CMA
Competition & Markets Authority

Linergy Limited and Ulster Farm By-Products Limited

A report on the completed acquisition by Linergy Limited of Ulster Farm By-Products Limited

6 January 2016

Members of the Competition and Markets Authority who conducted this inquiry

Phil Evans *(Chair of the Group)*

Ros Hedley-Miller

Michael Hutchings

Tim Tutton

Chief Executive of the Competition and Markets Authority

Alex Chisholm

The Competition and Markets Authority has excluded from this published version of the report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂]. Some numbers have been replaced by a range. These are shown in square brackets.

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Summary

1. On 28 July 2015, the CMA referred the completed acquisition by Linergy Limited (Linergy) of Ulster Farm By-Products Limited (UFBP) (together the Parties) for an in-depth phase 2 investigation. The CMA is required to address:

   (a) whether a relevant merger situation has been created; and

   (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC) within any market or markets in the UK for goods or services.

2. Both Parties are based in Northern Ireland (NI), and are active in the provision of animal rendering services. Animal rendering refers to the treatment of animal by-product materials through a process of heat and pressure treatment to produce meat and bone meal (MBM) and tallow. Some animal by-product material is regarded as high-risk, including that which carries a risk of transmitting transmissible spongiform encephalopathy (TSE). Such defined types of high-risk material are designated as Category 1. Fallen stock – animals that have died (usually on farms) of causes other than slaughter and whose carcasses therefore require disposal – is classified as Category 2, while Category 3 refers to low-risk animal by-product material, much of which is in principle fit for human consumption (and also includes hides, hair, horns etc). Such material can be used for a variety of uses other than Category 3 rendering, even if there is no commercial demand for it as cuts of meat. For example: edible fat can be used to produce beef dripping; bones can be used to produce stocks; new export markets are opening up for human consumption of animal parts not traditionally consumed in the UK; and material can be utilised for non-human food use, eg in pet foods and for composting. Meat processors therefore evaluate their options and decide what material should be sent for Category 3 rendering.

3. Rendered Category 1 material has to be processed in a dedicated Category 1 facility, with tight restrictions on the use of Category 1 MBM and tallow (requiring incineration). As there are no dedicated Category 2 plants in the UK or the Republic of Ireland (RoI), fallen stock is processed in Category 1 plants. Category 3 plants cannot handle any Category 1 or 2 materials due to the risk of cross-contamination. Given regulatory restrictions, the Parties' agreement on product market definition and the absence of any contradictory evidence, we conclude that there are separate product markets for the rendering of Category 1 material, Category 3 material, and for fallen stock. We also considered the geographic market in relation to rendering services provided in NI, taking account of the strength of competition from renderers located

outside NI, and the difference in outside options for different categories of meat processors. We conclude that the geographic market extends at least to NI, and extends beyond this for some customers.

4. Linergy operates a Category 1 rendering facility at Dungannon, County Tyrone. UFBP operates a Category 3 facility at Glenavy, County Antrim, and previously also operated a Category 1 plant. Linergy is part owned by Linden Foods Limited (Linden) and Dunbia Limited (Dunbia),[1] meat processors that each have substantial sites at Dungannon (among others). UFBP was purchased by SAPI S.p.A. (SAPI) on 6 June 2012. This followed the abandonment of a prospective purchase of UFBP by Linergy earlier in 2012, when the intended acquisition was referred to the Competition Commission (CC) for an in-depth investigation. We were told this abandonment was in light of UFBP's precarious financial position at the time and the need for a speedy resolution. SAPI is an Italian company active in the processing of animal by-products, and whose principal commercial interest is in the value of the end products that are produced as a result of the processing. It has acquired or taken minority stakes in several rendering businesses outside Italy.

5. SAPI approached Linergy in May 2012, saying that it wanted to find out whether Linergy was interested in the possibility of becoming a partner with SAPI in UFBP, if SAPI was successful in acquiring UFBP. This led to negotiations that culminated in the signing of a Memorandum of Understanding (MoU) between SAPI and Linergy (the MoU Parties; and each an MoU Party) on 31 May 2012.

6. In May 2014 the Parties agreed in principle to merge. The transaction was completed on 14 May 2015. Pursuant to sale and purchase agreements, Linergy acquired 100% of the issued share capital of UFBP (the Merger) and SAPI acquired 30% of the enlarged share capital of Linergy.

