Completed acquisition by Napier Brown Foods plc of James Budgett Sugars ltd

The OFT's decision on reference under section 22 given on 12 October 2004

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

PARTIES

1. **Napier Brown Foods plc (NBF)** was established in July 2003 to acquire the Napier Brown group of companies – **Napier Brown & Company Limited (Napier Brown)**, Garrett Ingredients Limited (Garrett) and Sefcol Ingredients Limited (Sefcol). The business of NBF is focussed on the supply of sugar, value added sugar and nut products, and dairy powders and associated food products.

2. **Napier Brown** is the largest sugar merchant in the UK. It supplies a range of sugar to customers throughout the industrial, retail and catering sectors of the food industry.

3. **James Budgett Sugars Ltd (Budgett)** is the second largest sugar merchant in the UK. Its principal activity is the supply of sugar to industrial users. Budgett's UK turnover for the year ended 31 October 2003 was £119.1 million.

TRANSACTION

4. On 7 July 2004, NBF acquired 100 per cent of the share capital of Budgett from ED&F Man Holdings Limited and Greencore Group plc.

5. The parties notified the transaction on 16 July 2004. The administrative deadline is 13 October 2004.

JURISDICTION

6. As a result of this transaction NBF and Budgett have ceased to be distinct. The UK turnover of Budgett 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 FRAME OF REFERENCE

Product scope

Types of sugar

7. There are a number of different types of sugar, the principal categories being: white granulated, bulk liquid and speciality sugar. Napier Brown submits that these different types of sugar are effectively the same basic product at different stages of the production process and therefore, do not constitute separate and distinct markets from the basic product.

8. The focus of this analysis is white granulated sugar, since this forms the vast majority of sugar sold in the UK and supplied by the parties in this case.[1]

Industrial and retail

9. Sugar is a commodity product which is supplied to two distinct categories of customers:

   - manufacturers of food products containing sugar (e.g., cakes, biscuits, confectionery, soft drinks) who mainly purchase in bulk tankers and in 25kg-50kg bags (the industrial sector); and
   - supermarkets, other retail outlets and food service companies who purchase sugar principally in 500g, 1kg and 5kg bags (the retail sector).

   While Napier Brown is active in both sectors, Budgett supplies industrial users only.

10. The industrial and retail sectors have been recognised in several previous decisions as the appropriate frames of reference for competition analysis in the supply of sugar.[2] The evidence in this case suggests the same.

---

[1] In the OFT's decision of 4 August 2004 with respect to the anticipated acquisition by British Sugar plc of Billington Food Group plc, the OFT took each different type of sugar as a starting point for its analysis since Billingtons' business is mainly based on the various types of specialty sugar.

[2] See, for example, Case No. IV/30.178 Napier Brown-British Sugar (OJ L 284 19/10/1988 p.41-59) and Case No. IV/34.621, 35.059/F-3 Irish Sugar (OJ L 258 22/09/1997 p.1-34).

Other natural sweeteners

11. Napier Brown submits that demand for sugar has been impacted by manufacturers' increased use of substitutes such as glucose. While this is so, the evidence is that where it is technically or economically feasible for manufacturers to switch from sugar to non-sugar substitutes (particularly glucose), such substitution has already taken place and further substitution is not expected. The OFT considers that other natural sweeteners do not form part of the relevant frame of reference for this analysis.

Geographic scope

12. Previous decisions of UK and EC competition authorities have found that sugar markets in the EU tend to be defined by national boundaries due to the operation of the quota system under the EU Sugar Regime. Although there is no compelling reason to adopt a different approach in this case, the strength of the competitive constraint posed by imports is considered in greater detail below.

Conclusion

13. In light of the above, the most appropriate point to begin an assessment of the competitive effects of this merger (i.e., the relevant frame of reference) is the supply of sugar to industrial users in the UK.[3]

HORIZONTAL ISSUES

The supply of sugar to industrial users

14. In the year to April 2004, around 1.6 million tonnes of sugar was supplied to the industrial sector with an estimated value of £800 million to £1 billion per annum. The main customers are food and drink manufacturers.

