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## Anticipated acquisition by British Sugar plc of Billington Food Group plc

The OFT's decision on reference under section 33 given on 4 August 2003

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Please note that square brackets indicate figures or text that have been deleted at the request of the parties for reasons of commercial confidentiality.

### **PARTIES**

1. **British Sugar plc (British Sugar)** is a wholly-owned subsidiary of Associated British Foods plc (ABF). British Sugar produces sugar from sugar beet grown in the UK for supply to the retail and industrial sectors. It also sells organic cane sugar sourced from Brazil [ ] to the retail and industrial sectors.
2. **The Billington Food Group Limited (Billingtons)** is a wholly-owned subsidiary of Billington Foods Limited, whose ultimate holding company is Edward Billington & Son Limited. Billingtons turnover for the year ended 30 April 2003 was around £29 million. Billingtons' principal operations are importing unrefined cane sugars from a number of countries (primarily Mauritius) into the UK, which it supplies to UK retail purchasers under its own brand and for private label sales. It also supplies UK industrial purchasers.

### **TRANSACTION**

3. On 26 May 2004, British Sugar agreed to acquire the entire issued share capital of Billingtons. British Sugar also agreed to acquire Billingtons' minority shareholding in Sukpak Limitee (Sukpak), a hand sugar packing operation in Mauritius.
4. The parties notified the transaction on 2 June 2004 and the administrative deadline is 4 August 2004.

### **JURISDICTION**

5. As a result of this transaction British Sugar and Billingtons will cease to be distinct. The parties overlap in the supply of sugar and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **BACKGROUND**

### **The UK sugar market**

6. Sugar can be produced from either sugar beet or sugar cane. In the European Union (EU), some 88 per cent of sugar consumed is produced from beet grown in the EU under a quota allocation (see below). The remaining 12 per cent is produced from raw sugar cane. Cane is generally imported from the African, Caribbean and Pacific (ACP) countries or Less Developed Countries (LDCs) under preferential import tariffs.
7. In the UK, British Sugar is currently the sole producer of sugar from beet and holds all the UK's quota for sugar beet. Tate & Lyle is currently the sole UK refiner of raw cane sugar which is sourced from ACP countries and LDCs and is the sole quota holder for ACP/LDC cane sugar in the UK.
8. Sugar merchants compete with British Sugar and Tate & Lyle at both the industrial and retail level, purchasing sugar from the UK producers and other European or worldwide producers, to sell directly on to industrial customers, or to pack and supply to retail customers. British Sugar has committed to maintain the position of merchants in the UK through undertakings it gave to the European Commission (EC) which state that British Sugar will not engage in predatory pricing practices or any practices that damage the continued existence of the merchants.

### **The EU Sugar Regime**

9. Under the EU Sugar Regime, processors are legally required to pay growers a minimum price for the beet they produce. These support prices are only guaranteed for production within quotas. The total quota amount for the Community is split between Member States, which then allocate their quotas to sugar producers (British Sugar holds all the UK's quota).
10. There is a fixed import duty for sugar entering the Community. However, sugar imported from certain ACP states enters duty free under the terms of the Sugar Protocol.
11. Since 2001/2002, the 49 LDCs have benefited from increased access to the EU Market under the Everything But Arms (EBA) Initiative, which provides for transitional quotas and phasing out of import duties (from 2007-2009). The EC is also considering a review of the Sugar Regime which may lead to quotas and intervention prices being cut.

## **RELEVANT MARKET**

### **Product market**

#### ***Types of sugar***

12. There is a wide range of different sugar types. The main categories are described briefly in Annexe 1 and include:
  - white granulated
  - caster
  - demerera
  - icing sugar
  - golden granulated
  - light and dark brown
  - organic sugar.
13. White granulated accounted for over 75 per cent by value of retail sugar and 90 per cent of supply to industrial customers in the year to the end of January 2004. Organic sugars accounted for less than 1 per cent.
14. In general the parties argue that there is limited demand-side substitutability between the different categories because different types of sugar have different qualities in flavour, texture and colour that make them more suitable for some applications than others. Price and volume correlation analysis, using monthly AC Nielsen data for sales of branded products to retailers, generally supports the parties' view as do third parties' comments.
15. However, similarities in the production processes for different types of sugar might make supply-side substitution possible between some categories. In particular, the parties point to the following:
  - caster sugar is obtained by sieving the finer particles of granulated sugar. The cost of the plant needed to do this is modest at around 5 per cent of the annual retail UK caster sugar sales
  - white icing sugar is produced by milling white granulated sugar. The plant required would cost the equivalent of 10 per cent of annual UK retail icing sugar sales.
16. Overall, the evidence available in this case suggests taking each product category separately as a starting point for the competition analysis but taking into account the possibility of some demand and supply substitution between some categories.

