
Anticipated acquisition by Dale Farm Limited of the fresh liquid milk business of Fane Valley Cooperative Society Limited

ME/4740/10

The OFT's decision on reference under section 33(1) given on 21 December 2010. Full text of decision published 10 January 2011.

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.

PARTIES

1. **Dale Farm Limited** (Dale Farm) is a wholly owned subsidiary of **United Dairy Farmers Limited** (UDF). Dale Farm has three dairy processing sites in Northern Ireland and two in Great Britain. It supplies raw milk and fresh processed milk in the UK and the Republic of Ireland.
2. **Fane Valley Cooperative Society Limited** (Fane Valley) is a farmer-owned co-operative based in Armagh, Northern Ireland. Fane Valley is active in dairy processing, meat processing, oats processing and animal feed production. It has stores selling farm requisites such as feeds, fertiliser, seeds, and silage additives. Fane Valley's dairy processing subsidiary is **Armaghdown Creameries Limited** (ACL). ACL supplies processed liquid milk and whole milk powder in Northern Ireland.

TRANSACTION

3. The proposed transaction (the Transaction) is for Dale Farm to acquire the following assets from Fane Valley's fresh processed liquid milk business:
 - the contracts and goodwill
 - some plant and equipment (for example, [])

- delivery vehicles
 - packing and other stocks, and
 - all active outstanding trading debtor net balances.
4. As a transitional arrangement until completion of the Transaction the parties intend to enter into a supply agreement whereby Dale Farm would provide Fane Valley with its fresh processed liquid milk requirements (since the pending acquisition coupled with staff redundancies could reduce Fane Valley's ability to produce this product).
 5. UDF will pay £[] following completion of the Transaction.

JURISDICTION

6. The Office of Fair Trading (OFT) considers that the assets being acquired constitute an enterprise for the purpose of the merger control provisions of the Enterprise Act 2002 (the Act). The Transaction includes the basic elements required for the Fane Valley fresh processed liquid milk business to continue and the staff involved will be subject to TUPE regulations.¹
7. As a result of the Transaction Dale Farm and the fresh processed liquid milk business of Fane Valley will cease to be distinct. The parties overlap in the supply of fresh processed liquid milk and the share of supply test in section 23 of the Act is met since together they supply more than 25 per cent of fresh processed liquid milk to 'middle ground customers' in a substantial part of the UK (that is, Northern Ireland). The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
8. The parties submitted the Transaction to the OFT on 2 November and the OFT's 40-day administrative deadline in this case is 4 January 2011.

MARKET DEFINITION

¹ The Transfer of Undertakings (Protection of Employment) Regulations 2006. OFT guidance says that the application of TUPE would be regarded as a strong factor in favour of a finding that the business transferred constitutes an enterprise ('Mergers: jurisdictional and procedural guidance', OFT527, June 2009, paragraph 3.10).

9. The Transaction involves an overlap in the supply of fresh processed liquid milk in Northern Ireland.

Product scope

10. Past cases have viewed fresh processed cows' milk as a separate product market from other types of milk.² Moreover, these cases also identified three distinct possible product markets in the supply of fresh processed liquid milk. That is, the supply to national multiple grocery retailers, the supply to doorstep customers and the supply to middle ground customers (those who are neither national multiple grocery retailers nor doorstep customers).
11. In this case the parties submitted that the product market should follow the findings of previous cases as set out above since they are not aware of any significant developments since these reports, or any Northern Ireland specific factors, which would cause the OFT to depart from them.
12. The OFT has restricted its analysis in the current case to the overlap activity of the supply of fresh processed cows' milk which, by excluding other types of milk, is also the most conservative basis for analysis.
13. Further, the parties do not overlap in the supply of fresh processed milk to national grocery multiples as defined by the Competition Commission (CC) in 2003; namely Asda, Marks & Spencer, Morrisons, Sainsbury's, Somerfield, Tesco and Waitrose.³
14. However, since 2003 there have been some notable changes in national grocery retailing. One is that Sainsbury's and Somerfield have been acquired by Morrisons and Co-operative Group (CGL) respectively. Indeed, by national share of supply CGL is now larger than both Marks & Spencer and Waitrose.⁴ Moreover, one of the key reasons why the CC listed these national retailers as being separate from other retailers is the importance that they attribute to their own label brand of milk.⁵ On this basis it is