15. The supply of sugar to industrial users involves not only the sourcing of sugar but also delivery according to the customer's specific requirements. Hence the supplier will usually arrange haulage and will sometimes have equipment on site so that the new deliveries are automatically triggered at the manufacturing plant when a certain level is reached. For most manufacturers, constant and guaranteed delivery of sugar is a crucial concern to ensure that their manufacturing operations are not interrupted.

[3] The only part of the UK where conditions of supply are somewhat different is Northern Ireland where the majority of sugar is supplied from the Republic of Ireland by Irish Sugar.

The suppliers

16. The supply of sugar to industrial users is principally carried out by the two vertically integrated producers and wholesalers, British Sugar and Tate & Lyle. Other suppliers active at the wholesale level include sugar merchants, small wholesalers and importers.

17. Traditionally, sugar merchants operated in two ways: as 'true' merchants, purchasing sugar from producers and then re-selling it on their own account, or as 'nominal' merchants, processing orders and invoicing customers on behalf of British Sugar or Tate & Lyle. Over the last 20 years, 'nominal' merchanting has declined substantially and almost all of the merchants' business today is as 'true' merchants.

18. In recent times, there have been three significant sugar merchants in the UK: Napier Brown, Budgett and Billingtons.[4] Napier Brown is the largest of the three merchants and while it predominantly supplies sugar to industrial users it also supplies sugar under the Whitworth brand to retail customers. Budgett supplies sugar to industrial users only. Billingtons mainly supplies speciality sugars to the retail sector.

Shares of supply

19. Shares of supply to industrial users in the UK by volume for the year to April 2004 are set out in Table 1 below.

[4] Billingtons was recently acquired by British Sugar. The OFT decided not to refer this acquisition to the Competition Commission on 4 August 2004.

Table 1: Shares of supply to industrial users in the UK by volume for the year to April 2004

Supplier	**Share of supply (per cent)**
British Sugar	38 per cent
Tate & Lyle	27 per cent
Napier Brown	16 per cent
James Budgett	12 per cent
Imports	6 per cent
Billingtons	1 per cent
Total	**100 per cent**
Pre-merger HHI	2607
HHI increment resulting from the merger	375

Source : OFT analysis of data provided in the anticipated acquisition by British Sugar plc of Billington Food Group plc.

Notes: These are the most recent data available to the OFT. Napier Brown provided shares of supply for the year to June 2003 which estimated their share of supply at 14.5 per cent and Budgett's at 9.8 per cent. This does not materially affect the competition assessment.

20. The HHI index indicates a highly concentrated sector pre-merger, and the HHI increment resulting from the merger provides an initial indicator of potential competition concerns.

21. Napier Brown submits that the [ ] of sugar supplied by Budgett as a nominal merchant on behalf of British Sugar and Tate & Lyle should be excluded from its share of supply. If such an exclusion is made, Budgett's share of supply decreases from 12 per cent to around [less than 10 per cent]. As explained below, this does not materially affect the competition assessment.

Non-coordinated effects

22. Napier Brown submits that this merger cannot be expected to have any competitive effects, first, because changes to the EU Sugar Regime will allow for renewed competition and, second, because the merged entity will in any event face strong post-merger competition. These two arguments are considered below.

The EU Sugar Regime

23. The supply of sugar in the UK is subject to the controls established by the EU Sugar Regime and, as a result, is a highly regulated sector with defined price

parameters. Nevertheless, previous decisions of UK and EC competition authorities have recognised that within these parameters, there remains a residual field of competition.[5] The evidence received in this case is consistent with continued competition within the parameters of the regime.

24. Napier Brown notes the European Commission has published options for potential changes to the regime as from 2006.[6] It argues that the effect of these changes would be to open up the EU market to much greater competition by reducing the gap which currently exists between the support price for EU sugar and the world price.

25. The OFT considers that the proposed changes to the EU Sugar Regime are not sufficiently certain or clear-cut in effect to affect significantly the competition assessment in this case.

Competitive constraints

Bidding market

26. Napier Brown submits that the supply of sugar to industrial users is a bidding market with customer specific prices[7] and therefore, price competition is more intensive than in a uniform per unit priced market.

