

# Anticipated acquisition by Muller UK & Ireland Group LLP of the dairy operations of Dairy Crest Group plc

## Notice under paragraph 2(1) of Schedule 10 to the Enterprise Act 2002 – consultation on proposed undertakings in lieu of reference pursuant to section 73 of the Act

### Introduction

1. Muller UK & Ireland Group LLP (**Müller**) has agreed to acquire the liquid milk, packaged cream, flavoured milk and bulk commodity ingredient business (**Target Business**) of Dairy Crest Group plc (**Dairy Crest**) (the **Merger**).
2. On 12 June 2015, the Competition and Markets Authority (**CMA**) decided under section 33(1) of the Enterprise Act 2002 (the **Act**) that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition (**SLC**) within a market or markets in the United Kingdom (the **SLC Decision**).<sup>1</sup>
3. On 19 June 2015, Müller offered an undertaking to the CMA for the purposes of section 73(2) of the Act. The CMA gave notice to Müller on 26 June 2015, pursuant to section 73A(2)(b) of the Act, that it considers that there are reasonable grounds for believing that the undertaking offered, or a modified version of it, might be accepted by the CMA under section 73(2) of the Act and that it is considering the offer.<sup>2</sup> The CMA stated in that notice that its decision on whether to ultimately accept the undertaking or refer the Merger for a phase 2 investigation would be informed by, among other things, third party views on whether the undertaking would be suitable to address the competition concerns identified by the CMA in the SLC Decision.
4. The purpose of this notice of consultation is to communicate that the CMA proposes to accept the undertaking offered by Müller, to explain the reasons why, and to receive representations on the CMA's proposal to accept. The

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<sup>1</sup> The [SLC Decision](#).

<sup>2</sup> The [notice to consider undertakings offered](#).

CMA will carefully consider any representations before making a decision under section 73(2) of the Act whether to accept the undertaking.

## The undertaking offered

5. Müller has offered to sell a toll processing arrangement option (**TPAO**) to a specified third party (the **Nominated Purchaser**), under which the Nominated Purchaser will have the option to require Müller to process up to 100 million litres per annum (**mlpa**) of fresh milk from Dairy Crest's Severnside dairy for the purpose of supplying this milk to major grocery retailers with national scope (**national multiples**).<sup>3</sup> The TPAO will have an initial term of five years, plus the option to fulfil any ongoing national multiple contract that is in place at the end of this initial term for an additional period of up to three years.
6. The price to be paid by the Nominated Purchaser for the TPAO will consist of two elements. First, the Nominated Purchaser will pay a fixed sum for the option. This sum will be determined in an auction process with potential Nominated Purchasers participating. Secondly, the Nominated Purchaser will pay a per litre price based on variable cost as the toll processing fee. Müller has proposed that the variable costs be determined using Dairy Crest's variable costs of operating its fresh milk processing facilities at the Severnside dairy as a benchmark.
7. The undertaking also includes Müller's commitment, if required by the Nominated Purchaser for part of or the entire duration of the TPAO:
  - (a) to enter into an agreement with the Nominated Purchaser for the procurement of raw milk;
  - (b) to enter into an agreement with the Nominated Purchaser for the collection of raw milk;
  - (c) to segregate fresh milk as required by the national multiple customer of the Nominated Purchaser;
  - (d) to enter into an agreement with the Nominated Purchaser for the distribution of the processed fresh milk to national multiples;
  - (e) to process and package all or part of the cream associated with the fresh milk volumes processed under the TPAO; and

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<sup>3</sup> In paragraph 115 of the SLC Decision and for the purpose of that decision, the CMA defined 'national multiples' as comprising: Tesco, Asda, Sainsbury's, Morrisons, Coop, Aldi, Lidl, Iceland, Waitrose and M&S.

- (f) to enter into a service level agreement with key performance indicators to set a level of acceptable service in relation to the TPAO.
8. Müller will commit to completing the sale of the TPAO to a Nominated Purchaser approved by the CMA before the CMA finally accepts the undertaking.
9. The TPAO, together with the other commitments offered by Müller set out in paragraphs 7 to 8, is hereinafter referred to as the '**Proposed Undertaking**'). The full text of the Proposed Undertaking accompanies this notice.

