

Completed acquisition by Dairy Crest Group plc of the dairy business of Midlands Cooperative Society Limited

The OFT's decision on reference under section 22 given on 8 September 2005. Full text of decision published 16 September 2005.

Square brackets indicate information removed or replaced for confidentiality reasons at the parties' or third parties' request.

PARTIES

1. **Dairy Crest Group PLC (Dairy Crest)** produces milk, cream, cheese, dairy spreads and other dairy products for supply to customers located mainly in Southern England and Wales.
2. **Midlands Cooperative Society Limited (MCS)** is active, inter alia, in the production of milk and cream at its dairy in Birmingham and the distribution and sale of these products to customers located mainly in the Midlands. In the financial year ended 22 January 2005, the UK turnover of MCS's dairy business was around £88.9 million.

TRANSACTION

3. On 16 May 2005 Dairy Crest acquired the dairy business and assets of MCS. MCS has retained its food and non-food stores and its other businesses. The statutory deadline in this case expires on 15 September 2005.

JURISDICTION

4. As a result of this transaction Dairy Crest and the dairy business of MCS have ceased to be distinct. The UK turnover of MCS's dairy 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.

RELEVANT MARKET

5. The parties overlap in the purchasing of raw milk and the processing and supply of fresh processed milk and cream.

Product market

Raw milk

6. Raw milk is produced by individual dairy farmers and is processed into either fresh milk or other dairy products at milk processing facilities. Milk processors may procure milk directly from individual dairy farmers or from cooperatives that collect milk from farmers under contract and transport it to the milk processors.
7. On the demand side, milk processors cannot substitute other products for raw cows' milk for the vast majority of their products. On the supply side, while some dairy farmers may be able to increase milk production, they are unlikely to do so currently because of low returns and excess capacity in the market. Switching from other farm activities to dairy farming is likely to be difficult and take time since the latter requires specific plant, buildings, technical knowledge and land in an area with a suitable climate. In line with previous OFT¹ and Competition Commission (CC)² merger decisions in this sector, it is concluded that raw milk cows' milk constitutes a distinct product market.

Fresh processed milk

8. The CC concluded in the Arla/Express Report that fresh pasteurised non-flavoured cows' milk (i.e. fresh processed milk) represented a distinct product. On the demand side, there was found to be little substitution with other products, while on the supply side, evidence from processors suggested that it was not easy to switch into the production of fresh processed milk from the production of other dairy products. This is in line with evidence obtained in more recent OFT merger investigations in the sector. Fresh processed milk is therefore considered to be a distinct product market.
9. The Arla/Express Report also notes that the supply of fresh processed milk can be split into three distribution channels:
 - supply to national multiples;
 - supply to middle ground customers (i.e. all customers who are neither national multiples nor doorstep customers); and
 - doorstep customers.

¹ See for example OFT decision of 7 April 2005 on the completed acquisition by First Milk Limited of a 15 per cent stake in Robert Wiseman Dairies PLC (ME/1459/04).

10. The Arla/Express Report states that different categories of customers require different standards, have variable levels of buyer power, varying geographic arrangements and different milk sourcing methods. Although it is expected that some blurring occurs between the different categories, the differentiation by distribution channel is appropriate and is in line with the approach adopted in previous OFT merger decisions in the sector.

Cream

11. Cream is milk with a substantial fat content.³ It is a by-product of the production of semi-skimmed and skimmed milk. Cream is supplied in bulk for export and for use by food manufacturers. Non-bulk cream is supplied in pots (potted cream) for retail sale or in larger containers (e.g. polybottles, palecons, etc.) for the food service sector. There appear to be significant barriers to switching quickly and easily from bulk to non-bulk cream due to the need to invest in packaging capacity and associated infrastructure.⁴
12. On the demand side, several types of cream and cream substitutes can be identified. However, fresh cream can be distinguished by taste, use and shelf-life from UHT cream, sterilised cream, frozen cream and non-dairy (synthetic) cream.
13. Similar to fresh processed milk, the market for non-bulk cream could be segmented according to distribution channel (e.g. national multiples, middle ground and doorstep). In the context of this inquiry it has not been necessary to conclude on this point.

Geographic market

Raw milk

14. Raw milk needs to be transported to the processor within 24 hours. A 100 mile radius is considered, on average, to be a viable delivery range for raw milk to processors and, as there are no clear geographic breaks, a chain of substitution within England, Scotland and Wales is considered to operate in Great Britain. In this case, it has not been necessary to conclude on the geographic scope for raw milk supply; alternative supply options for farmers within the region of overlap have been considered (see below).

