new plant would cost approximately £[ ] million.

117. Linergy states that the build and commissioning period for their prospective Category 3 plant would be around [ ]. [ ]. In total, it seems that Linergy's establishment of a Category 3 plant would take at least [ ] years. This time period would be likely to be longer for a new entrant not already established in Northern Ireland, and it does not include the time it would take to start to win customers and build a reputation (in an industry where the players at different levels of the market are often inter-linked). The OFT therefore believes that three years should be treated as the minimum time it would take to enter the market in a sufficient way to constrain the behaviour of existing competitors. A time period of this magnitude is too long to be treated as timely enough to constrain the parties' behaviour post-merger.<sup>22</sup>

118. The OFT believes that barriers to entry for new entrants are high enough such that possible new entry should not be treated as a mitigating factor to the OFT's competition concerns.

119. The parties submit that barriers to entry are low for existing renderers with suitable existing premises. The OFT agrees that barriers to expansion by existing renderers with existing suitable premises are likely to be substantially lower than for entirely new entrants, although it notes that there is only one such renderer in Northern Ireland (Foyle Proteins) that could be considered likely to enter.<sup>23</sup>

<sup>22</sup> See, for example, Merger Assessment Guidelines, paragraph 5.8.11.

<sup>23</sup> Moy Park also operates a rendering plant in Northern Ireland, but only to service its own upstream business.

Foyle Proteins currently operates a Category 1 plant but not a Category 3 plant, so its potential entry is only relevant for Category 3 processing.<sup>24</sup>

120. Both Linergy and Ulster Farm currently (or plan to) collocate Category 1 and Category 3 plants on the same site. The OFT believes that this is likely to reduce planning objections, with no planning necessary if an existing building is used. Therefore, barriers to expansion for existing market participants using their existing sites are likely to be low.

### **Conclusion on horizontal effects for non-fallen stock**

121. The merger would represent a 3 to 2 amongst Category 1 plants in Northern Ireland and a 2 to 1 amongst Category 3 plants in Northern Ireland (given the relevant counterfactual).

122. The competitive constraint from the Republic of Ireland (and from Great Britain) is weak, and the parties are close competitors. The great majority of the combined parties' capacity post merger will be unconstrained by a Northern Ireland renderer.

123. Barriers to entry are high for Category 1, but lower for Category 3 for the other renderer currently present in Northern Ireland. However, even if the OFT assumes that renderer will enter the market for Category 3 processing, the merger would still represent a 3 to 2 reduction in competitors.

124. The balance of the evidence indicates that there is a realistic prospect that the merger would result in a substantial lessening of competition in relation to the processing of both Category 1 and Category 3 animal by-products in Northern Ireland.

### **HORIZONTAL ISSUES FOR FALLEN STOCK**

125. This section considers whether the transaction may be expected to result in a substantial lessening of competition as a result of horizontal unilateral effects in relation to fallen stock.

126. As fallen stock must be processed in rendering plants, and all three Northern Ireland renderers are active in fallen stock, the discussion of de novo entry in relation to non-fallen stock applies equally to fallen stock.

<sup>24</sup> As Foyle operates a Category 1 plant, it is capable of processing Category 3 material, though any Category 3 material would be classed as Category 1 on exit.

## Competitive position

127. The parties estimate that their combined share of supply in over 48 month cattle is 93 per cent. The estimates are based on a representative sample of two six week periods, one in 2010 and the other in 2011, covering the whole of Northern Ireland. The parties' only competitor is Foyle Proteins, which has a seven per cent share.
128. As discussed above, it is not clear whether it is appropriate to view **over 48 month** cattle as separate from **under 48 month** cattle. However, the parties have confirmed that these shares of supply are indicative of the position for all fallen stock (that is, including cattle younger than 48 months). Linergy has stated that over 48 month old cattle represents half of its fallen stock business, which it says is typical of the industry. Linergy uses the same prices and collectors for both segments.
129. The parties have stated that collectors are free to take cattle aged under 48 months to renderers in the Republic of Ireland, but the OFT has seen no evidence of this happening in practice and also notes that the parties have stated that rendering fallen stock in the Republic of Ireland is more expensive than in Northern Ireland. Indeed, the parties' statement that their shares of supply for over 48 month animals is the same as their share of supply for all fallen stock supports this lack of competition from the Republic of Ireland.
130. Two fallen stock collectors operate in Northern Ireland and are registered under the NFS Scheme.<sup>25</sup> However, since all of their collected material must be taken to one of the three current rendering plants, collectors are not operating at the same level of the market and should not be regarded as competitors of the rendering plants. They are only able to affect the transport element of costs. This is reflected in the fact that they do not register as having any market share in the parties' market share figures.
131. Given all fallen stock in Northern Ireland aged over 48 months must be disposed of through one of the three rendering companies, and all fallen stock seems in practice to be disposed of in Northern Ireland, the merger would represent a three to two in the fallen stock rendering market in Northern Ireland. The only remaining competitor would have only a small market share.
132. As discussed above, the relevant catchment area for fallen stock may be [50-60] miles. Over this catchment area, the transaction would represent a two to one

