Anticipated acquisition of Illovo Sugar Limited by ABF Overseas Limited

The OFT's Decision on reference under section 33 given on 31 July 2006. Full text published 4 August 2006.

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

PARTIES

1. **ABF Overseas Limited (ABF Overseas)** is ultimately controlled by **Associated British Foods plc (ABF)**. ABF is the sole shareholder of **British Sugar**. British Sugar processes sugar beet to produce various different types of sugar which it sells to the retail and industrial channels.

2. **Illovo Sugar Limited (Illovo)** is a South African company that operates in all areas of sugar production from growing sugar cane to milling, refining, and packaging sugar. Its business is focused in the African continent, but it sells limited quantities of processed sugar and of cane raw sugar into the European Union (EU). Illovo's UK turnover in the financial year ending 31 March 2006 was [ ].

TRANSACTION

3. ABF Overseas announced on 19 May 2006 that it will acquire shares in Illovo entitling it to exercise 51 per cent of the voting rights in Illovo. British Sugar offered minority shareholder protection, which, inter alia, means that dealings between British Sugar and Illovo will be conducted on an arm's length commercial basis.

4. The OFT's administrative deadline for deciding whether to refer the merger to the Competition Commission is 1 August 2006.

JURISDICTION

5. As a result of this transaction ABF Overseas and Illovo will cease to be distinct. The parties overlap in the supply of granulated sugar in the UK. Although Illovo's sales to the UK represent [0-5 per cent] of the total market, British Sugar is a major supplier of granulated sugar with over 50 per cent of the sales to retail customers, and as a result the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. 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.

RELEVANT FRAME OF REFERENCE

Background

6. Some 88 per cent of the sugar produced in the EU is manufactured from beet grown within the EU. The remaining 12 per cent is produced by refining cane raw sugar, most of which is imported from countries belonging to the African, Caribbean and Pacific Sugar Group (ACP).[1] A small volume of cane raw sugar is also supplied from Brazil, Cuba and the Least Developed Countries (LDCs).[2]

7. British Sugar is currently the sole UK producer of sugar from beet. Tate and Lyle is the sole UK refiner of cane raw sugar. British Sugar and Tate and Lyle sell sugar directly to some end customers and through sugar merchants such as Napier Brown, Shepcote and Ragus. Sugar merchants are therefore both customers and competitors of the two UK sugar producers.

8. Illovo grows sugar cane in several African countries, including some LDCs. Its direct sales in the UK in the financial year ending in March 2006 were limited to the sale of approximately [confidential] tonnes of direct consumption sugar.[3] Its direct sales of direct consumption sugar to the EU are also very small ([confidential] tonnes in the year ending March 2006). It also sells a limited quantity of cane raw sugar to continental European processors for refining and onward sale.

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[1] The ACP Sugar Group is comprised of the eighteen African, Caribbean and Pacific countries signatories of the ACP/EU Sugar Protocol.

[2] LDCs are identified by the United Nations as such.

[3] Illovo sells part of its production through trading desks in Swaziland, Tanzania and Mozambique. Some of this sugar may then be sold in the EU, but Illovo submits it cannot determine to where that sugar is sold.

The Sugar Regime and forthcoming reforms

9. The supply of sugar is currently regulated by import quotas and tariffs under the Sugar Regime, which came into existence as part of the Common Agricultural Policy and is set to change according to the reforms adopted by the European Council in February 2006. The market will also be affected by the Everything But Arms (EBA) initiative, which grants duty free and quota free access into the EU market for all exports from the LDCs. The EBA initiative will be phased in over a period of time and by 1 July 2009 all sugar from the LDCs (and, it is anticipated, from the ACP countries as well) will have free access to the EU.

10. These changes are expected to move the EU from being the world's second largest sugar exporter to become one of the world's largest sugar importers and for domestic production to be reduced by 40 per cent.[4] They also mean that, from 2009, Tate and Lyle will no longer be the sole company entitled to refine cane raw sugar in the UK. This will allow British Sugar the opportunity to use its equipment to refine cane sugar during the beet off-crop season.

Product market

11. For the purposes of this decision, two levels of the supply chain are considered: first, the supply of direct consumption sugar; second, the supply of cane raw sugar used to make direct consumption sugar.

Direct consumption sugar

12. In previous cases,[5] the OFT and the Competition Commission (the CC) considered that there should be separate frames of reference for the supply of direct consumption sugar to industrial and to retail customers due to demand side substitutability issues. Although the OFT does not have any reason for deviating from that approach in this case, they are referred to jointly for practicality, because considering the impact of the merger on industrial and retail customers separately does not change in any manner the result of the assessment.

13. Sugar producers sell directly to industrial and retail end customers, as noted above. They also sell to sugar merchants, who also distribute sugar to the industrial and retail sectors. For the purposes of this decision, it is relevant to consider the supply of direct consumption sugar to sugar merchants separately

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[4] This is the European Commission's target.