Fresh processed milk

15. The parties overlap in the supply of fresh processed milk to middle ground customers. This is not a homogeneous group, with customers in this category ranging from individual stores to medium sized retail chains. As such, the geographic scope will vary

² Competition Commission report on the proposed merger of Arla Foods amba and Express Dairies plc of 15 October 2003 (Cm 5983).

³ Single cream has a milk fat content of between 18 per cent to 30 per cent, while double cream contains up to 40 per cent milk fat.

⁴ See Case No. COMP/M.3130 Arla Foods/Express Dairies, 10 June 2003.

between customers. In the Arla/Express Report, the CC found that the geographic scope for the middle ground could be regional rather than national in nature. In line with previous OFT merger decisions in this sector⁵, consideration has also been given to the competitive situation in the narrower geographic areas of the Midlands and East of England, where the parties both supply middle ground customers, as well as the effect of the transaction in Great Britain.

16. Doorstep customers are supplied by local delivery rounds from depots. As no competition concerns arise in the supply of fresh processed milk to this customer category, it has not been necessary to reach a conclusion as to the geographic scope of doorstep deliveries.

Cream

17. The UK is a net exporter of cream; most cream is exported in bulk to continental Europe. There are also some imports of cream.⁶ Dairy Crest dispatches its cream with other dairy products (such as cheese and dairy spreads) over a distance of up to 684km, whilst MCS has a target distribution range of 150km.
18. Third parties contacted by the OFT in this inquiry were predominantly customers of non-bulk cream; they had mixed views as to the geographic scope of the market. Some larger customers who responded said they would consider importing non-bulk cream following a 5-10 per cent increase in prices. However, it is considered that for smaller customers, the market is national and may even be regional.
19. In the context of this merger it has not been necessary to conclude on the geographic scope of the market; we have considered the effect of the merger on both an EU-wide and national basis.

HORIZONTAL ISSUES

Supply of fresh processed milk

20. The parties have a combined share of supply of around [20-30] per cent of the overall fresh processed milk market in Great Britain, with an increment of approximately [0-10] per cent.⁷
21. The parties do not overlap in supply to the national multiples, so this customer category is not considered.

⁵ OFT decision of 7 April 2005 on the completed acquisition by First Milk Limited of a 15 per cent stake in Robert Wiseman Dairies PLC (ME/1459/04).

⁶ Source: DEFRA.

⁷ Source: the parties.

Middle ground customers

22. The parties' estimated combined share of the supply of fresh processed milk to middle ground customers in Great Britain is around [20-30] per cent (increment [0-10] per cent).⁸ Data supplied to the OFT in the context of other recent mergers in the sector indicates that a number of alternative suppliers, with significant shares of supply, are present in this segment; these include Arla, Dairy Farmers of Britain and Robert Wiseman Dairies.
23. Moreover, according to the parties as well as third parties contacted by us in this case, Dairy Crest and MCS were not close competitors in either fresh processed milk or cream before the merger.
24. The geographic areas where the parties overlap are the Midlands and the East of England. MCS's processing facility is located in Birmingham and prior to the merger Dairy Crest was a (potential) supplier to the region from its dairies at Starcross (41 miles from MCS at Birmingham), Severnside (64miles) and Fenstanton (86 miles).
25. Two middle ground customers contacted by us stated that they have in the past obtained quotes from both parties. However, switching data supplied by the parties indicates that in the past two years the parties have not won/lost customers from/to each other. This data also shows that Dairy Crest has in the recent past lost business to Arla and Wiseman, while MCS has gained and/or lost business from Arla, Taylors and Dairy Farmers of Britain.
26. There are four other major dairies in the area which supply milk and cream. These are Wiseman at Droitwich (approximately 22 miles from MCS), Dairy Farmers of Britain at Fole (43 miles) and Arla at Ashby (30 miles) and Nottingham (50 miles). Golden Vale, Kirby & West and Medina also supply the Midlands and East of England, according to the parties. Customers have suggested that Cotteswold, Longslow and Milk Link are alternative suppliers, in addition to a number of smaller processors in the Midlands and East of England.
27. All customers that responded have stated that it is straightforward to switch supplier and that switching would be considered following a price increase of 5-10 per cent.⁹ Competitors reported spare capacity of between 10 per cent and 30 per cent, which could easily be deployed following an increase in demand.
28. We conclude that the transaction does not give rise to competition concerns in the supply of fresh processed milk to the middle ground.

⁸ Source: the parties and DEFRA.

⁹ One customer noted that negotiations can be costly, but that switching would be considered.