#### ***Retail versus industrial***

17. There are a number of factors that point to examining supply to the retail and industrial segments separately. In particular, the packaging, distribution and customer profiles for industrial and retail sugar appear to differ significantly. This is reflected in British Sugar's organisation structure which has separate organisational arrangements for industrial and retail supply.

18. The distinction has been put specifically to third parties and has not been challenged. It is also consistent with the findings of both the EC and the Competition Commission (CC) in previous sugar cases.

### ***Unrefined versus refined***

19. Within each of the categories of sugar there is a refined and an unrefined version. Unrefined sugars are cane sugars that have undergone some initial processing to make them suitable for direct consumption (so-called DC raws). The natural molasses of the sugar cane is locked in (rather than being refined out), which means that unrefined sugars are perceived to have a superior flavour and natural colour in contrast with refined sugars. Unrefined sugars for direct consumption can only be produced from cane because raw beet is not suitable for direct consumption. Refined sugars, however, can be produced from either beet or cane.
20. The parties argue that refined and unrefined products are substantially different in colour, texture and taste to the extent that they do not provide a strong competitive constraint on one another.
21. To support this, the parties produced price correlations between the parties' branded products in each of the above categories, based on monthly AC Nielsen retail data for the past three years. In general the figures support their view, with the exception of organic products (discussed below).
22. In terms of supply-side substitution, it is possible for cane to be processed in such a way that DC raws are produced rather than raw sugar for refining. Producers with access only to beet sugar, however, cannot produce and sell unrefined sugars since these can only be produced from cane.
23. Overall, therefore, the evidence available suggests taking refined and unrefined products separately as a starting point for the competition analysis but taking into account the possibility of some supply-side substitution potential for cane products.

### ***Branded versus private label***

24. No strong evidence has been put to us either way, by the parties or by third parties, to suggest that branded and private label should be taken separately or together in analysing retail supply. Prima facie, however, it would seem highly plausible that there could be significant competitive interaction (actual or potential) between branded and private label products in any given segment through both demand- and supply-side substitution. The starting point for the analysis below, therefore, is to consider them together.

### **Geographic market**

25. 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. There appears to be no strong reason to adopt a different approach in this case. The UK is therefore taken as the starting point for the assessment, recognising however that possible changes to the EC Sugar Regime

might make imports a stronger competitive constraint later in the decade and that not all products sold by the parties are subject to the Sugar Regime.

## HORIZONTAL ISSUES

### Market shares

26. Table 1 shows shares of supply figures for each of the major segments discussed above across all product types.

Table 1: Shares of UK supply by volume, per cent year ended 30 April 2004

	Industrial			Retail		
	Refined	Unrefined	All	Refined	Unrefined	All
British Sugar	39	0	38	57	0	53
Billington	0	29	1	0	80	5
Tate & Lyle	27	21	27	31	9	29
Ragus	0	11	0	0	0	0
Napier Brown	16	29	16	11	11	11
James Budgett	12	11	12	0	0	0
Imports	7	0	6	2	0	2
Other	0	0	0	0	0	0
Vol. ( '000 tonnes)	1606	28	1634	342	22	364
Pre-merger HHI	2658	2321	2607	4269	6587	3844
HHI increment	15*	0	51	1*	0	509

Source: OFT analysis of the parties' data

\*Although the table shows Billingtons' share of supply in these categories as zero, their share is actually between zero and one, hence the HHI increment.

27. The HHI increment is significant only if refined and unrefined categories are put together for retail customers. However, as noted earlier, the evidence on substitution suggests that taking the refined and unrefined categories separately is likely to be a more meaningful indicator of the actual competitive position faced by the majority of customers in most product categories.
28. This result also flows through to individual product categories, where significant HHI increments occur only if refined and unrefined products are considered together. In most categories, however, the price/volume correlation analysis referred to above, and the third party responses show no evidence that either party has been a major competitive constraint on the other. The possible exception is in the organic sugar retail category where price correlation data may be consistent with some competitive interaction between the parties' products.

### Organic sugar

29. There are three types of organic sugar – granulated, caster and demerara. British Sugar does not supply caster or demerara, so the parties overlap in the supply of organic granulated sugar only.