27. The evidence suggests that competition in this sector is mainly driven by price. The two merchants attempt to compete against the producers' prices by having more efficient and cheaper distribution operations. The fact that supply contracts to industrial customers are usually short term indicates that price competition does exist and is an expected feature of the negotiation process. Furthermore, many customers use more than one supplier and are prepared to change their supplier mix on a regular basis.

Closest competitors

28. Napier Brown submitted bidding data on annual contracts for the business year 2004 (i.e., contracts negotiated in November/December 2003), arguing that (a) its main competitors are British Sugar and Tate & Lyle and a range of wholesalers, but not Budgett, and (b) most customers seek, on average, three bids only and

---

[5] See, for example, Case No. IV/33708 IV/33709 IV/33710 IV/33711 British Sugar (OJ L 76 22/03/1999) and the Monopolies and Mergers Commission report 'Tate & Lyle plc and British Sugar plc. A report on the proposed merger' (Cmd 1435, 1991).
[6] The EC published its reform proposals on 17 July 2004.
[7] Contracts are typically negotiated with industrial customers individually each year in November and December.

therefore there is little competitive interaction between Napier Brown and Budgett, especially for smaller industrial users.

29. The OFT considers that there are a number of problems with this analysis. First, both merchants are part of the choice set of suppliers available to buyers, irrespective of whether they are invited to tender. Second, the bidding data referred to above clearly show that the parties compete; for example, it indicates that the parties compete over [ ] of the time for customers over 1500 tonnes per annum. Third, the data are based on Napier Brown customers only and therefore may not be a statistically reliable sample. Fourth, it is unclear whether the data actually show that customers generally seek three bids only, or whether they generally only receive three bids in response to their tenders. Finally, the data are contradicted by third party views, which are outlined below.

Customer base

30. More generally, Napier Brown has submitted that, in line with its analysis of bidding data above, merchants tend not to sell to the largest industrial users who purchase direct from the producers. In relation to small industrial users, Napier Brown claims that merchants compete with wholesalers and re-sellers such as bakers' sundriesmen who are able to supply sugar on very competitive terms as part of a wider range of products. The evidence in this case is not entirely consistent with Napier Brown's submissions.

31. Some substantial industrial customers perceive the parties as competing with each other, as well as with British Sugar and Tate & Lyle. These customers point to an ability to switch between these suppliers and fear that this ability will be reduced by the merger. The practice of sourcing sugar from several different suppliers is widespread and is used as a means to enhance customers' negotiating position with suppliers as well as ensuring continuity of supply. Third party responses indicated that some customers look to appoint a primary supplier (which will be either British Sugar or Tate & Lyle) and also have a secondary supplier (which will be either Napier Brown or Budgett, or sometimes both, depending upon the type of sugar required).

32. As regards small and medium-sized industrial customers, there is evidence to suggest that they view Napier Brown and Budgett as their principal suppliers. The strength of competition from the UK producers and importers appears to be limited in this segment of the business, since the order sizes from the smaller customers are insufficient for the producers and importers to supply directly. Hence, a key element of competition at this level of the distribution chain appears to be the rivalry between Napier Brown and Budgett. Moreover, the fact that customers seek to spread their sugar purchases over a number of suppliers to maintain as

much downward pressure on prices as possible suggests that further concentration in the market could enable the merged entity to raise prices as customers lose the ability to play off the parties against each other.

33. It is notable that most of the wholesalers and re-sellers who compete with the merchants in the small to medium part of the sector actually source their sugar from the parties, thus replicating the supplier/competitor relationship which exists at the producer/merchant level.

The position of British Sugar and Tate & Lyle

34. British Sugar holds the entire UK beet sugar quota and has long been identified as the price leader in the supply of sugar in the UK.[8] Tate & Lyle holds the entire UK cane sugar quota. For the year to April 2004, the two producers' combined share of supply to the industrial sector was around 65 per cent. The two producers supply most of the merchants' sugar and then also compete with them for contracts to supply industrial customers.

