
Completed acquisition by First Milk Limited of a 15 per cent stake in Robert Wiseman Dairies PLC

The OFT's decision on reference under section 22 given on 7 April 2005. Full text of decision published 14 April 2005

Please note square brackets indicate information replaced by a range or excised at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **First Milk Limited (First Milk)** is a farmer-owned dairy cooperative with approximately 3,600 members. First Milk procures raw milk from its members, collects it and then delivers it to milk processors such as fresh milk dairies, cheese producers and food processing factories. First Milk itself also has a number of processing facilities, including a fresh milk dairy in Glasgow, owned by Scottish Milk Dairies Limited (SMD), a wholly-owned subsidiary of First Milk.
2. **Robert Wiseman Dairies PLC (Wiseman)** is a public company whose shares are listed on the London Stock Exchange. The company produces fresh milk at processing facilities in Aberdeen, Glasgow, Manchester and Droitwich. Wiseman sources raw milk directly from farmers as well as from First Milk. Wiseman's turnover in the last financial year was £474.5 million.

TRANSACTION

3. On 17 November 2004 First Milk acquired approximately 15 per cent of the issued share capital of Wiseman. First Milk also has the right to nominate one non-executive director to the Wiseman board.
4. The statutory deadline, as extended, expires on 15 April 2005.

JURISDICTION

5. First Milk has acquired a 15 per cent stake in Wiseman. Other major shareholders are institutional investors (collectively accounting for around 7.5 per cent of shares (see note 1)) and the Wiseman family (accounting for approximately 47 per cent of shares).¹ The First Milk board appointee will be the director with most experience of raw milk procurement, and it is expected that particular weight will be accorded to his views in relation to this activity (see note 2). First Milk and Wiseman have a continuing business relationship by way of a milk supply agreement; Wiseman currently accounts for approximately [10-20] per cent of First Milk's total raw milk sales.
6. According to First Milk, the transaction delivers a degree of vertical integration into the liquid milk market and sets the scene for a developing relationship to create an efficient supply chain. The parties could therefore become more closely involved in the future; it is appropriate to have due regard to this possibility.
7. Taken together, and in the circumstances of this case, the OFT considers that the factors outlined above indicate that First Milk may be able materially to influence Wiseman's policy and thus, as a result of this transaction it may be the case that First Milk and Wiseman have ceased to be distinct for the purpose of section 26(3) of the Enterprise Act 2002 (the Act).
8. The UK turnover of Wiseman exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

COMPETITIVE ASSESSMENT

9. The transaction may give First Milk the ability to materially influence the policy of Wiseman. The competition assessment in this case takes into account the maximum level of influence that could arise at this level.
10. The activities of the parties overlap in respect of the procurement of raw milk and the processing and supply of fresh milk. The effect of the transaction on competition in each of these areas is considered below. The parties do not overlap in the supply of raw milk, since all the raw milk procured by Wiseman is used in its own processing facilities.

Raw Milk

Product market

11. Raw milk is produced by dairy farmers and is then transported to be processed into either fresh milk or dairy products such as cheese, milk powder, etc. Milk processors procure milk either directly from individual dairy farmers (direct supply), or from cooperatives (such as First Milk) or quota holding groups that collect milk from farmers and transport it to processors.
12. On the demand side, fresh milk processors cannot substitute other products for raw cows' milk to produce fresh milk. On the supply side, switching from other farm activities to dairy farming is difficult and takes time since the latter requires specific plant, buildings, technical knowledge and land in an area with a suitable climate.² The appropriate frame of reference in this case is the procurement and supply of raw cows' milk.

Geographic market

13. In previous OFT decisions³, a 100 mile radius was considered, on average, to be a viable range for delivery of raw milk to processors and, as there are no clear geographic breaks, a chain of substitution is likely to operate across England, Scotland and Wales. The Competition Commission (CC) noted in the Scottish Milk Report⁴ that a considerable amount of trade in raw milk between Scotland and the rest of Great Britain occurred. Sufficient evidence was believed to exist to conclude that Scotland was part of a continuous chain of substitution linking it with the English sector.
14. The evidence gathered in the course of this inquiry was inconclusive on the question of whether or not there is a separate market for Scottish milk. Some customers contacted by us stated that consumers in Scotland do have a preference for Scottish milk; others indicated that the only (potential) barrier to sourcing milk from across the Scottish border is the cost of transport. The analysis below focuses on the region of overlap, therefore, there is no need to conclude on this point.