² See, for example, Competition Commission, *Arla Foods amba and Express Dairies plc: a report on the proposed merger*, 24 September 2003 ('Arla/Express'); OFT, *Completed acquisition by Dairy Crest Group plc of the dairy business of East of England Cooperative Society Limited*, Case ME/3496/08, 19 March 2008 ('Dairy Crest/East of England'); and OFT, *Completed acquisition by Dairy Crest Group plc of the doorstep and depot based middle ground milk businesses of Arla Foods UK Plc*, Case ME/2622/06, 26 October 2006 ('Dairy Crest/Arla').

³ *Arla/Express*, paragraph 2.45.

⁴ Mintel International Group Limited, *'Food Retailing'*, November 2010, figure 20.

⁵ *Arla/Express*, paragraph 2.45.

arguable that CGL (and possibly others) should also now be included in the definition of national grocery retailers.

15. However, on the evidence submitted to the OFT whether some customers are allocated to the national grocery retailer category or the middle ground category makes no difference to the outcome of this case since even if all of Fane Valley's output were attributable to national grocery retailers its share in Northern Ireland would be small (around [0–10] per cent).
16. Therefore, while acknowledging that there may be some blurring of the boundaries between the national grocery retailers and middle ground customers categories for some retailers, and these two categories may indirectly to some extent constrain prices charged to doorstep customers (perhaps thereby blurring the boundaries between supply to doorstep customers and other customers), the OFT has examined this case on the basis of the supply of fresh processed cows' milk to middle ground customers and to doorstep customers separately.

Geographic scope

Middle ground customers

17. The middle ground category contains a variety of different types of customers with different purchasing behaviours. They range from small single store newsagents and petrol stations to smaller supermarket chains, and Education Board school milk contracts.
18. On the demand side, the different types of customer will have different characteristics and purchasing behaviours, and this may lead to different geographic frames of reference. For some customers, the geographic scope of the market may be quite broad, while for others, in particular, some smaller customers who require a small amount of milk to be delivered to a single site, the geographic scope could be local.
19. On the supply side, the OFT found in *Dairy Crest/East of England* that milk can be transported long distances from dairy to depot (in some cases up to 160 kilometres) and then further (30–50 kilometres) from depots to customers.⁶ The parties cite evidence in the OFT's *First Milk/Wiseman* case

⁶ *Dairy Crest/East of England*, paragraph 16.

to support a geographic market definition which is relatively broad.⁷ That is, the parties submitted that the appropriate geographic scope is no narrower than Northern Ireland and may even be the whole of the island of Ireland.

20. In investigating the geographic scope in this case almost all respondents to the OFT's questions said that they preferred to purchase milk from suppliers based in Northern Ireland. One customer said that it would purchase from suppliers located in the Republic of Ireland and/or Scotland following a small (around five to 10 per cent) increase in Northern Ireland milk prices.
21. In this case the OFT believes that the appropriate geographic scope will vary according to customer. However, comments and evidence received from third parties indicate that the appropriate frame of reference is likely to be at least the whole of Northern Ireland and possibly wider for larger customers. For the purposes of this investigation it is not necessary to define the geographic market precisely since the outcome of the competition assessment does not depend on this. The OFT has examined the Transaction on the basis of the whole of Northern Ireland only.

Doorstep customers

22. The parties submitted that the appropriate geographic market for doorstep customers is local, limited by individual delivery rounds. This is consistent with previous OFT and CC investigations.⁸
23. The OFT has been unable to identify any evidence as to why this approach is not appropriate in this case. Therefore, the OFT has examined the Transaction pertaining to doorstep customers on the basis of individual delivery rounds.