7. The Parties submitted that the MoU 'was not an expression of intent but rather a framework under which a merger could take place if the parties decided to attempt to proceed with one at some point in the two year period following the MoU'.[2] They also stated that the MoU had 'too many possible outcomes, dependent on too many events, to be taken into account by the Parties in important strategic decisions'. However, while the MoU stated that the envisaged merger was subject to regulatory approval and included arrangements in case the merger did not proceed, we considered that it showed the MoU Parties' intention to merge Linergy and UFBP. Clause 2.1 of

[1] It is Dunbia's owners rather than Dunbia itself that hold shares in Linergy. For simplicity we have referred to Dunbia as a shareholder in Linergy.
[2] Parties' initial submission, p40.

the MoU states that the '[MoU] parties acknowledge that subject to regulatory approvals it is their intention to complete a merger of UFBP and Linergy'. We also considered that following the signing of the MoU, each MoU Party acquired a stake in the other MoU Party's financial performance pending either completion of the merger envisaged in the MoU or, at least in a number of situations, a decision not to proceed with the merger. Even if this was not the intention of the MoU (as submitted by the MoU Parties), we were satisfied this was its effect. We considered that this created an incentive for each of the MoU Parties to take account of the impact of its commercial decisions on the other and that this would be the case in a sufficiently large number of scenarios that it could affect the MoU Parties' incentives (even if, as the MoU Parties submitted, it would not have affected matters in all scenarios that could have arisen after the signing of the MoU).

8. Given our assessment that the MoU created an incentive for each of the MoU Parties to take account of the impact of its commercial decisions on the other, we considered it was appropriate to examine the impact of the MoU on the decisions taken by the Parties after they signed the MoU. We therefore considered what would be the appropriate counterfactual to the Merger in the light of the MoU.

9. In order to determine the most likely counterfactual scenario we looked in turn at:

   (a) the sale of UFBP in 2012 and what would have been the most likely alternative situation in the absence of the MoU between SAPI and Linergy; and in the light of that alternative situation;

   (b) whether UFBP's Category 1 plant would have closed; and

   (c) whether Linergy would have built a Category 3 plant.

10. SAPI told us that it wanted to acquire UFBP due to UFBP's position as operating the only Category 3 plant in NI, and because it saw significant potential to improve the efficiency of UFBP, to increase its profitability and to produce additional Category 3 output that SAPI could use. We note that SAPI had put in a final offer with a marked up SPA (in accordance with the requirements of the UFBP sale process) prior to approaching Linergy about the possibility of future partnership. Furthermore, although discussions between SAPI and Linergy had been initiated, an agreement on the MoU had not been reached when SAPI paid a substantial non-refundable deposit to UFBP's owner, Glenfarm Holdings Limited (Glenfarm) in order to have exclusivity in the sales process. SAPI told us that this was because the

decision to acquire UFBP and the decision to enter into the MoU with Linergy were not mutually dependent.

11. SAPI said that while it normally sought local partners to manage acquired businesses, it did not always do so (and in this instance it had in any case brought in its own manager and engineers to run UFBP). While there is little hard evidence, dating from the time that the decisions were made, to corroborate what we have been told by SAPI about its rationale for the acquisition and the timing of the MoU discussions with Linergy, we have not seen any evidence that suggests otherwise. We conclude therefore that SAPI intended to purchase UFBP regardless of whether an agreement was reached with Linergy, and that its bid for UFBP was made without any firm expectation of an MoU being agreed. UFBP's previous owners were committed to a sale and as SAPI's bid was considerably higher than those of other bidders, we conclude that the most likely counterfactual situation is that SAPI would have purchased UFBP and operated it without a partner. It is possible that SAPI might in time have sought alternative local partners, but no plans to do so were advanced, and so we consider that this would have been unlikely in the short term.

12. We next considered whether SAPI would have closed UFBP's Category 1 plant in the counterfactual situation. SAPI told us that, following a review after its acquisition of UFBP, it had determined that there was no commercial rationale to continue operating the plant. The plant was heavily loss-making and we heard that the site required major upgrades and capital investment to resolve significant environmental problems. The Northern Ireland Environment Agency (NIEA) confirmed to us that there had been repeated problems relating to water discharges and odour and that it considered the plant 'not fit for purpose'. Further, there was a significant fire in the plant in October 2012 necessitating its shut down, and after which it was not reopened.