¹ Source: www.wiseman-dairies.co.uk.

² See OFT decision of 3 December 2004 on the completed acquisition by Dairy Farmers of Britain of Associated Cooperative Creameries and OFT decision of 26 February 2004 on the completed acquisition by Milk Link Limited, First Milk Limited and Dairy Farmers of Britain Limited of assets of United Milk Limited, namely the Westbury Milk processing plant.

³ See footnote 1.

⁴ Competition Commission report on the supply of fresh processed milk to middle-ground retailers in Scotland, December 2002, Cm 5002.

Horizontal issues

15. First Milk and Wiseman procure [10-20] per cent and [0-10] per cent respectively of raw milk purchased in Great Britain. In Scotland, First Milk procures [50-60] per cent of raw milk and Wiseman procures [20-30] per cent.⁵
16. As a cooperative, First Milk has undertaken to procure raw milk from its members. Since First Milk is owned by its members, it is therefore difficult to identify any incentives for First Milk to reduce the price it pays its members for raw milk, or to reduce the volume of milk that it takes from them. First Milk members contacted by the OFT – including First Milk members located in Scotland - stated that they did not expect that the price or volume of sales would be affected by the transaction. It is unlikely that, at the current level of influence, First Milk would be able to persuade Wiseman to reduce prices to the farmers who directly supply it, and in any case, such a strategy would lead merely to a displacement of direct suppliers from Wiseman to other processors; the effect on competition would be neutral.
17. Raw milk must be delivered to a processor within 24 hours, normally within a 100 mile radius. Therefore farmers are restricted by time and distance in accessing buyers for the raw milk they produce. In view of the high level of concentration, competition concerns could arise in Scotland if farmers were unable to supply raw milk to entities other than the parties (and if, due to market power downstream, lower raw milk prices were not passed on to consumers). However, there are a number of alternative outlets for raw milk in Scotland. These include Sorn, Milk Link, Claymore (a subsidiary of Arla), Graham's Dairies and numerous other smaller processors. The recent expansion by Arla into Scotland will also provide alternative supply opportunities for Scottish farmers. While some farmers contacted by us in this inquiry stated that they did not have alternative buyers for their milk, this was not as a result of the transaction, and generally farmers welcomed the transaction.
18. The possibility of foreclosure of supply of raw milk to Wiseman's competitors, including those in Scotland, is considered below.

Barriers to entry and expansion

19. Third parties contacted by us in this inquiry indicated that they could increase raw milk production but they are unlikely to do so currently because of low returns and excess capacity in the raw milk market. This also indicates that it is unlikely

⁵ Estimates for 2004; source: Dairy Industry Newsletter ('DIN') website and First Milk estimate.

that arable farmers would switch to dairy farming, assuming that soil and climatic conditions allowed them to do so.

Fresh Processed Milk

Product market

20. The parties submit that the appropriate frame of reference is the market for the supply of all types of fresh processed milk to all types of customers in Great Britain. On the demand side, there is little substitutability between fresh milk and other products. On the supply side, processor evidence suggests that it is not easy to switch production from other types of dairy products to fresh milk without considerable investment and time.

Segmentation by type of customer

21. In the Arla/Express Report⁶, the Competition Commission (CC) identified three different segments for liquid milk supply:
- national multiples (larger supermarket chains);
 - middle ground customers – all customers who are neither national multiples nor doorstep customers; and
 - doorstep customers.
22. The parties do not think that any distinction should be made in economic terms between the supply of milk to middle ground customers and national multiples. In the Arla/Express Report, the CC stated that there were competitive interactions between the sectors but, whilst some blurring of boundaries was acknowledged, the differing standards required by customers and the fact that a large volume of supply to the national multiples was at that time limited to the four largest processors, led the CC to conclude that it was worthwhile considering supply to national multiples and middle ground customers separately. National multiples and middle ground customers have different levels of buyer power, source their milk using different methods and have varying geographic arrangements. The supply to middle ground customers (the parties' area of customer overlap in fresh milk supply) will therefore be considered separately in this case.