30. Like other categories of sugar, organic granulated is available in both a refined and unrefined version. While Billingtons only supplies unrefined organic granulated sugar, British Sugar currently supplies both versions (although it will not do so in the longer term).
31. In 2001 British Sugar took the decision to seek to produce organic beet sugar from beet grown within the UK. To cover the period until that volume came 'on stream', British Sugar sourced a single bulk load of organic beet sugar from [ ] in December 2001 which it launched in the retail sector in conjunction with Sainsburys. British Sugar supplies Sainsburys from this single block of volume and does not intend to continue to source any further organic beet sugar from Holland once the remainder of this volume is sold to Sainsburys, due to very small volumes sold. British Sugar commenced production of its organic granulated sugar from beet grown in the UK in spring 2003 but only sells this sugar in the industrial segment. Approximately 60 per cent of British Sugar's sales to the industrial segment were of its beet sugar produced from UK beet. However, British Sugar submits that its organic granulated beet sugar has not been a successful line and on 10 July 2004 it publicly confirmed its decision to discontinue production of organic beet sugar due to lack of demand. Organic beet sugar will continue to be supplied from existing stocks as and when required.
32. Both parties source their organic granulated cane sugar from Brazil which means that the sugar imported does not fall within the EU quota system, nor the ACP or LDC preferential access regimes. Both parties pay full import duty on organic imports (as do their competitors in this sector).
33. The organic granulated sugar sector is a very small niche market. In the year ending 30 April 2004, the overall value of organic granulated retail sugar sales (excluding private label and organic beet sugar) in the UK was less than £1 million representing 653 tonnes of sugar sold per annum. This represents 0.21 per cent of the total sugar retail segment by value and 0.033 per cent by volume. If British Sugar's organic beet sugar retails sales are included, the overall value rises to £[ ] million and [ ] tonnes sold per annum.
34. Due to the lack of public information, it is not possible to further segment the industrial sector into granulated, caster and demerara figures. In the year ending 30 April 2004, the organic industrial sector had an overall value of £2.9 million and a volume of 3258 tonnes (excluding organic beet sugar sold by British Sugar). This represents 0.244 per cent of the total sugar industrial segment by value and 0.199 per cent by volume. If British Sugar's organic beet sugar sales are included, the value rises to £[ ] million and volume rises to [ ] tonnes.

35. Table 2 sets out shares of supply figures in the organic granulated sugar sector.

Table 2: Organic granulated sugar shares of UK supply by volume, per cent year ended 30 April 2004

	Industrial			Retail		
	Refined	Unrefined	All	Refined	Unrefined	All
British Sugar	100.0	14.3	30.0	100.0	11.8	18.2
Billington	0.0	33.5	27.4	0.0	67.5	62.6
<b>Merged entity</b>	<b>100.0</b>	<b>47.8</b>	<b>57.4</b>	<b>100.0</b>	<b>79.3</b>	<b>80.8</b>
Tate & Lyle	0.0	0.0	0.0	0.0	18.1	16.8
Napier Brown	0.0	18.4	15.0	0.0	2.6	2.4
Community Foods	0.0	15.3	12.5	0.0	0.0	0.0
James Budgett	0.0	3.1	2.5	0.0	0.0	0.0
Other	0.0	15.3*	12.5	0.0	0.0	0.0
Vol. ( '000 tonnes)	731	3258	3989	51	653	704

Source: OFT analysis of the parties' data

\* Tate & Lyle is included in this 'Other' figure

36. As noted earlier, the price correlation data provided by the parties suggested some competitive interaction between the parties' organic granulated sugars in the retail sector.<sup>1</sup> The parties argue that the data does not reflect the competitive realities of the marketplace. They maintain that the refined/unrefined distinction remains important in the organic sector, such that British Sugar's organic granulated beet sugar is not a competitive constraint on Billingtons' organic granulated cane sugar. The parties submit that, for organic granulated cane sugar alone, the price correlation might reflect significant common costs of supply, or might result from the fact that monthly volumes sold in the organic sector are very low. The parties also submit that their organic granulated cane sugars do not compete – whether in supply to retailer or consumers - because (a) British Sugar's organic granulated cane product is not branded as 'unrefined' which, when taken with British Sugar's brand profile as 'mainstream and refined', means that it is not perceived as a substitute for Billingtons' organic granulated cane sugar; and (b) Nielsen data indicates that none of the major supermarkets stock both products (therefore consumers do not have a choice of these products in-store).
37. The views of third parties, including specialist manufacturers and retailers of organic products, generally supported the view that British Sugar's products are perceived as mainstream and refined, and therefore, not a suitable substitute for Billingtons' products in the organic sector.

### Barriers to entry

38. The parties submit that producers and distributors of sugar can easily switch to supply each of the different types of sugars with relatively low cost implications.

<sup>1</sup> No such data was provided for the organic industrial sector. As noted below, the OFT contacted third parties specialising in the organic industrial sector and they were largely unconcerned about the transaction.

