

## Completed joint venture between Milk Link Limited and Glanbia Foods Limited

The OFT's decision on reference under section 22 given on 17 May 2004

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### PARTIES

**Milk Link Limited (Milk Link)** is a farmers cooperative active mainly in the south west of England. It is primarily active in the procurement, collection and supply of raw milk but also conducts some milk processing. In 2002 Milk Link's UK turnover was £267 million.

**Glanbia plc (Glanbia)** is an international dairy, consumer foods and nutritional products company based primarily in Ireland, UK and the USA. In 2002 Glanbia's worldwide turnover was €2,316.7 million. Its subsidiaries include:

- **Glanbia Foods Limited (GFL)**, which produces cheese at four creameries, located at Lockerbie, Taw Valley, Melton Mowbray and Malpas.
- **Glanbia Cheese Limited (GCL)**, which is a joint venture between Glanbia and the mozzarella business of Leprino Foods; and
- **Glanbia Milk Limited (GML)**, which is an intermediate holding company that procures and supplies milk to meet Glanbia's production requirements, e.g. for GFL and GCL.

### TRANSACTION

On 21 February 2004 Milk Link and Glanbia entered into a joint venture agreement for the manufacturing, packing and distribution of cheese. The statutory deadline is 20 June 2004 and the administrative timetable expires 25 May 2004. The joint venture company, The Cheese Company Holdings Limited ('Newco') is owned 75 per cent by Milk Link and 25 per cent by Glanbia. Newco has acquired the entire issued stock of GFL from Glanbia.

The transaction was also assessed by the Irish Competition Authority and cleared on 23 March 2004.

There are some ancillary restraints which directly relate to the implementation of the joint venture. These include:

- *Non-compete clause* - a three year non-compete clause in the manufacture, production, packaging or distribution or sale of cheddar cheese, English, Welsh or Scottish territorial cheese and/or Stilton cheeses between the joint venture and the parent companies.
- *Cheese Supply agreement* - a minimum annual order volume for cheddar cheese from Glanbia Ingredients Ireland (GII) for 4 years.
- *Cheese Cross-supply agreement*
- *Business Asset agreement* - Milk Link acquired the trade and assets of GML that relate to GFL.
- *Marketing agency agreement /ingredients agency agreement.*
- *IT support agreement and shared services agreement.*

The OFT generally follows the European Commission's Notice on ancillary restraints, which provides that restrictions that are 'directly related and necessary' are justified by the legitimate objective sought of implementing the concentration. In particular, restrictions to competition should be of limited duration. The Commission Notice indicates that restrictions are acceptable for up to five years. The ancillary restraints agreed by the parties are within these time limits. The agreements largely reflect existing trade patterns and merely formalise the previous informal intra-group relationship. Therefore, the restrictions are directly related and necessary in order to implement the merger.

## **JURISDICTION**

As result of the transaction Milk Link and GFL have ceased to be distinct. GFL's turnover 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 a relevant merger situation has been created.

## **RELEVANT MARKET**

Farming cooperatives, such as Milk Link, procure raw milk from their members, collect it and transport it to processors. Cooperative members generally receive a lower milk price per litre than direct milk suppliers to processors. However, they receive an additional annual payment (called the 13<sup>th</sup> payment) from their cooperative, dependent on the profits made over the course of the year. Farmers receive an average price across all regional areas. Dairy farmers that supply direct to processors are generally contracted to supply all of the milk they produce to one processor.

Processors, such as GFL, convert raw milk into dairy products such as liquid milk, butter, cheese, cheese by-products, cream and yoghurt. These products are sold to customers such as retail multiples as well as food processors.

The parties therefore overlap in the:

- **Procurement of raw milk.** There are two main purchases of raw milk within the UK: farming cooperatives and processors. Milk Link, as a farming cooperative, is a bulk buyer of raw milk and in 2002 procured approximately 1560 million litres per annum (mlpa) (approximately 11.1 per cent of the GB market). GML, as a processor, in 2002 procured 700 mlpa of raw milk to meet all of Glanbia's production requirements i.e. the requirements of GFL and GCL.
- **Supply of raw milk.** Milk Link is a bulk reseller of raw milk for its farmers whilst GFL is only active in a small amount of milk trading. GFL traded a less than 1 per cent of turnover of milk and only when unable to utilise all the milk supply purchased from GML. Due to small quantities of milk traded no competition concerns with respect to the supply of raw milk arise.
- **Supply of milk products.** Milk Link and Glanbia overlap in the production and supply of cheese, butter, by-products and bulk cream.

GFL is only active in a small amount of milk trading. Therefore, the supply of raw milk is not considered further.

## **Product market**

### *Milk Procurement*

Raw milk is a unique product and, as such, there are very few demand-side substitutes. Dairies and other milk processors can not substitute other products for raw cows' milk for the vast majority of their products.

On the supply side, switching into the production of raw milk is difficult. Dairy farming requires very specific buildings, equipment and knowledge on the part of the farmer.

### *Milk Products*

The parties overlap in the production and supply of cheese, butter, by-products and cream and for such products there appears to be limited demand side substitutability.

On the supply side, raw milk can be converted into a range of products, e.g. liquid milk, UHT, butter, cheese, cheese by-products, cream and yoghurt. Switching production between different milk products is difficult and converting production processes is likely to take in excess of a year. Due to the specialised production process and high capital cost of converting into different milk products, the areas of overlap i.e. cheese, butter, by-products and bulk cream will be considered under separate frames of references.