### **Suitability of the Proposed Undertaking to address the competition concerns identified by the CMA**

10. As set out in the SLC Decision, the CMA found that the Merger gives rise to a realistic prospect of an SLC in the supply of fresh milk to national multiples in the area served by Dairy Crest's Severnside dairy. This area includes parts of the South West, Wales, the Midlands and the South of England (**Severnside catchment area**). This SLC finding was based on a counterfactual in which, absent the Merger, Dairy Crest would downsize its dairy operations to a single dairy at Severnside. As a result of this downsizing, Dairy Crest would no longer be a supplier of fresh milk with national scope, but may have had 55 to 100 mlpa fresh milk capacity available at its Severnside dairy to compete to supply fresh milk to national multiples in the Severnside catchment area.
11. As the CMA found that the Merger could result in the loss of a competitive constraint emanating from the downsized Dairy Crest that may have existed absent the Merger, the purpose of the Proposed Undertaking is to replace any such competitive constraint such that the SLC identified in the SLC Decision is remedied in a clear cut way (consistent with the CMA's public guidance).<sup>4</sup>
12. In the CMA's notice to Müller on 26 June 2015, the CMA stated that it considered that the Proposed Undertaking might be acceptable as a suitable remedy to the SLC identified by the CMA, given that it may enable a third party dairy processor to compete to supply national multiples in the Severnside catchment area. As such, the Proposed Undertaking may result in replacing a competitive constraint that may have emanated from Dairy Crest absent the Merger.

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<sup>4</sup> *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance* (OFT1122), December 2010, chapter 5. The undertakings in lieu of reference guidance was adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2)*, January 2014, Annex D).

13. Following the 26 June 2015 notice, the CMA received feedback from third parties on the suitability of the Proposed Undertaking to remedy the SLC in a clear cut manner.<sup>5</sup> This feedback largely highlighted elements that the CMA itself believed required further consideration before it could accept the Proposed Undertaking. This has been carefully considered by the CMA and the key issues are addressed below. The CMA welcomes any further representations on how the issues raised by third parties can be addressed.

### **Coordination**

14. Some third parties suggested that the Proposed Undertaking may risk increasing the likelihood of coordination between Müller and the Nominated Purchaser. In particular, there was a concern that Müller and the Nominated Purchaser would have visibility of each other's variable cost of fresh milk processing, and that Müller would have visibility of the Nominated Purchaser's spare capacity.
15. The CMA currently considers, subject to further third party comments, that the Proposed Undertaking sufficiently mitigates any coordination risk, for the following reasons:
- (a) the toll processing fee represents only a small proportion of the total cost to serve a national multiple contract. As such, where the Nominated Purchaser requires Müller to provide only the processing of fresh milk, Müller and the Nominated Purchaser would not have visibility of the majority of each other's cost to serve. This visibility is increased where the Nominated Purchaser uses Müller to provide further additional services (ie procurement and collection of raw milk and delivery of fresh milk). The CMA has therefore considered the intentions of the potential Nominated Purchasers on this point, as set out below;
  - (b) Müller personnel involved in negotiations with the Nominated Purchaser (and who therefore will have knowledge of the upfront fee and the processing fee that the Nominated Purchaser faces) cannot be involved in commercial negotiations with national multiples, and *vice versa*.<sup>6</sup> Also, all Müller personnel involved in both types of negotiations must give non-

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<sup>5</sup> *Mergers – Exceptions to the duty to refer and undertakings in lieu of reference guidance* (OFT1122, December 2010 (**Exceptions Guidance**)), adopted by the CMA as set out in *Mergers: Guidance on the CMA's jurisdiction and procedure*, Annex D), at paragraphs 5.6-7.

<sup>6</sup> Müller's legal director will be involved in the negotiations with the Nominated Purchaser but will not have access to any cost, fee or price related information relating to a national multiple contract. However, it will review the language of Müller's agreement with National Multiples to ensure it captures in contract language the commercial proposition that had been formulated, negotiated and agreed by other Müller employees (not involved in the negotiations with the Nominated Purchaser). Müller's legal director confidentiality undertaking specifies that he will not have access to any cost, fee or price related information relating to a national multiple contract.

disclosure undertakings to the CMA restricting the disclosure of information relating to negotiations with the Nominated Purchaser;<sup>7</sup>