⁷ OFT, *Completed acquisition by First Milk Limited of a 15 per cent stake in Robert Wiseman Dairies plc*, Case ME/1459/04, 7 April 2005. In that case the OFT examined the supply of fresh processed milk on a Great Britain wide basis and on a Scotland only basis.

⁸ For example, *Arla/Express*; *Dairy Crest/East of England*; and *Dairy Crest/Arla*.

HORIZONTAL ISSUES

Middle ground customers

24. The parties submitted that they account for around [20–30] per cent of sales to middle ground customers in Northern Ireland (increment of [five–10] per cent). The parties estimated shares for themselves and their key competitors are in table 1.

Table 1 Estimated shares of supply of fresh processed milk to middle ground customers in Northern Ireland (2009, per cent)

Supplier	
Dale Farm	[15–25]
Fane Valley	[5–10]
Merged entity	[20–30]
Ballyrashane	[10–20]
Linwoods	[10–20]
Strathroy	[10–20]
Farmview	[5–10]
Grove Dairy	[5–10]
Draynes Dairy	[0–5]
Oakdene Dairy	[0–5]

Source: UDF.

25. The Transaction strengthens Dale Farm's position as the leading supplier of fresh processed milk in Northern Ireland. However, in order to demonstrate to the OFT that the parties are not especially close competitors they submitted bidding data from Dale Farm for the period since April 2008. These data show that the parties encountered each other only once in a bid (in that instance, neither party won the contract).⁹ They indicate that Dale

⁹ The bidding data submitted were not comprehensive. The parties submitted that [].

Farm's closest competitors are Strathroy and Farmview (and, to a smaller extent, Linwoods). [].

26. Customer responses to OFT questioning revealed that almost all customers are unconcerned about the Transaction. Customers considered that there would be sufficient choice and competition after the Transaction to prevent the merged entity from raising prices. Customers named Strathroy, Ballyrashane, Linwoods, Farmview and Really Good as their viable alternatives to the merger parties. Indeed, OFT market enquiries found that most middle ground customers source their milk requirements from multiple suppliers. One customer told the OFT that if the merged entity did raise prices it could feasibly source from mainland Britain (Wiseman Dairies or Arla, for example) or possibly from the Republic of Ireland.
27. Only one customer raised a concern about the Transaction. The customer was concerned that the Transaction reduces the number of suppliers of own label milk (not branded milk) from four to three, with the other two being Strathroy and Linwood. A customer in a similar position noted that any of the suppliers who currently supply large and middle ground customers can supply own label milk and thus the competitive assessment should not be undertaken for own label only.
28. The OFT has found some (albeit limited) evidence of spare capacity in the industry in Northern Ireland. Evidence submitted by the parties suggests that even if Dale Farm were to absorb all of Fane Valley's sales into its own production facilities it would have some (around [] per cent) spare capacity. Industry-wide spare capacity would counter any attempt by the merged entity to raise prices after the Transaction.
29. Overall, the OFT's investigation including evidence provided by third parties has found that sufficient choice and competition will remain after the Transaction (especially from Strathroy, Ballyrahsane, Linwoods and Farmview) to prevent a realistic prospect of a substantial lessening of competition on unilateral effects grounds arising as a result of the Transaction.

Doorstep customers

30. In *Arla/Express* the CC found that doorstep rounds were local monopolies and doorstep deliveries are more likely to be constrained (to the extent that they are constrained) by other sources of supply, such as retailers, than by

other suppliers of doorstep deliveries.¹⁰ The OFT found the same in *Dairy Crest/Arla* and in *Dairy Crest/East of England*.