39. The parties note that certain barriers to entry are an inherent feature of the UK sugar market in the form of the Sugar Regime and the quota system. However, they argue that the EBA Initiative and expected reforms to the Sugar Regime will progressively reduce the constraints on imports into the EU.

### ***Organic sugar***

40. The parties submit that barriers to entry into the organic sugar sector are low because supplies of organic sugar are easy to obtain and do not require a long-term commitment on the part of the buyer.
41. In particular, the quota system under the Sugar Regime and the preferential treatment of ACP sugars are not relevant to the import of organic granulated sugars which are sourced from countries outside the EU and the ACP/LDC countries. Both British Sugar and Billingtons source organic granulated sugar outside the quota system and the ACP preferential treatment regime, and pay a customs levy. While this levy is not insubstantial (representing approximately 40-45 per cent of cost), it applies equally to all importers so a new entrant would not be disadvantaged in this respect.
42. One third party suggested that (a) the availability of packing facilities, and (b) the branding and reputation of the parties might constitute barriers to entry into the organic sector.
43. The parties submit that there are a number of possibilities for a new entrant or existing participants in relation to packing requirements including contract packing, packing at source of supply, hand-packing (especially in a small volume sector) and machine-packing (the parties estimate the cost of second-hand machinery at around £50,000 to £100,000).
44. On branding and reputation, the parties note that British Sugar's retail brand Silver Spoon does not have a strong branding in organics or natural products. This is consistent with the views of third parties in the sector. Given the image associated with the organic segment (namely small, independent 'eco-friendly' companies), the parties believe that smaller companies with existing reputations in the organic food segment and strong relationships with retailers could easily enter the organic sugar segment. One third party commented that their Fair Trade branded sugar met the organic specification and therefore, they would probably be able to source their organic sugar requirements from their Fair Trade products supplier.
45. The parties argue that large customers could sponsor entry or launch an own label organic sugar if there were any attempt by the merged entity to raise prices. They also note that there are numerous organic sugar suppliers in the EU and also numerous potential sources of organic sugar worldwide.
46. Finally, the parties note that there are there are a number of players already active in the organic granulated sector: Tate & Lyle, Napier Brown, James Budgett, Community Foods and Pronatec (a new entrant). Of these, Tate & Lyle offers a full range of organic sugars and has increased its market share by 180 per cent (by value) from 2002 to 2004. Billingtons lost £[ ] sales in the year to February 2004 which appear to have been lost to [ ].

## **Buyer power**

47. According to the parties, approximately 76 per cent of British Sugar's total retail sales and around 95 per cent of Billingtons' total retail sales are to major supermarkets.
48. The parties submit that the supermarkets make a small (if any) margin on their sugar sales and are therefore concerned to ensure that their retail price of sugar is not out of line with competitors. The parties consider any attempt by a supplier to raise the prices of sugar would be strongly resisted by the supermarkets.
49. The parties also consider that there is no obstacle to supermarkets switching suppliers should they wish to do so or alternatively sourcing supplies from other Member States in the EU.
50. The industrial sugar sector is characterised by a few substantial purchasers such as Coca Cola, Unilever, MasterFoods, Kraft, Nestle, Kellogg's and Cadbury. The parties argue that these purchasers face fierce competition for their products and are determined to keep their input costs as low as possible. [ ]

## ***Organic sugar***

51. The parties submit that buyer power is more acute in the organic sector where all of British Sugar's retail sales and over 95 per cent of Billingtons retail sales are to major supermarkets. In support of this, the parties point to evidence of supermarkets switching between organic sugar suppliers: [ ]

## **Coordinated behaviour**

52. The OFT considered whether the transaction might enable coordinated behaviour given the reduction in the number of suppliers; the removal of a competitor who has led innovation in the organic sector; apparent transparency of pricing; and potential barriers to entry to the organic sector in the form of the Sugar Regime.
53. In response to this issue, the parties submitted that any coordinated behaviour would not be sustainable because the sector is characterised by a lack of transparency in terms of product prices and availability at the wholesale level; low barriers to entry since the Sugar Regime does not apply to the organic sector; and strong countervailing buyer power.

## **VERTICAL ISSUES**

54. British Sugar supplies a number of other companies in the ABF group. However, there is no evidence to suggest that material vertical issues arise from this transaction.

## **THIRD PARTY VIEWS**

55. Customers (including customers specifically in the organic sector) have not raised widespread concerns about the effect of this transaction on competition in any product category. Where concerns have been raised, they have tended to focus

on the merger potentially reducing product range, rather than on increasing prices. British Sugar stated that it does not intend to rationalise its range (or Billingtons' range) in relation to organic cane sugar. It adds that the parties' organic cane products are currently stocked in different supermarkets and it would not make commercial sense to rationalise any of these product ranges as this would remove sales at a number of supermarkets which could not be guaranteed to be regained by the merged entity.