- (c) the Nominated Purchaser will have visibility of only the aggregate variable cost reflected in the processing fee per litre (ie. not the individual components of that cost);
- (d) the processing fee per litre is based on Dairy Crest's current variable costs of the Severnside dairy fresh milk operations (and indexed according to various external benchmarks), not on Müller's variable costs of operating the plant if the Merger is completed. Those costs are therefore different from the costs at Dairy Crest's and Müller's other dairies and, in addition, are likely to diverge from the actual variable cost at Severnside over the life of the TPAO; and
- (e) where the Nominated Purchaser has other milk processing facilities that may also be used to serve national multiples in the Severnside catchment area, the TPAO will not give Müller visibility of the spare capacity of those other facilities. Müller will therefore be uncertain about the spare capacity to serve national multiples of the Nominated Purchaser. The CMA has therefore considered the other facilities of the potential Nominated Purchasers, as set out below.

### ***Input foreclosure***

16. A concern was raised that Müller may have the ability and incentive to degrade non-price aspects of its service under the TPAO, which could undermine the competitiveness of the Nominated Purchaser. The CMA currently considers, subject to further third party comments, that any input foreclosure risk is sufficiently mitigated by the Proposed Undertaking, for the following reasons:
- (a) Müller has committed to enter into a service level agreement with the Nominated Purchaser, the terms of which will be approved by the CMA. The service level agreement includes key performance indicators (**KPIs**) that Müller must meet to provide an acceptable service under the TPAO.<sup>8</sup> The CMA understands that this type of service level agreement is common in existing toll processing agreements in the dairy industry in the UK;

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<sup>7</sup> See clauses 11.1 (c) and 12.1 (c) of the Undertakings text.

<sup>8</sup> See clause 2.4 (c) of the Undertakings text.

- (b) The Nominated Purchaser will have the right to appoint an independent auditor, at shared cost with Müller, to review Müller's compliance with the terms of the TPAO, including its compliance with the KPIs;<sup>9</sup>
- (c) The Proposed Undertaking includes an obligation on Müller to comply with the terms of the TPAO (and the terms of any optional service agreements for the procurement and collection of raw milk and the delivery of fresh milk).<sup>10</sup> Therefore, if Müller does not comply with the TPAO, the CMA may, under section 75 of the Act, make an order to address Müller's non-compliance. This non-compliance is actionable by the CMA and affected third parties in civil proceedings, and the CMA will have the power to require appointment of a trustee to monitor further compliance.

### ***Suitability of Nominated Purchaser***

17. Some third parties stated that the effectiveness of the Proposed Undertaking was dependent on the selection of a suitable Nominated Purchaser (ie a Nominated Purchaser that has the resources, capability, expertise, incentive and intention to serve national multiples). A number of third parties also considered it important that the competitive constraint provided by the Nominated Purchaser continue beyond the term of the TPAO. The CMA currently considers, subject to further third party comments, that the Proposed Undertaking addresses these representations, for the following reasons:

- (a) The Proposed Undertaking gives the Nominated Purchaser the option to enter into an agreement with Müller for the supply of additional services, including for the procurement of raw milk, the collection of raw milk, the delivery of the finished fresh milk product to the customer, and the processing and packaging of cream. These additional services, should they be required by the Nominated Purchaser, will preserve or enhance the Nominated Purchaser's capability to serve national multiples;
- (b) As set out below, under the Nominated Purchaser approval process, the CMA has assessed the resources, capability and expertise of the two potential Nominated Purchasers and is satisfied that, on the balance of the evidence available, each may credibly supply fresh milk to national multiples. The CMA is also satisfied that each has the incentive and intention to tender for national multiple contracts in the Severnside catchment area. The CMA also notes that the fixed sum that will be paid by the Nominated Purchaser (see paragraph 6 above) provides an

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<sup>9</sup> See clause 2.4 (d) of the Undertakings text.

<sup>10</sup> See clause 5 of the Undertakings text.

incentive to tender for such contracts, since operation of these contracts will allow the Nominated Purchaser to recoup this sum; and

- (c) The CMA has also assessed each potential Nominated Purchaser's commitment to supply national multiples beyond the TPAO, by examining *inter alia* the strategic plans and financial capability of the proposed Nominated Purchasers. As set out below, the CMA is satisfied that, subject to securing the TPAO, each intends to continue to compete to supply fresh milk to national multiples in the Severnside catchment area following the expiry of the TPAO, and that each has access to the financial resources to do so.
18. For the above reasons, the CMA currently considers that, subject to the TPAO being sold to either of the potential Nominated Purchasers, and subject to further third party comments, the Proposed Undertaking is acceptable as a suitable remedy to the SLC, given that it would enable a third party dairy processor to compete to supply national multiples in the Severnside catchment area. The Proposed Undertaking would resolve the SLC in a clear cut way by replacing a competitive constraint that may have emanated from the downsized Dairy Crest absent the Merger.