Geographic market

23. The parties submit that the geographic market is as wide as Great Britain. This is due to the distances over which milk can be transported, which have increased in

⁶ Competition Commission report on the proposed merger between Arla Foods amba and Express Dairies plc, September 2003, Cm 5983.

recent years. The parties note that there are large overlaps between the areas supplied by rival companies, resulting in what they believe to be an unbroken chain of substitution operating throughout Great Britain.

24. In the Scottish Milk Report, the CC was split in its views on the relevant geographic market for the middle-ground segment.⁷ In coming to its conclusions, the CC looked at various factors, including the extent to which there have been price differences between Scotland and England, transport costs and consumer preferences. Furthermore, in the Arla/Express Report, the CC found that the geographic scope for the middle ground could be more regional in nature.
25. For the purpose of analysis in this case, we have considered the effect of the transaction in Great Britain as well as in the geographic area of overlap in Scotland.

Horizontal issues

Level of influence

26. In identifying any horizontal competition concerns which may result from this transaction, the first issue which arises is whether the level of influence brought about by this transaction is such as to create a single pricing unit. In this context, the relevant questions are whether the transaction creates a relationship that encourages a degree of common interest that leads to a different attitude by the parties to mutual competition and whether First Milk has the ability and incentive to influence Wiseman's pricing and/or output policy to the detriment of consumers.
27. As noted above, the transaction has two aspects: the board appointment and the acquisition of a 15 per cent stake. Each of these aspects is considered below. The raw milk supply agreement between First Milk and Wiseman predated the acquisition of shares. While it is relevant to the jurisdictional analysis, this aspect of the relationship between the parties is not dependant upon, or brought about by, the transaction; it is therefore not considered further.
28. In considering the effect of the appointment by First Milk of a non-executive director to the board of Wiseman, the following observations are relevant. Responsibility for setting prices and negotiating fresh milk supply contracts rests with the management and directors of Robert Wiseman & Sons Limited, the trading company within the Wiseman group. Some members of the Wiseman board have some involvement in price negotiations for major customer accounts in

⁷ Two members believed the market to be Scotland alone, two members were of the view that there was a single Great British market in the supply of fresh processed milk.

the context of their management roles, but the Wiseman board to which the First Milk representative is appointed is not involved in the setting of the price of fresh milk. It is therefore expected that the level and nature of board representation brought about by this transaction does not *per se* give First Milk the ability to directly influence the price and/or output of fresh milk charged by Wiseman to its customers.

29. However, representation on the Wiseman board will give First Milk an insight into the issues discussed at board level (and, possibly, also at management level) and this could contribute to the development of a shared view of the market and a mutual awareness of the benefits of developing a common strategy. However, it must be borne in mind that, although there is a limited horizontal overlap between the activities of the parties, First Milk and Wiseman are essentially in a vertical supply relationship and the alignment of interests and development of a common strategy is more difficult in such a situation than it would be if the parties only competed on a horizontal level.
30. Since Wiseman is a public limited company, information available to shareholders is in the public domain and the shareholding of 15 per cent does not give First Milk access to information that it would not otherwise have. In terms of decision making at general meetings, it is possible (although by no means certain) that First Milk would be able to exercise a degree of influence on Wiseman's market strategy that would affect competition, in particular if First Milk's stake in Wiseman increased.
31. Considering the incentives arising from the 15 per cent shareholding⁸, if First Milk was able to persuade Wiseman to increase its fresh milk prices (or limit its output) then First Milk would benefit from the price increase only in terms of the dividend payable by virtue of its 15 per cent shareholding, and to the extent that it could fulfil the requirements of any of Wiseman's customers that wished to divert to First Milk due to the price increase.⁹
32. Clearly, First Milk's ability to take price and output decisions in respect of its own fresh milk supply is not affected by the transaction. However, price coordination and/or customer allocation between the two parties may fall for consideration under the Competition Act 1998, with the consequent risk of financial penalties. This disincentive must be viewed in light of the returns to be expected from a coordination strategy which in turn are dependent on the competitive conditions in the sector.