35. In this context, Napier Brown submits that the merchants are clearly constrained as to the prices they can charge – they cannot sell at a lower price than they have paid for sugar; and if they sell at too high a price, customers will buy direct from the producers or will import. Consequently, Napier Brown argues that the merchants have no ability to increase prices above the prevailing market price, (effectively the 'import parity price' – discussed further below) and this position will not change as a result of the merger.

36. It is conceivable that merchants, being largely dependent on the producers for sugar, would provide limited price competition against the two producers. The OFT observes, however, that not only does this ignore competition between the parties – as the two principal merchants – but also that customers routinely seek bids from the merchants alongside the producers, presumably because they believe it is in their interests to do so (i.e., they will benefit from lower prices). It does not follow that where regulatory barriers limit the scope for competition, existing competition could not be substantially lessened by a merger that eliminates one of only four significant suppliers.

Imports

37. Napier Brown submits that imports represent a strong competitive constraint on the price of sugar in the UK, despite the fact that they only represent around 6 per

[8] See, for example, Case No. IV/33708 IV/33709 IV/33710 IV/33711 British Sugar (OJ L 76 22/03/1999) and the Monopolies and Mergers Commission report 'Tate & Lyle plc and British Sugar plc. A report on the proposed merger' (Cmd 1435, 1991).

cent of sugar supplied (for the year to April 2004). As Napier Brown rightly points out, the fact that imports are not high does not necessarily mean that they do not pose a competitive constraint. Rather, the threat of imports might act as an effective price ceiling on domestic prices. In this connection, Napier Brown claims that continental suppliers regularly compete for customers in the UK but that British Sugar is able to react to this competition by adjusting its price to a point just below that at which imports would be incentivised (the 'import parity price'), thus holding off an influx of imported supply.

38. In British Sugar,[9] the European Commission stated that there appears to be a 'structural limit' on imports due to a number of factors:

    (a) transport costs for imports;
    (b) the price leadership of British Sugar which enables it to price at a level to deter imports;
    (c) the need for security of supply and just-in-time delivery for many industrial users of sugar; and
    (d) absent a high price differential between the UK and other EU markets, the low propensity to export sugar to the UK due to fear of retaliation.

39. The evidence in the current case indicates that the Commission's analysis is still relevant today.

40. Napier Brown argues that the opening of the Channel Tunnel has changed the economics of transporting sugar from other EU member states, making sugar produced in northern Europe (particularly northern France) easily accessible to the UK, and so increasing the competitive threat of imports. This view was not supported by third parties.

41. There is uncertainty around the ability of the import parity price to act as a constraint on Napier Brown's pricing behaviour. [ ]

42. Some larger UK manufacturers have imported some of their sugar requirement but most of those contacted by the OFT source the overwhelming majority of their sugar from the UK producers. The merchants themselves have imported very little sugar despite the fact that they have the logistical capability to source significant volumes from overseas.

---

[9] Case No. IV/33708 IV/33709 IV/33710 IV/33711 British Sugar (OJ L 76 22/03/1999), para 63.

Barriers to entry

43. Market entry as a vertically integrated supplier is not feasible due to the fact that sugar production quotas can only be granted to undertakings in existence when the UK acceded to the EU.

44. Entry barriers for a potential merchant are lower and not prohibitive. Fixed costs, as for many commodity trading businesses, are low. Nevertheless there has been no significant market entry in the last fifteen years. Indeed the trend has been in the other direction: the 1980s witnessed the last period of consolidation when Budgett purchased two independent merchants, and more recently, British Sugar acquired Billingtons.

45. Lack of market entry might be explained by the existence of several less obvious barriers to entry. First, experience of the sugar market and the ability to understand and negotiate prices with the two refiners might be crucial to successful market entry. [ ] Second, large customers may be unwilling to risk sourcing from a new entrant without an established reputation given the importance of guaranteed, just-in-time delivery. Finally, the position of British Sugar and Tate & Lyle and their reputation for aggressive marketing (if required) might have deterred entry.

46. The history of the sugar sector, its unusual structure, the fact that it is a low margin business for merchants and the lack of certainty over changes to the EU Sugar Regime suggest that significant market entry is not expected to occur. Indeed, Napier Brown does not cite market entry as a significant competitive constraint.