## **Proposed purchasers**

19. Müller proposed two potential Nominated Purchasers:
- (a) Medina Holdings Limited (**Medina**); and
  - (b) Nijjar Group Holdings (Acton) Limited (trading as **Freshways**).
20. Generally, in approving a purchaser, the CMA's starting position is that it must be confident without undertaking a detailed investigation that the proposed purchaser will restore pre-merger levels of competition.<sup>11</sup> The CMA therefore seeks to ensure that:
- (a) the acquisition by the purchaser remedies, mitigates or prevents the SLC concerned;
  - (b) the proposed purchaser is independent of and unconnected to the merged parties;

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<sup>11</sup> *Mergers: exceptions to the duty to refer and undertakings in lieu of reference guidance*, paragraph 5.11.

- (c) the proposed purchaser has the necessary expertise, financial resources, incentive and intention to maintain and operate the divested business (or, in this case, the TPAO) as an effective competitor in the marketplace;
- (d) the proposed purchaser is reasonably expected to obtain all necessary approvals, licences and consents from any regulatory or other authority and
- (e) the acquisition by the proposed purchaser does not itself create an SLC within any market or markets in the UK.<sup>12</sup>

## **Suitability of the proposed purchasers**

21. The CMA currently considers, subject to further third party comments, that each of the potential Nominated Purchasers is a suitable purchaser. Should the CMA ultimately decide that both purchasers are suitable following this public consultation process, Müller will decide which purchaser will proceed with the acquisition. The sale of the TPAO is conditional upon acceptance by the CMA of the Proposed Undertaking, including approval of the Nominated Purchaser.<sup>13</sup>

### ***Freshways***

22. Active since 1991, the company supplies milk and cream to wholesalers and also to manufacturers for use in various products found in national multiples and high street stores. With a turnover of £181.7 million in the financial year ending in 31 December 2013, Freshways supplies a range of middle ground customers and has a nationwide wholesale distribution network. Some recent large middle ground contracts won by Freshways include Londis, Costa Coffee, Buyco (Palmer & Harvey), and The Restaurant Group.
23. There are no significant financial, ownership, management or personal links between Freshways and the merging parties which would influence Freshways' and Müller's incentive to compete.
24. Freshways has experienced significant growth in recent years, supported by positive profits. It currently has a strong balance sheet and submitted that it does not expect to require any additional finance for either the purchase of the TPAO or the supply of fresh milk under the TPAO. Based on the evidence provided, the CMA is satisfied that Freshways has access to the necessary financial resources to implement the TPAO and simultaneously invest in

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<sup>12</sup> *Mergers: exceptions to the duty to refer and undertakings in lieu of reference guidance*, paragraphs 5.25–5.30.

<sup>13</sup> See clause 2.1 of the Undertakings text.

Freshways' own processing capabilities to service the national multiples independently, once the TPAO ends.

25. In terms of expertise and commitment to the market, Freshways currently owns and operates a liquid fresh milk processing facility in Acton, West London, with 350 mlpa capacity. It has seven distribution centres located in London, South East, the Midlands, South Wales, North East and the North West, and its delivery network currently covers the majority of the Severnside catchment area. Freshways recently acquired Dairystix in Plympton, which is currently configured to produce UHT (ultra high temperature processed) milk. Freshways submitted that, based on their current plans, it could continue to compete to supply fresh milk to national multiples following the expiry of the TPAO by expanding its Plympton facility to process fresh milk volumes that are similar to or larger than the TPAO volume. Additionally, there may be capacity at its Acton facility with which to supply national multiples.
26. Although Freshways does not currently supply fresh milk to national multiples, it currently supplies large and sophisticated national customers, including food manufacturers that incorporate Freshways' products into products for national multiples. Freshways submitted that the TPAO would enable Freshways to enter the supply of national multiples more swiftly than is currently possible, and that expanding into the national multiple segment is the natural next step in its business progression. Evidence provided by Freshways shows that it had planned to target supply to national multiples independently of the TPAO. Freshways submitted that it is unlikely to require support from Müller for the collection or delivery of raw milk, or its assistance for the procurement of raw milk. Freshways will only require Müller to process and package the cream resulting as a by-product from milk processing.
27. Freshways does not require any consents or approvals to complete the acquisition of the TPAO and commence trading, other than CMA approval. The acquisition of the TPAO by Freshways does not raise competition concerns as Müller and Freshways do not overlap in the supply of fresh milk to national multiples in the Severnside catchment area.
28. The CMA therefore currently considers Freshways to be a suitable purchaser of the TPAO, subject to further third party comments.