⁸ Or any increment of this shareholding that falls within the category of control that amounts to 'material influence'.

⁹ Due to the limited volumes of fresh milk produced by First Milk, it would not be able to meet requirements of Wiseman's larger customers such as the national multiples.

33. It follows from the horizontal and vertical competition analyses below that potential returns resulting from a coordination strategy are not expected to be significant or sustainable due to the discipline provided by the presence of a substantial number of alternative suppliers to the middle ground, low barriers to switching and spare capacity in both raw milk and fresh milk.

Fresh milk supply in Great Britain

34. The parties overlap in the supply of fresh processed milk in Great Britain. Wiseman has a share of supply of approximately [10-20] per cent; the increment resulting from the transaction is around [0-10] per cent, attributable to First Milk's subsidiary, SMD.¹⁰ Competition concerns do not arise at this level.

Regional analysis

35. In Scotland, Wiseman supplies [70-80] per cent of fresh processed milk to all customers; the increment resulting from the transaction is around [0-10] per cent. In terms of customer segments, the parties overlap only in respect of supply to middle ground customers in Scotland.¹¹ Wiseman's share of supply in this segment is estimated by the parties to be around [50-60] per cent; the increment resulting from the transaction is around [0-10] per cent. After Wiseman, the largest suppliers are Graham's Dairies (around 16 per cent) and Arla Foods (around 9 per cent).¹²
36. In terms of the supply of fresh milk to all customers in Scotland, the parties' combined share of supply is high and, although the increment is small, the sector is concentrated. However, there are a number of factors which indicate that the fresh milk sector is nevertheless competitive and this transaction will not affect this.

Regional analysis - Alternative suppliers and spare capacity

37. The main geographical area of overlap is the Glasgow region. Wiseman has dairies at Bellshill and East Kilbride¹³, First Milk's site is at Hamilton. There are up to fifteen alternative processors in the fifty mile radius around Glasgow. Eight processors are located within an average of thirty road miles from the parties'

¹⁰ Annualised estimate September 2003; source: DIN website and Wiseman estimates.

¹¹ First Milk does not supply fresh milk to doorstep customers or the national multiples (ASDA, M&S, Safeway/Morrisons, Sainsbury's, Somerfield and Tesco); these customer segments are therefore not considered.

¹² Source: Wiseman estimates and Scottish Milk Report.

¹³ Wiseman also has a dairy in Aberdeen, but First Milk has no dairies in this area.

sites¹⁴, five of these are an average of fifteen road miles away from the parties' sites. While the volumes of fresh milk produced by some of these may be modest, the processors contacted by us in the course of this inquiry all indicated that they have no difficulties in sourcing raw milk in Scotland and that they could increase their fresh milk production in the event of an increase in price.¹⁵ In addition, Arla Foods UK has announced that it will open a processing plant at Lockerbie, Dumfriesshire. This plant will have a capacity of 150 mlpa and is expected to come on-stream this year. The parties also note, and most third parties agreed, that dairies located in Northern England¹⁶ can supply Scottish and/or English fresh processed milk to the middle ground in Scotland. The behaviour of the parties is therefore constrained by the presence of alternative suppliers that have spare capacity and the threat of expansion/entry.

Regional analysis - Customers' ability to switch

38. When selecting a fresh milk supplier, customers consider that price and service are important, as is the quality of milk. Switching is possible because usually there are no formal contracts and no penalties are incurred when a customer switches supplier. OFT analysis of switching data provided by the parties¹⁷ indicates that there is a significant level of switching: out of 487 First Milk customers, [...] switched to an alternative supplier in the past three years. Moreover, the evidence submitted by the parties indicates that [...]. Customers contacted by the OFT in this inquiry confirmed that they had a sufficient choice of alternative suppliers and were able to switch if they wished to do so.

Regional analysis - Buyer power and barriers to entry

39. A proportion of Wiseman's customers consists of the national multiples that possess a high degree of buyer power. This is bolstered by the lack of brand loyalty (as milk is sold under the supermarkets' own labels) and spare capacity in the sector.
40. Middle ground customers possess a degree of buyer power commensurate with their size, and the buyer power of the larger middle ground customers is likely to be similar to that of the national multiples. At the other end of the scale, small independent stores are unlikely to possess any buyer power. However, some of

¹⁴ These include: G Ballantyne, Bonaly, J. Steel, Renfrew, Yester Farm Dairies, Craig Dairy, Pollock, Quothquan, Mitchells and Graham's Dairies.