13. Taking into account the points set out above, the substantial costs that would need to have been incurred to refurbish the plant, and that SAPI's primary interest is in Category 3 outputs, we conclude that SAPI would still have been expected to have closed the Category 1 plant in the counterfactual situation.

14. We then considered whether Linergy would have opened a new Category 3 plant in the absence of the MoU with SAPI. Linergy put these plans on hold when it first sought to buy UFBP in early 2012, as this transaction would have given it access to a Category 3 facility without the cost and delay of building its own plant and where it was uncertain whether it could obtain all the planning consents it might require. As noted at paragraph 4, the proposed acquisition of UFBP was subsequently abandoned. Linergy said that it had been interested in building such a plant prior to 2012 in order to realise more

value for Linden and Dunbia. These shareholders were at the time obliged through agreements [✂], made at the time of the original investment to establish Linergy's Category 1 plant, to have all the Category 1 and 3 material from their Dungannon plants processed by Linergy in its Category 1 plant. However, opportunities for realising substantial value from Category 3 material had by then emerged, because Category 3 outputs from rendering were in greater demand and realising higher prices.

15. Following SAPI's acquisition of UFBP, UFBP started to offer significantly higher prices to meat processors for the supply of Category 3 materials. We were also told that [✂] and therefore Linden and Dunbia were no longer constrained by previous obligations to have all their material processed by Linergy. SAPI was thus seen as an attractive option for Linden and Dunbia's material, because of the higher prices offered. The Parties told us that Linergy had been charging Linden and Dunbia £[✂]/tonne to dispose of material while UFBP was offering to pay £[✂]/tonne for Category 3 material. Consequently, there was no longer a strong incentive on Linden and Dunbia to press for Linergy to build its own Category 3 plant, and they could also avoid having to tie themselves into an extended undertaking to have all materials processed by Linergy. In terms of expected financial performance, Linergy's new plant would have needed to offer higher prices to source material, both from Linden and Dunbia, and also from third party suppliers. This was because a new Linergy plant would also now be in competition with SAPI, which was seen as a much more efficient operator of UFBP, and so was expected to continue to offer higher prices to acquire Category 3 materials. Linergy told us this meant the plant's costs would increase and profitability decrease; the period before the returns would pay back the costs of investment would increase from [✂] to over [✂] years.

16. We consider that SAPI increasing the price paid for Category 3 material had a significant effect on the risk profile of the Linergy project. It increased the payback period making the investment less attractive to both shareholders and potential providers of external finance. SAPI's ownership of UFBP also reduced the incentives of Linergy's meat processing shareholders to support the building of a Category 3 plant as their Category 3 material could now be rendered for attractive prices by an operator located nearby. We also note that, at the time of the review of its plans to build a new Category 3 plant, Linergy's meat processing shareholders were already having their Category 3 material rendered elsewhere.

17. We therefore conclude that, in the counterfactual, Linergy would not have built its own Category 3 plant.

18. Given our conclusions on the counterfactual and the relevant product markets, the Parties do not overlap, and would not have overlapped under the counterfactual, in the supply of rendering services for Category 1 material, Category 3 material, or for fallen stock. The number of options available to customers and the way in which Linergy and UFBP would be expected to compete does not differ in the counterfactual from the actual outcome. In either case, farmers would not have had a choice of using either Linergy or UFBP for the disposal of fallen stock as only one plant would have remained open to serve them. Similarly, meat processors would only have had the option of one of these two renderers for Category 1 material, and one of the two for Category 3 material. Therefore, we conclude that the Merger does not give rise to horizontal unilateral effects in relation to these services.

19. We also considered whether the Merger would give rise to vertical input foreclosure. This refers to a theory of harm whereby the merged firm harms the ability of its rivals to compete following a merger, for example by raising effective prices to its rivals or the rivals of its shareholders (also known as partial foreclosure), or by refusing to supply them at all (total foreclosure). We considered whether the Parties have the ability and the incentive either to: *(a)* worsen the terms that they offer to third party meat processing customers to process their material (partial foreclosure); or *(b)* stop serving these customers altogether (total foreclosure), in each case to benefit Linergy's shareholders' meat processing operations.

20. In this respect, the Merger has not changed Linergy's position in relation to Category 1 rendering, as it already had control of the Category 1 facility, but it has given rise to possible vertical effects in relation to Category 3 rendering, due to the relationship the Merger has introduced between UFBP and Linergy's shareholder meat plants.