Buyer power

47. Napier Brown submits that major manufacturers are increasingly purchasing sugar on a pan-European basis and centralising their manufacturing facilities. It also notes that food manufacturers face substantial pressure from the major supermarkets to keep their prices as low as possible and this feeds through to the suppliers, including sugar suppliers.

48. The evidence in this case suggests that the buyer power of industrial sugar customers is weak. While the bidding nature of the market should foster keener price competition than if uniform prices existed, and it is relatively easy to switch supplier, industrial users have a limited ability to affect materially the market price or the terms of delivery.[10] This lack of negotiating power is illustrated by the fact

[10] Several large industrial users stated that they could not get quotes for factory gate prices and therefore, were unable to use their own haulage contractors.

that contract prices are adjusted every two weeks to take account of the impact of fluctuations in the euro/£ exchange rate on the support price under the EU Sugar Regime.

49. Industrial buyers have limited opportunity to impose any additional costs on sugar suppliers (such as non purchase of other goods) as a means of generating buyer power. For the reasons discussed earlier, sourcing of large scale imports is difficult and also does not allow industrial users to generate buyer power. In fact, if any buyer power exists it is dependent on the ability to switch between the various UK suppliers. Several third parties were concerned that the merger diminishes their negotiating leverage by reducing the number of possible suppliers from four to three.

Efficiencies

Cost savings

50. Napier Brown submits that it needs to reduce its costs and increase its efficiency to maintain its position in the market. It identifies two potential areas for efficiency gains:

    (a) indirect cost savings from reduced overheads; and
    (b) direct cost savings via purchasing sugar from the UK producers on better terms [ ]

51. Napier Brown estimated that the merger would generate up to [ ] in annual indirect cost savings but did not provide a breakdown of these savings.

52. The evidence on direct cost savings has been contradictory throughout the OFT's investigation. [ ]

53. The OFT considers that the merger could deliver some customer benefits as a result of economies of scale available to the enlarged merchant. However, what is less clear is whether the loss of the only competing merchant will lead Napier Brown to retain those cost savings rather than pass them on.

Third force

54. Napier Brown submits that the merged entity will be better placed to provide a competitive third force to the two UK producers, and to take advantage of the opportunities which will be available when the EU sugar sector is opened up to more competition. Several third parties also raised this point.

55. The merchants' ability to remain competitive in the market is based on several key factors:

    (a) the ability to operate more efficiently than the two UK producers' supply operations;
    (b) the ability to obtain alternative supplies via imports; and
    (c) the ability to negotiate low prices from the two refiners.

56. The first factor has been discussed above. In short, some cost savings could be generated through reduced overheads and may enable the enlarged merchant to compete more effectively with the two refiners.

57. The second factor has also been discussed earlier. Various structural factors mean that merchants have a limited ability to import sugar to satisfy volume requirements.

58. The most compelling argument supporting the pro-competitive benefits of a third force in the supply of sugar is the combined merchants' enhanced capability to negotiate lower prices from the two refiners. It is arguable that sugar customers might benefit from the increased buyer power of a larger merchant.

59. However, it is not clear that scale will necessarily deliver lower costs to an enlarged merchant. Such a result assumes that British Sugar and Tate & Lyle actively compete on price for the account and that their respective supply prices to an enlarged merchant would fall accordingly. The evidence on this is unclear.

60. An enlarged merchant might be able to obtain a larger volume of imports from European suppliers at better prices and use these to supply its customer base. If the enlarged merchant can deliver a significant share of the UK market, European producers might be prepared to risk retaliation from UK refiners. Again, there is no supporting evidence at this stage.

61. Overall, while the OFT does see some merit in the concept of a third force, it does not have sufficient evidence for such an argument to counter the competition concerns identified earlier.

Financial status of Budgett

62. Napier Brown submits that, in current trading conditions, the merger is required to ensure that at least one independent merchant remains in the market.

63. Both merchants have lost market share (in terms of volume) over the last [ ], but not to such an extent that it has threatened their existence. In fact, Budgett

reported a profit before tax of £4.3 million for the year to October 2003 (up from £3.8 million for the previous twelve months). Napier Brown was willing to pay around £17 million for the business.