¹⁵ Processors contacted by the OFT in this inquiry estimated their spare capacity to be in the range of 25-40 per cent.

¹⁶ Arla in Newcastle and Associated Cooperative Creameries (now owned by Dairy Farmers of Britain) in Blaydon.

¹⁷ The switching data submitted by the parties related to the parties' middle ground customers in Scotland.

these may be members of buyer consortia which do have buyer power. The CC noted in the Arla/Express Report that the smaller middle ground customers have less buyer power, but they are more flexible in terms of being able to switch to small dairies, wholesale suppliers or cash & carry stores. Evidence gathered by the OFT in this inquiry supports this conclusion.

41. Compared to the national multiples, barriers to entry are lower in respect of supply to the middle ground. The parties estimate that the cost of establishing a new depot capable of supplying 20m litres per annum to middle ground customers would be about £500,000. As noted above, it is also possible for the smaller processors to expand.

Regional analysis - Third party views

42. DEFRA confirmed the view put forward by the parties that there is spare capacity in the Scottish milk sector and the existence of sufficient alternative sources of supply in the geographic area of overlap was confirmed by the customers of the parties who responded to our inquiries. With one exception, customers and competitors of the parties were unconcerned, as was the Scottish Executive (SEERAD).

Regional analysis - Conclusion

43. Middle ground customers in Scotland, in particular in the Glasgow region where the activities of the parties overlap, can and do switch to the alternative processors. The existence of this competitive fringe, together with the possibility of processors deploying spare capacity, mean that competition concerns do not arise in this segment.

VERTICAL ISSUES

44. The transaction does not constitute a full vertical merger. As noted above, the transaction does increase the momentum for cooperation between the parties. Cooperation could take the form of attempts to foreclose other processors, either through price increases in raw milk (raising rivals' costs) or through the withholding of raw milk supplies. In the assessment of such a strategy, the ability and incentives of the parties to implement it, in light of the characteristics of the market, must be considered.
45. In order to dampen competition downstream, First Milk (and Wiseman) could, theoretically, decide to divert all of First Milk's raw milk to Wiseman and cut supplies to other processors. In the absence of changes on the supply and demand side, this strategy would not be viable because First Milk supplies more

than 50 processors and dairies and procures volumes of raw milk far in excess of Wiseman's requirements. Currently, approximately [10-20] per cent of First Milk's raw milk sales are to Wiseman; if it supplied all of Wiseman's requirements this could rise to around [40-50] per cent. First Milk's internal processing requirements (fresh milk and other dairy products) take up approximately [10-20] per cent of its raw milk. This would leave [20-30] per cent of First Milk's raw milk unsold.¹⁸ A foreclosure strategy would therefore depend on First Milk being able to sell this raw milk at increased prices.¹⁹

46. As indicated above, processors contacted by us in this inquiry indicated that they have no problems obtaining (increased quantities of) Scottish raw milk. First Milk exports around [0-10] per cent of its raw milk supplies from Scotland and DEFRA notes that there is over supply in the Scottish raw milk market. In addition, direct suppliers to Wiseman would be displaced and their output would be available to other processors. Third parties in Scotland contacted by the OFT noted that raw milk production could be increased if it were profitable to do so, e.g. in the event of a price increase (or output reduction) by First Milk. Coupled with the ability of farmers to increase direct supplies to processors, this would effectively prevent the parties from implementing a foreclosure strategy.
47. Processed fresh milk accounts for approximately 54 per cent of raw milk usage and the processing of raw milk into fresh milk (as opposed to dairy products such as cheese, milk powder, butter, etc.) commands a premium. Therefore any Scottish raw milk currently destined (by direct supply) for production of dairy products could be diverted to the production of milk. Similarly, processors who produce both dairy products and fresh milk could divert supplies of raw milk away from the production of dairy products to increase fresh milk supply.
48. DEFRA also notes that reliance on one supplier would not be in Wiseman's best interest; the level of control resulting from this transaction is not sufficient to cause it to act to its detriment.
49. These factors indicate that the parties do not have the ability or the incentive to engage in a foreclosure strategy which discriminates against other fresh milk processors. This analysis was confirmed by third parties contacted by us in this inquiry. With one exception, processors who responded stated that the transaction would not affect their raw milk supplies and that they would be able to increase their fresh milk output if it were profitable to do so. DEFRA confirmed

¹⁸ As a cooperative, First Milk has obligations towards its members to take certain volumes of raw milk from them.