21. The ability for Linergy to foreclose depends to a large degree on the alternatives available to meat processor customers. The Parties would not be able to foreclose meat plants that are easily able to switch away from them. We consider that the Parties would not have the ability to foreclose larger meat processor customers because these customers have effective outside options, other than UFBP and Linergy, available to them. We note that many of the large meat processing companies have existing vertical relations with renderers on the island of Ireland. Moreover, their size makes them attractive suppliers to renderers (and transport costs for a given distance are likely to be proportionately lower than for independents who may have smaller loads).Further, they are more likely to be able to negotiate acceptable deals with alternative renderers in the UK and the RoI than are smaller and independent meat processors that do not have existing vertical relations with

renderers (independents). Our considerations therefore focused on these independents.

22. We heard different views on which alternative renderers were realistic options for independents. Renderers in the north of the RoI, and Dundas Chemicals (Dundas), a Scottish renderer, serve independent processors in NI. Some independents have informed us that they have used the threat of switching to alternative renderers to secure better prices. Although the Parties own the only Category 3 rendering plant in NI, we also received evidence that there is sufficient spare Category 3 rendering capacity (in plants currently serving NI other than the Parties) to absorb the volumes of independents should they be refused supply by the Parties. However, we note that certain independents may not be attractive to some renderers, in part because of their small scale, and because transport costs for collecting their material are proportionately higher. In some cases, specialised independents produce Category 3 material which is less suitable for certain renderers (for example, too many bones may cause the rendered output to be unsuitable for pet food manufacturers) and so fewer renderers would want to purchase their material. On the other hand, the Parties noted that the volumes of such material are small and some renderers produce by-products for which bones are required.

23. The smaller the proportion of total costs (or total revenues) accounted for by the cost (or revenue) of the foreclosed input (in this case, Category 3 rendering revenues), the less effective a foreclosure strategy will be. In this respect, we note two separate facts. First, the costs of rendering represent a very small proportion of a meat processor's total overall costs (less than [✂]%), meaning the impact of a partial foreclosure strategy on independents is likely to be small. Second, much of the material that could be rendered as Category 3 is not actually rendered. This is because there are also alternatives to rendering available for material that would otherwise be rendered in a Category 3 plant (see paragraph 2). Where a meat processor sends Category 3 material for such uses, it typically earns more revenue than sending material for Category 3 rendering would. Figures from one independent meat processor indicated that the revenue received from rendering of its Category 3 material represented only [✂]% of the total revenue it received for the disposal of potential Category 3 material, as the prices achieved for these other uses were much higher. Therefore, as most of the value of Category 3 materials is derived from alternatives to rendering, this also indicates that the impact on independents from facing lower revenues for Category 3 rendering services is likely to be small. These two points suggest that the harm that a foreclosure strategy could inflict on rival meat processors through increasing costs or lowering revenues would be limited.

24. We considered whether Linden and Dunbia were likely to benefit through better margins or volumes on their meat products if foreclosure could inflict significant harm on independents in NI. We were told that all meat processors in NI tend to sell into a wide market for meat products, with most of the output sold to UK supermarkets. Linden and Dunbia would, therefore, be in competition with major food groups in the whole of the island of Ireland, in Great Britain (GB), and also potentially in the rest of Europe or even the rest of the world. Even if independent meat processors in NI lost demand for their products due to foreclosure by UFBP, Linden and Dunbia appear unlikely to gain much benefit. The potential amount of displaced demand due to foreclosure of the independents would appear to be low relative to the total size of the market for meat products. Linden and Dunbia themselves account for a small share of supply to this market and there is no reason to believe that Linden and Dunbia would pick up a disproportionate share of any demand for meat products that was displaced from those independents. Therefore, there appears to be relatively little for Dunbia and Linden to gain from foreclosing independents and no guarantee that they would capture the gain which might theoretically arise.

25. We also looked at whether Linden and Dunbia would benefit from a reduction in the numbers of independent meat processors seeking to acquire livestock. If independents were less active in purchasing livestock, then, under certain conditions, the demand for livestock in NI may be reduced and this may lead to lower livestock procurement costs for Linden and Dunbia.

26. Meat processors other than Linden and Dunbia account for a large proportion of procured livestock in NI. Therefore, even if independents were less active in purchasing cattle, it is unlikely that this would have a significant impact on livestock prices. In addition, there is scope for farmers to move livestock between NI and the RoI or GB if prices fell in NI due to a reduction in the number of meat processors bidding for livestock. This further reduces the likelihood of a foreclosure strategy impacting on livestock prices. Furthermore, if the Parties did seek to foreclose independents, it is unclear that Linden and Dunbia would pick up a large share of displaced livestock sales, and so the benefits of a foreclosure strategy would be very uncertain.