[5] Competition Commission *A report on the acquisition by Napier Brown Foods plc of James Budgett Sugars Ltd* (March 2005); Office of Fair Trading *Anticipated Acquisition by British Sugar plc of the Billington Food Group Limited* (4 August 2004).

from the supply of direct customers. This is because, as discussed below, merchants may be able to source from a wider geographic area.

14. In this case, since no horizontal issues were raised and we did not receive any third party comments regarding horizontal concerns in relation to any particular type of sugar (e.g. white granulated, caster, etc), the OFT did not consider it necessary to split the analysis of sugar according to different sugar types.

15. In summary, in this case, the OFT considers the supply of direct consumption sugar to the retail segments and to the industrial segments (referred to jointly as the 'supply of direct consumption sugar') and the supply of direct consumption sugar to sugar merchants.

Cane raw sugar

16. In relation to the supply of raw material for production of sugar, British Sugar submits that cane raw sugar is a separate frame of reference from sugar beet. First, supply-side substitution is not possible because of different growing conditions and the fact that they are processed in different ways. Second, there is no demand-side substitutability from a cane raw sugar refiner's perspective as large scale investment would be required to start producing sugar from beet. However, beet processors could refine cane sugar with a relatively small scale investment in factory changes. The fact that beet processors could refine cane but cane refiners cannot refine beet suggests that there is an asymmetry in demand side substitution: cane raw sugar and beet could be substitutes for beet producers but not for cane producers.

17. Third parties suggested that British Sugar may be able to refine cane raw sugar beyond 2009, and that other beet refiners have similar plans, but it is likely that cane raw sugar will be used in addition to, rather than instead of, beet crop.

18. The OFT therefore considers that, at least at present, the supply of cane raw sugar is part of a different frame of reference than sugar beet. Because British Sugar does not supply cane raw sugar, the parties do not overlap in this segment and it is therefore not considered further under horizontal issues.

Geographic market

Direct consumption sugar

19. Previous decisions[6] have considered the direct consumption sugar market to be UK-wide, while recognising that regulatory changes affecting the EU sugar market may cause imports to be a stronger competitive constraint in the future.

20. British Sugar submitted bidding, import and price data which suggests it faces a significant degree of competition from European suppliers. The parties also submitted that the changes in the Sugar Regime will further increase competition from within the EU. Retail and industrial customers suggested that they mainly source from UK suppliers, using EU suppliers as a second source, and that they do not source from outside Europe at present. However, some sugar merchants source sugar on a world-wide basis.

21. The OFT therefore considers that the supply of direct consumption sugar to final customers is at present national (UK-wide) or EU-wide, but notes that it may widen to include ACP and LDC countries in the future. Sugar merchants may source from outside the EU even at present, and this frame of reference may therefore be global. On this basis the OFT considered the merger's impact both on the current frame of reference (which is national or EU-wide), but it has also taken into account the more speculative global frame of reference.

HORIZONTAL ISSUES

Direct consumption sugar

Industrial and retail customers

22. As the geographic scope of the supply of direct consumption sugar to end customers has been defined as national or European at its widest, the parties' activities do not overlap at present. This is supported by customers and by some of the competitors, who were unconcerned about the elimination of present competition between the parties. However, it is possible that LDC producers will compete with EU suppliers in the future.

23. Illovo's share of supply of direct consumption sugar from LDC countries is estimated to be around [20-30 per cent] (as estimated by British Sugar) to 35 per

[6] Competition Commission *A report on the acquisition by Napier Brown Foods plc of James Budgett Sugars Ltd* (March 2005); Office of Fair Trading *Anticipated Acquisition by British Sugar plc of the Billington Food Group Limited* (4 August 2004).

cent (as estimated by third parties). Nonetheless, a third party suggested that the current figures could understate Illovo's future importance and that it could, after 2009, account for 50 per cent of the total EU imports of direct consumption sugar. Another third party estimated that Illovo could represent as much as half the additional EBA sugar made available as a consequence of the regulatory changes affecting the EU sugar market. Third parties accept, however, that these estimates are highly speculative.

24. On the other hand, third parties submitted that additional volumes of sugar will be available from new suppliers and that there are strong incentives for other LDC countries to invest in sugar production.

25. All end customers contacted by the OFT believe that there are many other sources of LDC sugar on a global basis.

26. Moreover, even if Illovo's share of LDC supply increases, there will still be competition from ACP and, for refined sugars, from other European producers. European Commission's estimates suggest that LDC countries will account for only 14 per cent in 2009 (they account for only one per cent at present) of total imports into the EU. On the basis of these figures, even if Illovo were to be the largest LDC supplier (and this is by all accounts speculative), there are sufficient alternative suppliers to direct consumption sugar customers, such that even if the market were to become global, the merger will not result in a substantial lessening of competition.