¹⁹ It is unlikely, in our view, that it would be possible to increase the price of fresh milk to a level at which it would become profitable to destroy raw milk.

that a large number of alternative suppliers of raw milk exist which would prevent the successful implementation of a foreclosure strategy.

50. The parties' shares of supply in the GB market as a whole are not such as to make a GB-wide foreclosure strategy possible.

COORDINATED EFFECTS

51. A number of characteristics of the dairy sector could lead to collusion in the industry at processor level, and there have been various regulatory investigations into the supply of fresh milk. Considering supply to middle ground customers, the Arla/Express Report found that coordinated effects were less likely to arise due to the diverse range of customers, the large number of dairies capable of supplying them, low barriers to entry and the higher degree of price differentiation. The OFT investigation in this case found that middle ground customers are a diverse group and that there are a significant number of alternative processors in the Glasgow region. Evidence indicates that these processors do act as a competitive constraint on the parties and that they may be able to disrupt coordination, in particular in view of spare capacity at this level.
52. In rare cases, vertical integration may facilitate collusion. Increased transparency in the price of inputs between vertically integrated firms may make it easier to monitor the prices charged by rivals at the upstream level. However, this transaction does not lead to an increase in price transparency and processors do possess some buyer power and have the option of switching to alternative (direct) suppliers.
53. It is concluded that this transaction does not increase the likelihood of collusion in the sector.

THIRD PARTY VIEWS

54. We contacted a number of First Milk members, customers of First Milk and Wiseman (including, a number of middle ground customers in Scotland), as well as competitors of the parties (including competitors based in Scotland). None of the respondents were concerned, with the exception of one competitor/customer. The concerns of this party have been addressed in the competitive assessment. In the course of this inquiry we also obtained the views of SEERAD, DEFRA and OFT sectoral branches; none of these raised any concerns.

ASSESSMENT

55. The analysis and evidence gathered in the context of this inquiry indicate that the level of influence resulting from this transaction does not result unambiguously in the creation of a pricing unit. Although the transaction creates a relationship between the parties that could encourage mutual awareness and alignment of interests capable of affecting competition, the characteristics of the markets are such that this transaction does not create the incentive and ability for the parties to increase the price of fresh milk to the detriment of consumers, or to prevent farmers from selling raw milk to alternative buyers, should they wish to do so.
56. In respect of raw milk procurement in Great Britain, the parties' combined share of supply is unproblematic. The combined share of supply in Scotland is high and the increment is significant. However, suppliers are unconcerned and cooperative members expect that benefits will arise from the transaction in terms of supply chain efficiencies. In the circumstances of this case a downstream foreclosure strategy would not be viable. This is supported by evidence from customers who are generally not concerned.
57. In relation to the supply of fresh processed milk, the combined share of supply in Great Britain is unproblematic and the increment is low. The combined share of supply in Scotland is higher but the increment is still low. However, any concerns arising from the level of concentration are mitigated by the fact that, in the region of overlap, sufficient alternative sources of supply exist, in particular for middle ground customers, and that barriers to switching for these customers are low. In addition there is considerable excess capacity, barriers to expansion are low and larger customers (the national multiples and larger middle ground customers), who do not have as wide a range of alternative suppliers to whom they could switch, have considerable buyer power.
58. Given the history of investigations into coordination at processor level, due attention was given to the possibility that the transaction could increase the likelihood of coordination, but our conclusion is that this acquisition of a minority stake does not facilitate collusion on the wider market.
59. 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

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

Note 1: The parties note that institutional investors account for approximately 35 per cent of shares.

Note 2: The parties submit that there is no formal requirement for the director appointed by First Milk to have raw milk expertise; the First Milk director has not yet been appointed.