27. For these reasons we consider it unlikely that Linden and Dunbia would profit from a strategy of foreclosure against independent meat processors, and so would not have the incentive to instigate such a policy. Even if there were gains to Linden and Dunbia, these would need to be weighed against reduced profitability of Category 3 rendering services provided by UFBP as it would be turning away the custom of the independents. This strategy would be against the interests of other shareholders, particularly SAPI, which would forego the benefit of profits from rendering in NI, and there would be lower volumes of

Category 3 MBM that SAPI would be able to send for further processing at its facilities in Italy.

28. For these reasons, we conclude that an SLC has not arisen and may not be expected to arise in relation to the vertical aspects of the Merger.

Finding

29. For the reasons set out in this report, we conclude that the Merger has not resulted, and may not be expected to result, in an SLC in the markets for the rendering of Category 1 material, Category 3 material and fallen stock, each having a relevant geographic market extending at least as far as NI.

Findings

1. The reference

1.1 On 28 July 2015, the CMA referred the completed acquisition by Linergy of UFBP for an in-depth phase 2 investigation. In exercise of its duty under section 22(1) of the Act, the CMA made a reference to its chair for the constitution of a group[3] in order to investigate and report on, within a period ending on 11 January 2016, the following questions in accordance with section 35(1) of the Act:

(a) whether a relevant merger situation has been created; and

(b) if so, whether the creation of that situation has resulted, or may be expected to result, in an SLC within any market or markets in the UK for goods or services.

1.2 Our terms of reference, along with information on the conduct of the inquiry, are set out in Appendix A.

1.3 This document, together with its appendices, constitutes our findings. Further information, including non-commercially-sensitive versions of the Parties' initial submission and summaries of evidence from third parties can be found on our website.[4]

2. The market

Description of rendering

2.1 Animal by-product materials are the remains of an animal after meat and offal have been removed for human consumption. While some animal by-products can be used for non-human food uses, such as for pet food and leather, those that remain need to be disposed of. Animal rendering refers to the rendering of animal by-product materials through a process of heat and pressure treatment to produce MBM[5] and tallow.[6] These animal by-products not intended for human consumption come from meat processing plants (slaughter houses, deboning plants, and other food processors) and some

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[3] Section 22(1) of the Act provides that the group is to be constituted under Schedule 4 to the Enterprise and Regulatory Reform Act 2013.
[4] See the Linergy/UFBP case page.
[5] MBM is the protein product after the fat and moisture have been extracted from the raw material. It is typically 48-52% protein, 33-35% ash, 8-12% fat and 4-7% moisture. Category 1 MBM is incinerated. Category 3 MBM can be used for various purposes, such as the formulation of animal feed (subject to restrictions on what animal species can be used for different end uses).
[6] Tallow is the fat extracted from animal tissue in the normal rendering process. It can be used as an energy source, for animal feed or used in the manufacture of soaps and oleo-chemicals.

other sources (eg butchers). MBM and tallow have value and have a variety of uses (see paragraph 2.13).

2.2 Renderers are also used for the disposal of fallen stock. Fallen stock refers to those animals that have died (usually on farms) of causes other than slaughter and whose carcasses therefore require disposal.

2.3 Some animal by-product material is classed as high risk because of its risk of transmitting TSE (among other risks). In order to negate this risk, this material has to be rendered through approved processes and/or destroyed through incineration.

2.4 Regulations on the treatment of animal by-products are enforced in NI by the Department of Agriculture and Rural Development (DARD).

2.5 Of particular relevance is the classification, defined in the Animal By-Products Regulation,[7] of animal by-products into Categories 1, 2 and 3, according to their risk, and requiring the different categories to be treated differently at all stages. In the UK and the RoI, these categories currently consist of the following materials:

- **Category 1** – This is the material that carries the greatest risk, including that of transmitting TSE. It mainly consists of specified risk material (SRM):[8]
  - For cattle, SRM consists mainly of the intestines and tonsils of all animals; the skull (including the brain and eyes) and spinal cord of cattle aged over 12 months; and the vertebral column of cattle aged over 24 months.
  - For lambs, sheep and goats, SRM consists mainly of the spleen and ileum (part of the small intestine) of all animals; and the skull (including the brain and eyes), spinal cord and tonsils of animals aged over 12 months.
  - Other animals, such as pigs and poultry, do not produce SRM.