31. The parties submitted that they are not aware of any examples of switching between suppliers of doorstep deliveries in Northern Ireland over the past five years. This corroborates the view that each local delivery area is its own local monopoly. Accordingly, the parties do not overlap on any doorstep delivery routes.
32. The parties are strongest in doorstep deliveries closer to their production facilities, albeit UDF has two territories further away from its production facilities. The OFT has examined whether the parties had adjacent doorstep runs and so could be characterised as being potential rivals. It found that Dale Farm's Portadown delivery area is adjacent to Fane Valley's Armagh delivery area. At their closest, there is around a 25-minute drive time between Dale Farm's Craigavon route and Fane Valley's Banbridge route. Internal documents showed that Fane Valley withdrew from four delivery routes in the Armagh area but Dale Farm did not enter these areas.
33. The OFT received no evidence during the current investigation to suggest that it should depart from the approach adopted in the previous cases quoted above (that is, that the most likely source of constraint is retailers rather than other suppliers of doorstep deliveries).
34. The OFT does not consider that a realistic prospect of a substantial lessening of competition in doorstep deliveries on unilateral effects grounds arises as a result of the Transaction.

COORDINATED EFFECTS

35. The OFT has received no evidence of pre-existing coordination in Northern Ireland in the supply of either fresh processed milk to middle ground customers or to doorstep delivery customers.
36. There are some aspects of the supply of milk in Northern Ireland that may make it conducive to coordination. For example, prices of raw milk are transparent;¹¹ the product is homogenous; and the market is mature with

¹⁰ Paragraph 2.64.

¹¹ UDF sells part of its milk pool via auction. The prices are publicly available. For example, here: www.dairyco.org.uk/datum/dairy-processing--trade/wholesale-prices/udf-auction-prices.aspx

demand and supply being relatively stable. The following factors, however, mitigate against this theory of harm.

37. With regard to middle ground customer sales, the increment to Dale Farm's market share is unlikely to be sufficient to tip the market towards coordination. Further, the OFT has received no evidence to suggest that Fane Valley is a maverick (that is, a supplier whose own profit-maximising incentives differ significantly from its rivals).
38. In terms of doorstep sales, coordination may not be externally sustainable given the possible competitive pressure from retailers. Sales to doorstep customers are declining, hence creating an incentive for suppliers to 'cheat' on a coordinated outcome.
39. Moreover, the parties' market shares are not symmetric with rivals' in any of the overlap markets. Symmetry is important in providing parties with the same incentives to maintain coordination rather than deviate from it and suffer similarly from retaliatory action.
40. The evidence in this case suggests that industry parties' incentives are not aligned and that coordination is unlikely to be externally sustainable.

THIRD PARTY VIEWS

41. The OFT received responses to its questionnaire from a reasonable number of customers and a small number of competitors.
42. Almost all third parties were unconcerned about the Transaction. One customer expressed concerns about the supply of own label milk. However, the evidence in this case indicates that the supply of own label milk is not a discrete segment and that after the Transaction other suppliers will remain to constrain the merged entity. The concerns have been addressed in this decision, above.

ASSESSMENT

43. The Transaction causes an overlap in the supply of fresh processed cows' milk to middle ground customers and doorstep customers in Northern Ireland.

44. For middle ground customers, the Transaction increases Dale Farm's share of supply by around [five–10] percentage points to [20–30] per cent. The OFT's investigation has found that a number of strong competitors will remain after the Transaction to act as a competitive constraint on the merged entity, in particular Strathroy, Ballyrashane Co-op, Linwoods and Farmview. The parties' internal documents support this view. Almost all customers are unconcerned about the Transaction.
45. For doorstep delivery customers, the Transaction does not materially change the pre-Transaction position. That is, each supplier of doorstep deliveries enjoys a local monopoly in their delivery areas which, to the extent there are any constraints, are more likely to be constrained by final consumers switching to buy milk from retailers than by switching to other suppliers of doorstep deliveries. The OFT has not received any evidence which shows that the parties to the Transaction competed against each other for doorstep deliveries before the Transaction.
46. Consequently, the OFT does not believe that it is or may be the case that the Transaction may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

47. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.