## **Geographic market**

### *Milk Procurement*

Raw milk needs to be delivered within 24 hours and a large proportion is delivered within 12 hours which suggests that there is both a regional and national dimension to milk supply. Low volumes of milk supply can make transport over large distances unviable. However, delivery can be extended if a number of independent farmers transport together, similarly to what a cooperative such as Milk Link achieves. Cooperatives will transport milk over significant distances of up to 250 miles which would tend to suggest the chain of supply might be GB-wide.

### *Milk Products*

The frames of reference for cheese, butter, bulk cream and by-products are considered to be at least EU wide if not global. These products are far less perishable than milk and are regularly traded across national borders. For cheese, UK producers compete with suppliers from New Zealand, Canada, Ireland and Australia. Transport costs appear to be low in relation to production costs.

## **HORIZONTAL ISSUES**

### *Milk Procurement*

GML procures milk for GFL and GCL, and Milk Link has acquired the parts and distribution business of GML that relate to GFL. Under the milk supply agreement Milk Link will be the exclusive supplier to the joint venture. In addition, it has entered into a three year exclusive supply agreement with GCL.

GFL has four processing plants, Melton Mowbray, Lockerbie, Malpas and Taw Valley. Post transaction the existing supply would change little. Milk Link has no members producing in the three counties that are possible suppliers to the Melton Mowbray plant; therefore it is unable to supply the GFL processing plant. For Lockerbie, even though Milk Link has no members in Scotland, it is theoretically possible to transport milk to the site, Milk Link submits, however, that this option is uneconomic. Transportation of milk is feasible for the requirements of the Malpas plant and Milk Link has surplus in the vicinity of Taw Valley to supply all the raw milk needed. Milk Link is unlikely to supply GCL's Llangefni plant as it does not have members in North Wales and the supply of milk to mozzarella manufacturers requires a tightly guaranteed secure supply chain.

It has been submitted that membership has been offered to direct suppliers, but if farmers choose not to join, the supply contracts will remain with GML. If all direct supply farmers were to join Milk Link it would add approximately a further 220 mlpa to

Milk Links procurement at a national level. The parties' combined share of supply is 12.7 per cent, increment 1.6 per cent.

#### *Milk Products*

The parties are also active to some extent in raw milk processing and overlap in the production and supply of cheese, butter, by-products and bulk cream.

The total EU production of cheese in 2001 was 7.9 million tonnes. Milk Link produced 2,900 tonnes representing 0.03 per cent of EU production, and GFL produced 56,000 tonnes representing 0.7 per cent of EU production. Post transaction the parties combined share of supply of cheese is less than 1 per cent of the EU production.

Milk Link and GFL both produce by-products as part of their cheese production process. The EU combined share of supply is less than 1 per cent.

Third party responses agreed that there were many suppliers of these products in the EU and worldwide. There are therefore no horizontal issues in the supply of cheese, butter, by-products and bulk cream.

### **Barriers to Entry and Expansion**

#### *Milk Procurement*

Barriers to entry in dairy farming are high; farming of this type requires specific plant, buildings, technical knowledge and land in an area with a suitable climate.

#### *Milk Products*

Barriers to entry in processing appear to be high relative to the return earned. A new cheese plant producing approximately 55,000 tonnes would cost approximately £50 million to build and take 2 1/2 years to complete. A new cream plant would cost £7.5 million.

### **Buyer Power**

Third party responses suggest that buyers of raw milk, particularly the large processors, have a significant advantage when negotiating supply contracts and can exert a significant degree of buyer power. Smaller purchasers, however, do not have negotiating strength due to the low volumes of milk procured.

According to third parties, customers of milk products, especially large retail multiples exert buyer power to reduce prices.

## **VERTICAL ISSUES**

As discussed above, GFL has four processing plants, Taw Valley, Melton Mowbray, Lockerbie and Malpas. Transportation of milk is feasible for the requirements of the Malpas plant and Milk Link submits it has surplus in the vicinity of Taw Valley to supply all the raw milk needed.

Following the transaction independent farmers that previously supplied GML have three options. They can either join Milk Link, find an alternative processor or stay with GML.

If farmers choose to join Milk Link there is a £250 joining fee and a £5 per share charge. As a cooperative, Milk Link does not have an incentive to foreclose or exert a margin squeeze on its members.

The second option is to find an alternative purchaser. Milk Link submits that alternative buyers are available, however some third parties contend this is not the case and maintain that no alternative buyers exist. From third party responses it appears that the location and size of the farmer and processor are crucial. The farmers and processors contacted indicated that there is a circa 100 mile delivery range over which raw milk deliveries and collections are viable and this may limit choice.

Responses from processors indicate milk product suppliers are willing to source from independent farmers but their capacity levels are limited. Even though it appears current supply requirements are met there is some evidence of switching.

Given that farmers have the option to join Milk Link or find alternative supply the transaction is not considered to lead to foreclosure.

## **THIRD PARTY VIEWS**

The majority of third parties did not express any concerns about the transaction.

## **ASSESSMENT**

On the basis of the evidence, no horizontal competition issues arise. The overlaps between Milk Link and Glanbia in the procurement of raw milk are small, and as a result shares of supply and accretions to those shares are modest. For milk products a number of competitors remain post-merger and the shares of supply, and accretions to those shares, do not appear to be significant.

At a vertical level, because of the relatively large delivery ranges for raw milk, the option to join Milk Link and the possibility to supply alternative processors it is not considered that the joint venture would lead to foreclosure for independent farmers.

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**

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