[7] The main EU regulation on the treatment of animal by-products is Regulation (EC) 1069/2009 (the Animal By-Products Regulation). This replaced Regulation (EC) 1774/2002. The Animal By-Products Regulation has been implemented in European Commission Regulation (EU) 142/2011 (OJ L 54/1) (as subsequently amended) (the Animal By-Products Implementing Regulation). In NI, the Animal By-Products Regulation is implemented in the Animal By-Products (Enforcement) Regulations (NI) 2011 (SI 2011/124). Articles 8-10 of the Animal By-Products Regulation discuss the classification of animal by-product materials.

[8] The EU has laid down rules on the control and eradication of BSE in Regulation (EC) 999/2001 (as subsequently amended) (the BSE Regulation). See Annex V of the BSE Regulation. Article 5 of the Animal By-Products Regulation provides that other Category 1 material includes, for example, pet, zoo and circus animals (due to the level of veterinary drugs in their bodies) and catering waste from outside the EU.

Category 1 also covers all animals suspected of having been infected by bovine spongiform encephalopathy (BSE) or another strain of TSE, or killed in the context of BSE/TSE eradication measures.

- **Category 2** – This is also high-risk material and includes fallen stock, digestive contents and manure.
- **Category 3** – This is a wide category of animal material that is, in principle, fit for human consumption, but is not intended for human consumption, either for commercial reasons or because it is not normally eaten (eg hides, hair, feathers, bones etc). It includes carcasses and parts of animals slaughtered and not intended for human consumption, and blood of slaughtered animals (unless the animals showed signs of communicable disease).

2.6 Rendering plants are licensed for a particular category so as to avoid cross-contamination. As there are no dedicated Category 2 plants in the UK or the RoI, fallen stock that is rendered is processed in Category 1 plants. The relevant regulations allow for Category 3 material to be processed in a Category 1 plant (although the outputs would all be treated as Category 1). Renderers may not process Category 1 material in a Category 3 plant.

2.7 Individual countries are currently assigned a risk status based on criteria in the BSE Regulation. In countries with a 'negligible risk status', certain types of SRM are not classified as Category 1 but as Category 3. This applies, for example, to the vertebral column and intestines of cattle.[9] In countries with a 'controlled risk status', all SRM is classified as Category 1.

2.8 Both the UK and the RoI currently have controlled risk status. The RoI gained negligible risk status in May 2015, but returned to controlled risk status on 26 June 2015 after the identification of a BSE case earlier in June 2015.[10] The European Commission maintained controlled risk status for the ROI in its most recent risk status decision of 4 August 2015. According to DARD, the UK will not be able to gain negligible risk status until 2018 at the earliest (although NI may be able to apply for a separate risk status earlier than this) and the RoI

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[9] DARD estimated that the consequence of reclassification is a reduction in the amount of Category 1 material harvested from cattle from around 40-50 kilos per animal to 13-14, with the difference classified as fit for human consumption, Category 2 or Category 3 material. This represents a reduction in SRM of around three-quarters, which applies to around two-thirds of Category 1 material (the other one-third consists of fallen stock). DARD noted, however, that meat plants may dispose of some Category 2 and 3 material with Category 1 material because it is part of their process, or cheaper, to do so.

[10] According to both EU rules and World Organisation for Animal Health (OIE) rules, a country can gain negligible risk status if: *(a)* there has been either no case of BSE (or only imported cases) or every indigenous case of BSE was born more than 11 years ago and all potentially infected cattle were destroyed; *(b)* certain monitoring and awareness programmes have been in place for at least seven years; and *(c)* neither MBM nor greaves derived from ruminants have been fed to ruminants for at least eight years. If a country does not meet these criteria, it has controlled risk status.

will not be able to regain negligible risk status until 2021 at the earliest. Further information on the history of BSE in the UK and the uses of animal by-products is contained in Appendix B.

The rendering process

2.9 Rendering involves the physical and chemical transformation of animal by-product material, using a variety of possible equipment and processes, and yielding MBM and tallow as outputs. All rendering processes involve the application of heat, the extraction of moisture and the separation of fat from other materials.[11]

2.10 The CMA understands that the capacity of a rendering plant is determined by the capacity of its cooker, as defined by the volume of water that it is able to cause to evaporate. As the moisture content of different types of animal by-product material also varies, the capacity of a rendering plant is therefore also dependent on the type of material being processed.

