

Completed acquisition by First Milk Ltd of the majority of the retailer branded cheese operations of Dairy Crest Group plc

The OFT's decision on reference under section 22 given on 22 December 2006. Full text of decision published 12 January 2007.

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

PARTIES

1. **First Milk Ltd** (First Milk) is a farmer-owned cooperative that procures raw milk from its members, collects it and then delivers it to milk processors. FM is also active in the production of cheese, skimmed milk and butter through its subsidiaries [and certain businesses in which it has invested].¹ It also owns a 15 per cent stake in Robert Wiseman Dairies plc. Its UK turnover in the year to 31 March 2006 was £477 million.
2. **Dairy Crest Group plc** (Dairy Crest) is a chilled dairy food company. It has a wholly owned trading subsidiary, Dairy Crest Limited (DCL), which operates in two divisions: Foods and Dairies. The former includes spreads, cheese and fresh dairy products, whilst the latter includes liquid products, household products and ingredients. Dairy Crest's UK turnover in the year ending 31 March 2006 was approximately £1,330.9 million.

TRANSACTION

3. On 14 October 2006 the First Milk Cheese Company Ltd, a wholly-owned subsidiary of First Milk, acquired from DCL and Haverfordwest Cheese Limited (both wholly owned subsidiaries of Dairy Crest) certain cheese and

¹ FM owns a small cheese manufacturer, has [a 20 per cent stake in another cheese plant] and owns 40 per cent of a skimmed milk powder and butter plant.

dairy ingredients business and related assets that comprise the majority of the Dairy Crest's UK retailer branded cheese business² (the 'acquired business').

4. The parties notified the transaction on 3 November 2006. The administrative deadline is 3 January 2007 and the statutory deadline expires on 13 February 2007.
5. Ancillary restraints that are directly related and necessary to the implementation of the merger are excluded from scrutiny under the Competition Act 1998.³ The OFT's approach to ancillary restraints will generally follow the European Commission's Notice on restrictions directly related and necessary to concentrations⁴.
6. In order for restraints to be directly related, the restriction must be connected with the merger, but ancillary or subordinate to its main object. In addition, in determining their necessity to the implementation of the merger, account will be taken of whether the duration, subject matter and geographical field of operation of the restraint are proportionate to the overall requirements of the merger.⁵
7. In this case, the parties submitted that two of the agreements implementing the transaction contain restrictions on the parties' conduct but which the parties consider to be ancillary to the main purpose of the transaction.
8. []
9. []
10. Taking into account all the relevant factors - that the restrictions all directly relate to the separation of the acquired business from Dairy Crest's retained cheese business; the geographical scope is limited to the UK; and that the duration is limited - the OFT considers that the agreements are

² The business of the sale of cheese to retail customers based in the UK for sale under those customers' own brands. This cheese is also referred to as 'own-label' cheese.

³ Schedule 1 Competition Act 1998

⁴ European Commission Notice on restrictions directly related and necessary to concentrations, OJ [2005] C56/24.

⁵ OFT Mergers Substantive Guidance para 11.18

sufficiently necessary to the implementation of the merger to fall within the ancillary restraints exclusion.

JURISDICTION

11. As a result of the transaction First Milk and the acquired business have ceased to be distinct. The UK turnover of the acquired business exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

FRAME OF REFERENCE

12. The parties overlap in the supply of cheese, cheese packing, and whey products.
13. The supply of raw milk (for processing) has also been considered in our vertical analysis of the transaction.
14. There is minimal overlap between the parties in the supply of whey products and the parties account for less than [five] per cent of supply in the EU.⁶ Furthermore, there are a number of other competitors present in the sector. As a result, competition concerns are not considered to arise in this sector and therefore whey products will not be considered further.

Cheese

15. In previous cases⁷ the OFT considered the supply of cheese to be separate from the production and supply of other dairy products due to the specialised processes involved and high capital costs involved in setting up production. The OFT found no evidence in this case to suggest departing from this view.

⁶ Evidence was provided to show that whey products are generally traded on a pan-European basis.