64. Napier Brown has not provided any convincing evidence that Budgett is a declining business. While it is true that Budgett was not a growth business there is no compelling evidence that it is a failing firm or that its competitive significance was declining.

Coordinated effects

65. The European Commission has found the four principal suppliers of sugar to industrial users in the UK to have engaged in collusive behaviour in violation of Article 81 EC Treaty.[11] Indeed, several factors suggest this sector may be susceptible to collusion. As discussed, sugar competition has only price as a significant variable, although reaching terms of coordination may be complicated by the bidding nature of competition. Agreeing a common bidding price may not be a prerequisite for coordination, however, selective bidding for contracts based on the volume requirements of the customer is also a conceivable additional or alternative mechanism. Moreover, bidding competition between the three suppliers could be less intense than it was pre-merger as the two producers will supply the one remaining merchant, all of whom stand to benefit from higher prices and are largely protected from import competition. The producers, at least, may have the ability to punish deviation by the merged entity as a result of its dependence on their sugar.

66. In this case, the OFT has not been provided with any substantiated evidence that the merger has resulted in any collusive behaviour. In these circumstances, the OFT has insufficient basis to conclude that the merger may create or increase incentives for coordinated behaviour by reducing the number of players to the two producers and one merchant.

VERTICAL ISSUES

67. The position of the vertically integrated producers in the supply of sugar to industrial users has been discussed previously.

68. No express concerns about the vertical effects of this merger have been raised with the OFT. Any such concerns relating to possible foreclosure of downstream wholesalers would be dependent on the creation of market power at the merchant level and so depend on the same reasoning as that set out above.

THIRD PARTY VIEWS

69. Third party views in relation to the merger were mixed. Most seemed to consider that the UK sugar sector lacked effective competition and their responses tended to be framed in that light.

70. A number of customers were, nevertheless, concerned that the merger would reduce competition and choice, while others felt that the merger could be pro-competitive through the creation of an enlarged merchant as a third force. Several competitors considered that the merger would reduce competition, particularly in the supply of sugar to small and medium industrial users.

71. A number of third parties stated that competition would be improved by the proposed changes to the EU Sugar Regime without substantiating this further.

ASSESSMENT

72. The supply of sugar to industrial users in the UK is subject to the controls established by the EU Sugar Regime and is principally carried out by the vertically integrated producers, British Sugar and Tate & Lyle. Their most significant competitors are the two remaining independent sugar merchants, Napier Brown and Budgett.

73. Given the structure of the sector, it is arguable that the merchants only provide limited price competition for the two producers. However, the evidence in this case suggests that the merchants do represent a competitive constraint on each other as well as the producers. Larger industrial users actively use the merchants to generate some leverage against the two UK producers. Small and medium industrial users see the merchants as their main sources of supply.

74. The evidence also indicates that constraints on the four major UK sugar suppliers are weak. The extent of imports as a competitive threat is not clear, [ ]. The threat of entry and buyer power are not competitive constraints in this sector.

75. It is arguable that the merger will lead to a 'third force' in the supply of sugar to industrial users, by creating an enlarged merchant that is better placed to compete with the two producers. The merger might create cost savings in overheads for the merged entity. More importantly the enlarged merchant might be able to generate cost savings as a result of the larger volumes it supplies. Such economies of scale are crucial in a commodity business.

---

[11] Case No. IV/33708 IV/33709 IV/33710 IV/33711 British Sugar (OJ L 76 22/03/1999).

76. While the third force argument is plausible, the OFT has not been provided with sufficient reliable or consistent information to counter the competition concerns identified above. It is also unclear to what extent any savings will be passed on to customers.

77. In light of the above, the OFT believes that it may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition in the supply of sugar to industrial users in the United Kingdom.

UNDERTAKINGS IN LIEU

78. Napier Brown considered the scope for providing undertakings in lieu of reference, were that to be the outcome, but concluded that it was not possible to structure an appropriate and proportional undertaking.

DECISION

79. This merger will therefore **be referred** to the Competition Commission under section 22(1) of the Act.