56. There has been some competitor concern, focusing on the strengthening of British Sugar's overall position in sugar supply. However, no evidence was received in support of this concern.

## **ASSESSMENT**

57. Generally speaking, British Sugar specialises in refined sugars while Billingtons specialises in unrefined sugars. This appears to be an important distinction for most types of sugar and on this basis, the parties do not have any overlaps in most categories. The quantitative evidence and the views of the third parties confirm this and indicate that the two parties have not been a competitive constraint on each other in most categories.
58. The one possible area of concern is organic sugar, specifically organic granulated cane sugar, where the price correlation on retail figures is consistent with some competitive interaction between the parties' products and the shares of supply are relatively high. Nonetheless, as noted, it is arguable that the parties' products in this sector are not perceived as being substitutable and in any event, there are a number of additional factors to consider, namely:
- barriers to entry to the organic granulated sugar sector appear to be low, especially since all suppliers of organic cane sugar source from outside the Sugar Regime and ACP preferential treatment regime, and therefore face the same customs levy
  - there appears to be countervailing buyer power in that all of British Sugar's organic granulated sugar sales and over 95 per cent of Billingtons' are to the major supermarkets
  - third parties specialising in organic products were mostly unconcerned about the effect of the transaction in that sector
  - the evidence has allayed concerns about the risk of coordinated behaviour arising as a result of the transaction and
  - the value and volume of the organic granulated sugar sector is very small and a tiny proportion of total sugar sales.
59. Consequently, the OFT does not believe that it is or may be the case that the merger 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 33(1) of the Act.

## Annexee 1: Main categories of sugar

Type of sugar	Brief description
<b>Granulated</b>	<p>Produced from sugar beet or refined from sugar cane. White granulated sugar is regarded as a general purpose sugar, suitable for use in many varied food and drink manufacturing processes and by consumers generally as a sweetening ingredient in recipes and for sweetening drinks and sprinkling over cereals.</p> <p>Golden granulated sugar is produced from refined sugar using the same process as for white granulated but then spraying the white granulated with molasses. Unrefined golden granulated is produced from cane and retains some natural molasses.</p>
<b>Caster sugar</b>	<p>Sieved from white granulated sugar crystals. It is particularly used in bakery and confectionery products.</p> <p>Unrefined golden caster sugar is sieved from unrefined golden granulated sugar crystals.</p>
<b>Icing sugar</b>	<p>Milled (ground) from standard white granulated sugar and is used extensively in sweet bakery and in sugar and chocolate confectionery. Unrefined golden icing sugar is milled from unrefined golden granulated sugar.</p>
<b>Demerara sugar</b>	<p>A brown granulated sugar of a certain crystal size and comes in both refined and unrefined versions. It is used particularly in cakes and biscuits to provide extra flavour, colour and texture.</p>
<b>Muscavado sugar</b>	<p>Predominantly extracted from sugar cane. It is obtained by evaporation of cane sugar and draining off the molasses. It has a nutty, caramel flavour and a strong molasses aroma. It is available in light and dark brown forms. The darker the colour, the more molasses so that the sugar is stronger flavoured. Refined muscavado sugars are produced by spraying white granulated sugar with molasses.</p> <p>Muscavado can be used for a wide variety of biscuits, cakes and sweets and is ideal for marinades, chutneys and fudgy puddings.</p>
<b>Light and dark soft brown sugars</b>	<p>Sugars produced from beet are caster sugar-based with the addition of different amounts of cane molasses. Refined cane-based light and dark soft brown sugars are usually manufactured</p>

	<p>using a similar process, whereby a white granulated sugar is produced from the raw sugar cane, to which molasses is added.</p> <p>Soft dark brown sugar is used products such as rich fruit cakes , Chistmas puddings, ginger cake, toffee and fudge.</p>
<b>Organic sugars</b>	<p>Mainly derived from organically-grown sugar cane meeting the Soil Association standards and produced in the same way as described above. British Sugar also produces a white organic granulated sugar from organic sugar beet grown in the UK.</p>
<b>Molasses sugars</b>	<p>Unrefined sugars and are therefore derived solely from cane.</p>
<b>Sugar crystals</b>	<p>Large, golden-coloured crystals mainly used in coffee. The distinction between refined and unrefined crystals is that the former contain added caramel. Demerara is produced by spraying molasses on white granulated sugar</p>