<sup>25</sup> The parties submit that Castlehill Vets also operates privately, though not through the NFS Scheme.

reduction in competitors (that is, a merger to monopoly) for a substantial number of customers. This is because Ulster Farm is located 33 miles by road from Linergy, and Foyle Proteins is 60 miles by road from Linergy.

### **Closeness of competition**

133. Ulster Farm is Linergy's closest geographic competitor and third parties have stated that they are the two leading competitors (as would be expected given their shares of supply). Additionally, the OFT has received evidence suggesting that Ulster Farm is the price leader in fallen stock.

134. The fallen stock collector companies should not be regarded as competitors to the renderers. Indeed evidence submitted by the parties shows that Castlehill Vets did not submit a tender to the NFS Company in 2011 or 2012 and Linergy has stated that McGirr is the official collector for Linergy for all fallen stock.

135. The OFT has received evidence that the parties' only competitor, Foyle Proteins, is less conveniently located than the parties for many customers, and even though its prices tend to be lower, this is offset by the higher resultant transport costs.

136. [ ].

137. The OFT believes that the two parties are each other's closest competitor and that they are the two leading providers of rendering services for fallen stock in Northern Ireland.

### **Conclusion on horizontal effects for fallen stock**

138. The merger represents a three to two amongst renderers of fallen stock in Northern Ireland and a two to one based on a catchment area of [50-60] miles. The parties estimate that they have a [90-100] per cent market share for fallen stock in Northern Ireland.

139. There is no evidence of a competitive constraint from the Republic of Ireland (or from Great Britain) and barriers to entry are high.

140. The competitive structure of the market for the processing of fallen stock is already weak pre-merger and would be made substantially weaker as a result of the merger.

141. One of the stated aims of the NFS Company is 'to create competition at local level to keep prices low'.<sup>26</sup> In the OFT's view, this transaction would undermine this aim.

142. The OFT finds that there is a realistic prospect that the merger would result in a substantial lessening of competition in relation to the processing of fallen stock in Northern Ireland.

#### **HORIZONTAL ISSUES ON THE OUTPUT SIDE**

143. The OFT has seen no evidence that the parties' market positions are significant for tallow or MBM, and it seems likely that their outputs are constrained by other commodities in any case. The OFT has received no complaints about this aspect of the transaction.

144. The OFT has no basis on which to conclude that there is a realistic prospect that the merger would result in a substantial lessening of competition in relation to the manufacture and sale of rendering outputs.

#### **VERTICAL ISSUES**

145. The OFT has considered whether the transaction causes potential vertical competition concerns because Ulster Farm is the only renderer in Northern Ireland that is currently independent of an upstream animal by-products producer. Linergy has two large shareholders (Linden and Dunbia) who are meat processors. Foyle Proteins is also owned by a meat processor, Foyle Meats.

146. Therefore, post-merger, there would be no remaining independent renderers in Northern Ireland. Animal by-products suppliers that are not vertically integrated would be legally obliged (as a result of the relevant regulations) to purchase rendering services from a direct competitor, who would be able to set the price for these services.

147. One third party has told the OFT that it would find this objectionable and would fear that their business would be materially disadvantaged, as its rivals would be able to influence one of its key costs and this could lead to foreclosure.

<sup>26</sup> See <http://nfsco.co.uk/blogsection/about-us>.