⁷ OFT decision of 17 May 2004 on the completed joint venture between Milk Link Limited and Glanbia Foods Limited and; OFT decision of 3 December 2004 on the completed acquisition of Dairy Farmers of Britain Limited of Associated Cooperative Creameries Limited.

16. Cheese is sold for retail (as branded and as retailer own label products) and on a commodity basis for industrial uses (for example, in ready meals or other food production).
17. The parties submitted that retail and industrial/commodity cheese should not be considered separately because many UK cheese producers currently supply both and argued that there is supply-side substitutability between them. This view was supported by third parties, although they indicated that switching to branded cheese requires greater investment in branding, advertising and packing.
18. Although third party responses also indicated that there was less demand-side substitution due to the need to meet differing product standards, in this case, it has not been necessary to reach a definitive conclusion on the product scope of the frame of reference as no competition concerns are considered to arise regardless of whether the two types of cheese are examined together or separately.
19. In terms of the appropriate geographic scope of the frame of reference, in previous cases⁸ the OFT considers the supply of cheese to be at least EU-wide, if not global. This view is supported by data provided by the parties, which showed that imports into the UK make up more than half the total of net sales of cheese in the UK, the majority of which are from the EU.

Cheese packing

20. The parties argued that, although most cheese packing is done in-house by cheese producers, cheese packing should be considered separately from the production of cheese as cheese is typically transported in bulk form and then packed at plants near to the end customer.
21. On the supply-side, the parties argued that third party food packing facilities could easily switch to providing cheese packing facilities due to standardised packaging equipment used throughout the food industry. Whilst, on the demand-side, there are no substitutes for cheese packing. The vast majority of cheese needs to be packaged to be sold, whether in

⁸ OFT decision of 17 May 2004 on the completed joint venture between Milk Link Limited and Glanbia Foods Limited and;
OFT decision of 3 December 2004 on the completed acquisition of Dairy Farmers of Britain Limited of Associated Cooperative Creameries Limited.

bulk form for industrial/commodity customers or bespoke product specifications for retail customers.

22. Third parties indicated that the majority of UK-based cheese producers have their own packing facilities and they consider them to be an essential part of their ability to compete for retail customers. Responses from customers suggested that they do not buy cheese packing services separately from their cheese supply, although a relatively small volume of cheese packing services were available on the open market from cheese producers or food packing services providers who have spare capacity.
23. Based on the evidence available, there are good arguments that cheese packing could be considered as a subset of the wider food packing services. However, it is considered appropriate to take a cautious approach and adopt a narrower frame of reference for the purposes of the analysis in this case - the supply of cheese packing services.
24. The parties and third parties agreed that the geographic scope of the frame of reference for cheese packing is at least UK-wide as over 70 per cent of cheese consumed in the UK is packed in the UK.⁹

Raw Milk

25. The OFT has previously¹⁰ considered there to be a separate product scope of the frame of reference for raw cows' milk, given the lack of demand- or supply-side substitutability of other products for raw cows' milk. In addition, the OFT has previously concluded that the geographic scope for the supply of raw cows' milk is Great Britain.¹¹ The OFT found no evidence during its investigation to suggest a departure from this approach.

⁹ It is worth noting that the competition assessment would not materially differ if the geographic scope of the frame of reference was made wider.

¹⁰ OFT decision of 3 December 2004 on the completed acquisition of Dairy Farmers of Britain Limited of Associated Cooperative Creameries Limited and;
OFT decision of 3 May 2006 on the completed acquisition of Claymore Dairies Ltd of the milk business of Allarburn Farm Dairy Ltd.

¹¹ OFT decision of 3 December 2004 on the completed acquisition of Dairy Farmers of Britain Limited of Associated Cooperative Creameries Limited and;
OFT decision of 3 May 2006 on the completed acquisition of Claymore Dairies Ltd of the milk business of Allarburn Farm Dairy Ltd.