### ***Medina***

29. Medina was established in 1980. Besides the processing and supply of fresh milk and other dairy products, the company is also active in the supply of bread, morning goods, eggs and drinks. Medina supplies to wholesale and retail customers daily and has a projected turnover of £160 million for the

current fiscal year. Its current key customers include NHS, SSP UK, Home Bargains, Farmfoods, Poundworld, Costco Wholesale, Reynolds, Parfett's and Caffè Nero.

30. There are no significant financial, ownership, management or personal links between Medina and the merging parties which would influence Medina's or Müller's incentive to compete.
31. Medina has experienced earnings growth in recent years, and strong financial support from the shareholders has enabled Medina to fund its growth and development. Funding to support the TPAO will come from equity, external debt funding and retained profits. The CMA is confident that Medina has access to the necessary financial resources to implement the TPAO and simultaneously invest in Medina's own processing capabilities to service the national multiples independently, once the TPAO ends.
32. In terms of expertise and commitment to the market, Medina operates from two processing sites, Watson Dairy (Hampshire) and Denby Dale (Yorkshire) and a nationwide network of 18 depots, including in the Severnside catchment area. Medina has experience in milk segregation, farm management services and delivery to both regional distribution centres and direct to store nationally. Medina submitted that it would seek to continue to supply fresh milk to national multiples following the expiry of the TPAO by investing in further processing capacity, either by acquiring an existing facility or building a new facility. Although initially Medina is likely to procure raw milk via Müller whilst it explores its supply options, in the long term it will seek direct supply from farmers. Medina anticipates that it will take around 18 months to secure additional direct raw milk supply. Medina will only require Müller's services for the collection of raw milk in the first three years of the TPAO and will use a third party logistics provider for the distribution of processed milk. Medina will require Müller to process and package the cream resulting as a by-product from milk processing.
33. Medina's strategy in recent years has been focused on increasing its penetration into the larger customer segment in the UK, including national multiples. Medina is already seeking to leverage its existing platform and experience with large middle ground customers to gain customers within the national multiples segment.
34. Medina does not require any consents or approvals to complete the acquisition and commence trading, other than CMA approval. The acquisition of the TPAO by Medina does not raise competition concerns as Müller and Medina do not overlap in the supply of fresh milk to national multiples in the Severnside catchment area.

35. The CMA therefore currently considers Medina to be a suitable purchaser of the TPAO, subject to further third party comments.

### **Proposed decision and process going forward**

36. For the reasons set out above, the CMA currently considers, subject to further third party comments, that the Proposed Undertaking offered by Müller is, in the circumstances of this case, appropriate to remedy, mitigate or prevent the competition concerns identified in the SLC Decision.
37. Before reaching a decision as to whether to accept the Proposed Undertaking, the CMA invites interested parties to make representations on the Proposed Undertaking.
38. The CMA will have regard to any representations made in response to this consultation and may make modifications to the Proposed Undertaking as a result. If the CMA considers that any representation necessitates any material change to the Proposed Undertaking, the CMA will give notice of the proposed modifications and publish a further consultation.
39. The CMA therefore gives notice that, subject to the response received to this public consultation, it proposes to accept the Proposed Undertaking in lieu of a reference for a phase 2 investigation.
40. Representations should be made in writing to the CMA and be addressed to:

Maria Duarte or Richard Davidson  
Mergers Group  
Competition and Markets Authority  
Victoria House  
37 Southampton Row  
London  
WC1B 4AD

Email: [maria.duarte@cma.gsi.gov.uk](mailto:maria.duarte@cma.gsi.gov.uk)  
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**Deadline for comments: 25 August 2015**