Supply of fresh processed milk to doorstep customers

29. Most doorstep rounds operate as local monopolies and competition between them is very limited. Of Dairy Crest's [1500-2000] doorstep rounds and MCS's [0-500] rounds, there are [10-20] overlaps; these are in the Oxford and Farringdon areas, where both companies deliver to the same road. As noted in the Arla/Express Report, it appears that the competitive constraint comes from customers switching to obtaining milk from supermarkets, rather than from other doorstep deliveries. DEFRA estimates indicate that doorstep sales now account for only 15 per cent of household milk purchases (down from 45 per cent in 1995) as a result of customers switching to supermarkets for their milk. We conclude that the transaction does not give rise to competition concerns in the supply of fresh milk to doorstep customers due to the limited overlap and the competitive constraint exercised by supermarkets.

Supply of cream

30. Both parties supply bulk cream as well as non-bulk cream. The parties' combined share of the supply in the European market for cream is below [0-10] per cent. Their combined share of the national market for non-bulk cream is around [10-20] per cent.¹⁰ These shares of supply are not such as to raise competition concerns.

Barriers to entry and expansion

31. It has not been necessary to reach a conclusion on the likelihood of new entry, as the transaction does not raise competition concerns. Barriers to expansion are low, as processors have identified spare capacity which could easily be deployed.

Buyer power

32. While middle ground customers are not likely to possess the same degree of buyer power as the national multiples, The Arla/Express Report noted that this was not likely to cause concern as most middle ground customers had a greater number of immediate supply options than the national multiples. This has been confirmed in this investigation.

COORDINATED EFFECTS

33. A number of characteristics of the dairy industry could lead to coordinated effects at processor level. However, in considering supply to middle ground customers, the Arla/Express Report noted that the diverse range of customers, the large number of processors capable of supplying them and the high degree of price differentiation indicates that this segment is less conducive to coordinated behaviour.¹¹ This

¹⁰ Source: OFT estimates based on volume data supplied by the parties.

¹¹ In the Arla/Express Report, the CC considered new entry (particularly in respect of supply to the middle ground) to be a constraint; this investigation has not uncovered strong evidence of likely new entry.

investigation has also found that middle ground customers are a diverse group and that a number of alternative processors exist in the geographic area of overlap. These alternative processors would have the incentive and ability to disrupt any coordination in the supply of fresh processed milk to the middle ground. In addition, third parties have not raised the issue as an actual or potential concern. We therefore conclude that coordinated effects are not expected to arise as a result of this merger.

VERTICAL ISSUES

Raw milk procurement

34. Dairy Crest submits that there is little geographic overlap between their existing raw milk suppliers and those of MCS. The MCS field is north of Dairy Crest's Stanton Harcourt collection area and between those of Severnside and Fenstanton.
35. All MCS raw milk suppliers have been offered the opportunity to transfer to Dairy Crest supply contracts and Dairy Crest expects that most will do so. DEFRA has indicated that dairy farmers will still have a number of alternative customers for raw milk following the transaction. The parties have suggested that these include Arla, Milk Direct, Dairy Farmers of Britain and Wiseman. After the merger the parties' combined share of raw milk procurement will be around [20-30] per cent in Great Britain, with an increment of around [0-10] per cent.¹²
36. None of the processors contacted by us in this inquiry expressed the view that their access to raw milk supplies would be affected by the transaction. Therefore competition concerns do not arise in this area.

Dairy Crest to supply MCS retail outlets

37. Dairy Crest has entered into an agreement to supply MCS retail outlets. A foreclosure strategy aimed at MCS's rival retail stores is unlikely to be successful because a number of alternative suppliers of fresh milk and cream (who have spare capacity) are available to retailers in the Midlands.

THIRD PARTY VIEWS

38. The third parties (customers and competitors) contacted by the OFT in this case were generally unconcerned, although one customer raised some concern about the consolidation of smaller dairies; the customer did, however, identify a number of alternative suppliers in the region. DEFRA expressed the view that the merger would not result in a significant lessening of competition.

¹² Source: parties' estimates.

ASSESSMENT

39. The main area of overlap between the activities of Dairy Crest and MCS is the supply of fresh processed milk to middle ground and doorstep customers. The combined share of supply in respect of middle ground customers is not such as to raise competition concerns. Moreover, middle ground fresh milk customers contacted by us in this inquiry have indicated that there are a number of alternative dairies in the geographic area of overlap to which they could easily switch following a price increase. The overlap in the doorstep segment is limited, and a strong competitive constraint is expected to come from supermarket sales.
40. Dairy Crest and MCS both also supply bulk and non-bulk cream; the combined shares of supply do not raise competition concerns.
41. In the procurement of raw milk, the increment resulting from the transaction is small and the geographic areas in which the parties obtain raw milk are adjacent rather than overlapping. This indicates that the merger will not adversely affect dairy farmers in terms of the number of buyers for their milk.
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.