HORIZONTAL ISSUES

Cheese

26. Following the acquisition, First Milk accounts for less than [five] per cent of cheese supplied in the EU. It is also worth noting that Dairy Crest remains present in the sector, selling its own branded cheese (such as Cathedral City), so there is no reduction in the number of cheese suppliers as a result of the acquisition. A comparison of the pre- and post- transaction Herfindahl-Hirschman Indices (HHIs)¹² actually shows a decrease, indicating the acquisition may have resulted in a reduction in concentration. In addition, First Milk will continue to face constraint from numerous UK and European cheese suppliers.
27. Responses from large retailers stated that they source their cheese from at least two or three of the major cheese producers, supplemented by smaller regional producers, and which will continue to provide a sufficient constraint on the merged entity post-merger. This, combined with the fact that the acquired business produces only retailer branded (own label) cheese (so does not have any brand strength) means that it would be difficult for First Milk to profitably sustain an increase in prices.
28. Given these factors, the OFT considers that the acquisition does not give rise to competition concerns in respect of the supply of cheese.

Cheese packing

29. As a result of the acquisition, First Milk is the largest UK supplier of cheese packing with about a quarter of the supply. However, as indicated above, the effect of the transaction has been to transfer the share of supply accounted for by the acquired business from Dairy Crest to First Milk so both parties remain present in the sector post-acquisition. Similarly, HHIs suggest that concentration may have decreased as a result of the acquisition.
30. Most of the cheese producers who responded indicated that they had in-house cheese packing capabilities. For those who do not, third parties have

¹² This was calculated on a UK basis as insufficient data was available to estimate the change in HHIs on an EU basis.

confirmed that these services can be acquired either from existing cheese producers who have spare capacity or potentially from firms that supply general food packing services, and which will continue to provide a sufficient constraint on the merged entity post-merger. In particular, the parties argued that existing cheese producers can quickly expand their packing capabilities by working additional shifts or adding new packing lines at relatively low cost. Furthermore, no third parties raised any concerns regarding cheese packing services.

31. Overall, on the basis of the information available, the OFT considers that the acquisition does not give rise to any competition concerns in respect of the supply of cheese packing services.

VERTICAL ISSUES

32. The issue of foreclosure (the extent to which a supplier might withhold supply or worsen supply terms to a downstream competitor with a view to benefiting its own downstream operations) has been raised in a previous case in connection with the raw milk market¹³.
33. The parties argued that no vertical concerns arise as, apart from the continued supply of milk by certain Dairy Crest farmers, no additional volumes of raw milk have been acquired by First Milk as a result of the transaction.
34. [] The parties also considered that there is sufficient excess capacity in the market such that creameries have sufficient access to alternate supplies of milk if they considered themselves to be disadvantaged by First Milk.
35. One third party raised concerns that it currently purchases raw milk from First Milk and that with this acquisition First Milk has become a significant competitor in the supply of cheese. However it confirmed that it is [confident it will be] able to purchase raw milk from other sources.
36. Furthermore, there continues to be a number of alternative suppliers of raw milk post-acquisition (either other buying groups or direct supply from the dairies themselves) who would be expected to constrain First Milk's

¹³ OFT decision of 7 April 2005 on the completed acquisition by First Milk Ltd of a 15 per cent stake in Robert Wiseman.

behaviour, thus making any attempts at foreclosure difficult. On this basis, the acquisition is not considered to give rise to any competition concerns at the vertical level.

THIRD PARTY VIEWS

37. The vast majority of third parties were not concerned by this transaction. There were only two concerns raised regarding foreclosure and the reduction in supplier choice. However these concerns have been addressed above.
38. No concerns were raised in relation to cheese packing or whey products.

ASSESSMENT

39. The parties overlap in the supply of cheese, cheese packing and whey products. In relation to whey products the overlap between the parties is minimal and there are a number of other competitors present.
40. For both cheese and cheese packing services, the transaction has effectively transferred the share of supply accounted for by the acquired business from Dairy Crest to First Milk. As a result, both parties still remain present in these sectors post-acquisition. In addition, there continues to be a number of alternative suppliers for these products sufficient to constrain First Milk's behaviour post-acquisition.
41. One third party did raise concerns regarding First Milk's ability to potential foreclose the supply of raw milk following the acquisition. However, the transaction has a limited impact on the amount of raw milk procured by First Milk, and there are a number of alternative suppliers present in the sector.
42. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

43. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.