148. On balance, the OFT does not have sufficient evidence to conclude that there is a realistic prospect of a substantial lessening of competition as a result of vertical effects. This is an aspect of the transaction that the Competition Commission may wish to explore in further detail.

## **COORDINATED EFFECTS**

149. The OFT generally assesses co-ordinated effects against three conditions:

- a. firms need to be able to reach and monitor the terms of coordination
- b. coordination needs to be internally sustainable among the coordinating group (that is, firms have to find it in their individual interests to adhere to the coordinated outcome), and
- c. coordination needs to be externally sustainable, in that there is little likelihood of coordination being undermined by competition from outside the coordinating group.<sup>27</sup>

150. The merger would result in only two renderers operating in Northern Ireland. This would increase the risk of coordination, particularly within the fallen stock market, but also for the processing of Category 1 and Category 3 animal by-products.

### **Fallen stock**

151. Prices for fallen stock are determined by prices that each registered collector submits to the NFS Company. Under the NFS Company's system, prices are submitted by renderers electronically and all go live at the same time. However, prices are externally published so they are visible to each market participant. Therefore, monitoring of any collusive agreement would be relatively easy.

152. Prices are currently tendered on an annual basis, which would mean any deviation from the collusive strategy would be maintained for one year before any punishment could occur. However, the OFT understands that the tendering system may be more frequent in the near future, which would allow far quicker punishment of any deviation from the collusive strategy and reduce the payback from deviation. The OFT believes that coordination is likely to be internally sustainable going forward.

153. Any collusive agreement between the two remaining Northern Ireland renderers is likely to be externally sustainable as any independent collector must be use

<sup>27</sup> Merger Assessment Guidelines, paragraph 5.5.9.

one of their plants, at least for over 48 month cattle, so they are able to price in such a way so as to ensure that they are not undercut.

154. The parties have provided data on the prices tendered for each of the 58 product categories for the past four years. These data show that there was significant variation in the prices charged by the different renderers for fallen stock collection in 2009 (the first tender after the public subsidy ended), but by 2011 and 2012 there was almost no variation in prices. This could be construed as pre-existing evidence of coordination, although the parties have offered an explanation of why prices have evolved in this way. Linergy was first allowed to bid for over 48 month old cattle in November 2009, before which time only Ulster Farm was active. Linergy submit that they bid aggressively in the first two years in order to gain market share. In 2011 and 2012, Linergy sought to charge a more economically stable price. The reason suggested by the parties for the converging prices is that competitors have started charging more economically sustainable prices, although it is unclear how this explains the rising prices each year.

#### **Non-fallen stock**

155. A similar analysis applies to non-fallen stock (Category 1 and Category 3 animal by-products) as for fallen stock. Although prices are not published in the same way, there is a considerable amount of transparency as a result of the small number of industry players and their vertical integration, and punishment for deviation is arguably likely to be easier and quicker than for fallen stock because competitors are not confined to an annual tender process.

#### **Conclusion on coordinated effects**

156. The merger would lead to further concentration in an already-concentrated and vertically-integrated industry. This is likely to enhance the conditions for coordination, which are already quite high.

157. However, the OFT believes that there is not enough evidence at this stage to conclude that there is a realistic prospect of a substantial lessening of competition as a result of coordinated effects in relation to the processing of Category 1 and Category 3 animal by-products and in relation to the processing of fallen stock.

158. This is an aspect of the transaction that the Competition Commission may wish to explore in further detail.

### **THIRD PARTY COMMENTS**

159. Third party comments have been taken into account where appropriate in the competitive assessment above.

160. The OFT has received unsolicited complaints about the proposed merger from a number of third parties, including:

- a. a customer/supplier
- b. a member of the Northern Irish Assembly on his own behalf and on behalf of his constituents who have raised concerns with him, and
- c. an organisation representing farmers.

161. The OFT has also received views from a number of third parties, including:

- a. meat processors, farmers, and other suppliers
- b. organisations representing farmers
- c. Government agencies and other regulators
- d. animal waste collectors, and
- e. animal waste renderers in Northern Ireland, the Republic of Ireland, and Great Britain.

162. A high proportion of third parties were concerned about the effects that the transaction would have on competition.

### **ASSESSMENT**

163. The parties are two of the three animal waste renderers in Northern Ireland. Both parties are active in the processing of Category 1 animal by-products, Category 3 animal by-products and fallen stock.