27. We have no reason to believe that, were the market to be segmented on the basis of different sugar types, the situation would materially change.

28. No third party suggested that the merger may result in a lessening of competition to industrial and retail customers and the OFT does not have any evidence to believe that this is or may be the case.

Sugar merchants

29. Although the parties are currently competitors in the supply of direct consumption sugar to sugar merchants, on a global scale the acquisition of Illovo does not represent a significant increment to British Sugar's share of supply today and there is no evidence that will do so in the future. No third party raised horizontal concerns.

30. The OFT therefore does not believe that the merger will lead to a substantial lessening of competition in the supply of direct consumption sugar to sugar merchants.

VERTICAL ISSUES

Future foreclosure of access to refined sugar

31. One third party expressed concerns that the merger would reduce its access to supplies of direct consumption sugar. This is because it believes that Illovo would become an important player in future as it is better developed than the remaining LDC producers, and that it would be difficult to find other sources of produce at competitive prices. However, third parties identified a variety of alternative sources both in Europe and abroad, including several LDC countries, even though not all sources are as well developed as Illovo. In addition, these estimates about Illovo's future market position are highly speculative.

32. This third party's internal documents – which are particularly important in this case because of the speculative nature of the concerns - suggested that the third party would be inconvenienced, but not foreclosed, without access to Illovo. In addition, nothing in the documents presented by the merging parties to the OFT suggested that foreclosing competitors' access to refined sugar formed a rationale for the transaction.

33. In view of the notional nature of the concern, the presence of other ACP, European and (albeit less developed) LDC suppliers, the OFT does not have sufficient grounds to conclude that the merger may result in market foreclosure.

Future foreclosure of access to cane raw sugar

34. Another third party's concern was centred on the possibility that, after 2009, Illovo will only supply British Sugar with cane raw sugar during the beet off-crop, or, if it did supply rival sugar producers, it would drive up the market price as British Sugar will recapture some of the excess payment through its 51 per cent share holding in Illovo. While the concerned third party agreed supply would increase, it thought demand from processors would also.

35. The parties submitted that there are plenty of alternative sources of LDC sugar for refining, which is supported by Illovo's share of supply of LDC sugar (see paragraph 22 above) and by comments from a European manufacturer on this subject. In addition, sugar manufacturers already have and will continue to have access to preferential tariff cane raw sugar from a variety of sources including the ACP, Brazil and Cuba.

36. Again, nothing in the business documents presented to the OFT by the merging parties suggested future foreclosure of access to cane raw sugar formed a

rationale for the transaction or that such action would be in British Sugar's interest.

37. In view of the notional nature of the concern, the lack of evidence that it is a genuine concern or a motivation for the merger and the views of the other sugar manufacturer, and the presence of other ACP and (albeit less developed) LDC suppliers, the OFT does not have sufficient grounds to conclude that the merger will result in market foreclosure.

THIRD PARTY VIEWS

38. The parties' customers contacted by the OFT were not concerned about the merger. Although one customer did mention vertical concerns, it did not respond to invitations to expand on these. Competitors' concerns about vertical issues created by the merger have been dealt with above.

39. One third party that currently trades with Illovo was concerned that information passed to Illovo in the course of its previous trading relationship would be passed to British Sugar. However, the third party did not supply any evidence or internal documents that this is a genuine concern and nothing in the documents the parties presented to the OFT suggested this formed a rationale for the transaction. In addition, the parties stated that Illovo has no knowledge of operations in relation to that third party which either British Sugar would not already be aware of, or which Illovo anticipates British Sugar could in any way use to its advantage. Furthermore and in any event it is not clear that this constitutes a competition concern.

ASSESSMENT

40. The parties overlap in the supply of direct consumption sugar to sugar merchants. In the future, in absence of the merger, it is possible that the parties would also compete for the supply of direct consumption sugar to UK end customers in view of the regulatory changes affecting the EU sugar market.

41. The OFT does not believe that the merger will result in a substantial lessening of competition for a number of reasons. First, there are currently a number of alternative suppliers of direct consumption sugar to serve sugar merchants, and in the future many of these alternative suppliers – and possibly many more - will be competing for final customers and sugar merchants in the UK and the EU. Even though Illovo may be expected to be in a better position to take advantage of the increasing LDC quotas than other LDC players, this expectation is speculative. In addition, its current share of LDC direct consumption sugar supply is low, and its share on a global basis will be even lower.

42. Second, the vertical issues raised by third parties were largely notional. There was no evidence in internal documents or otherwise to suggest that the proposition that British Sugar could foreclose the access of other UK sugar producers and merchants to sugar supplies in such a way that they would not have a reasonable alternative supply source was more than fanciful.

43. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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