164. The OFT's market investigation has found that there are three separate frames of reference for assessing this merger, namely:

- a. the processing of Category 1 animal by-products
- b. the processing of Category 3 animal by-products, and
- c. the processing of fallen stock.

165. The OFT has found that the competitive constraint from outside Northern Ireland is weak for all three product markets. It is likely that the geographic market for each of the three markets does not extend outside Northern Ireland, and it may be narrower than Northern Ireland (at least for fallen stock).

166. The parties are currently each others' closest competitors. Post-merger, the parties would face very little competition in Northern Ireland in each of the three markets, with only one remaining competitor (at most). The great majority of the combined parties' non-fallen stock capacity would be unconstrained by a Northern Ireland renderer.
167. The merger would represent a three to two amongst Category 1 renderers in Northern Ireland. Only one of the parties (Ulster Farm) currently operates a Category 3 plant, but it is highly likely that the other (Linergy) would have invested in a Category 3 plant absent the merger, and thus the existence of this plant is the appropriate counterfactual against which the merger has been assessed. On this basis, the merger would represent a two to one amongst Category 3 renderers in Northern Ireland. Even if a third Northern Ireland renderer were to start operating a Category 3 plant, the merger would represent a three to two reduction in competitors.
168. The merger represents a three to two reduction in renderers of fallen stock in Northern Ireland and a two to one (for many customers) based on a catchment area of just over 50 miles. The parties estimate that they have a 93 per cent market share for fallen stock in Northern Ireland.
169. The OFT finds that there is a realistic prospect of a substantial lessening of competition as a result of horizontal unilateral effects in relation to each of the three relevant markets.
170. The OFT has not received sufficient evidence to conclude that there is a realistic prospect of a substantial lessening of competition as a result of vertical effects or coordinated effects. These are aspects of the transaction that the Competition Commission may wish to explore in further detail.

## **UNDERTAKINGS IN LIEU**

171. Where the duty to make a reference under section 33(1) of the Act applies, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned undertakings as it considers appropriate.
172. The OFT has therefore considered whether there might be undertakings in lieu of reference (**UILs**) which would address the competition concerns outlined above.

The OFT's guidance states that UILs are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut, and those remedies are capable of ready implementation.<sup>28</sup>

173. The parties offered UILs to divest Ulster Farm's Category 1 plant. However, it is not clear the extent to which Ulster Farm's Category 1 and Category 3 plants can be separated. The parties state that the two plants currently share effluent treatment facilities and boilers, both of which are important parts of an animal waste rendering plant. It is not clear whether it would be economically efficient or practically possible to run these services separately for two adjacent plants.
174. The parties have stated that significant capital expenditure would be required on the plant and that an 'interim contract' would be required for the supply of effluent treatment services.
175. The parties have also confirmed that there are other aspects of the plants that would need to be separated or upgraded before the plant could be sold. Services such as electricity and water are currently shared between the two plants and would need to be altered so that they can be metered separately. Access roads are currently shared and easements or other access rights would need to be put in place for a new owner of the Category 1 plant. It is not clear whether employees are currently shared by the two plants, nor is it clear whether any other equipment is currently shared.
176. The OFT has concerns that the Category 1 plant would not be an attractive asset for a potential purchaser and that the remedy would not be capable of ready implementation.
177. The parties have not offered an upfront buyer provision. The OFT has concerns that there may not be a sufficient number of potential buyers interested in the plant because it would not be an attractive asset.
178. Even if the divestment of the Category 1 plant was capable of acting as a sufficient remedy for the competition problems identified in relation to Category 1 processing, it would not remedy the problems identified in relation to Category 3 processing.
179. Taking into account the above considerations, the OFT considers that the parties' proposed UILs are not sufficient to act as a clear-cut and comprehensive remedy to the competition concerns identified by the OFT.

<sup>28</sup> Mergers – substantive assessment guidance, OFT516, June 2003, paragraph 8.3 and Mergers: jurisdictional and procedural guidance, OFT527, June 2009, paragraph 8.5.

## **DECISION**

180. This transaction will therefore be referred to the Competition Commission under section 33(1) of the Act.