2.11 Animal rendering is a high fixed cost activity and renderers must process a certain level of material in order to cover their fixed costs and generate an adequate profit margin. Further, stopping and starting a plant is expensive and takes time. This means that a renderer has an incentive to increase the volumes rendered to run its plant efficiently.[12]

2.12 The rendering processes employed vary according to the composition of the raw material. The temperature and length of time of the cooking process are important factors and can determine the quality of the outputs. All rendering systems involve raw material being ground and conveyed to a cooking vessel, where cooking is generally carried out with steam at temperatures of 115º to 145ºC for 40 to 90 minutes, depending upon the type of system and materials being processed. The cooking process inactivates any bacteria, viruses, protozoa and parasites present in the material. Melted fat is separated from the protein and bone solids and a large portion of the moisture is removed, producing tallow. The remaining materials, which include protein, minerals and some residual fat, are further processed into MBM by additional moisture removal and grinding.

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[11] Description of rendering process adapted from: Meeker, DL and Hamilton, CR (2006), An overview of the rendering industry.

[12] For example, Linergy explained that '[t]he processors [renderers] that will generally be able to be more competitive in the industry are those which can reduce costs within their operation or run with a lower cost model (for example, using a cheaper fuel such as gas, where available), maximise efficiencies within their operation, or decrease costs by maximising throughput and therefore achieve a greater spread of fixed costs per tonne processed and lower the processing cost per tonne of material intake.' See Parties' initial submission, p22.

Uses of tallow and MBM

2.13 Tallow and MBM are classified as either Category 1 or 3 depending on the categorisation of the material from which they are produced and the plant in which the material is processed. Category 1 material can only yield Category 1 tallow and MBM. Category 3 material yields Category 3 tallow and MBM if it is processed in a Category 3 plant, and Category 1 tallow and MBM if it is processed in a Category 1 plant. Category 1 and Category 3 tallow and MBM have different potential uses. Regulations require that outputs from Category 1 rendering are incinerated. Category 1 MBM is used as a fuel for power generation, while Category 1 tallow is used either directly as a fuel or as feedstock for biodiesel. If suitable, cheap energy such as natural gas is not available, renderers may use their own tallow as a fuel to operate the rendering plant. Renderers sell Category 3 MBM and tallow, either directly or through intermediaries, principally to customers active in the following areas: animal feed; fertilisers; oleo-chemicals; and energy. The Parties told the CMA that rendered Category 3 material can also be used in the production of animal feedstuffs, although TSE-related restrictions on the feeding of processed animal protein[13] severely restrict this. These different uses mean that Category 3 MBM and tallow normally command higher prices than Category 1 MBM and tallow.

2.14 According to the Parties, ignoring transport costs, in 2014 Category 1 MBM had an average price of £[✂] per tonne while Category 3 MBM had an average price of £[✂] per tonne. The price of Category 1 tallow averaged £[✂] per tonne in 2014, while the price of Category 3 tallow was £[✂] per tonne.[14]

2.15 Production yield rates also vary between Category 1 and Category 3 plants. DARD told us that yields by weight from raw material at large Category 3 plants are approximately [✂]% for tallow and [✂]% for MBM. Linergy told us its yields for Category 1 output are approximately [✂]% for tallow and [✂]% for MBM.[15] Differences in yields arise because Category 1 materials and fallen stock typically have a much higher water content. Rendering this material is therefore much more energy intensive, and the quality of the outputs is typically lower.

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[13] Processed animal proteins are animal proteins processed from any Category 3 animal by-products except: milk, colostrum or products derived from them; eggs and egg products, including eggshells; gelatine; collagen; hydrolysed proteins; dicalcium phosphate and tricalcium phosphate of animal origin; blood products. See DEFRA and APHA (2014), Animal by-product categories, site approval, hygiene and disposal.
[14] The prices quoted are not inclusive of transport costs, which in some cases, if included, would make the price of Category 1 MBM negative.
[15] The yield percentages quoted can vary according to the type and quality of either the Category 1 or Category 3 material processed.

2.16 In consequence, there is a substantial difference in the price paid (gate fee) for Category 1 and Category 3 materials.

Gate fees

2.17 Renderers normally charge gate fees to meat processors to take the Category 1 material which meat processors need to dispose of (similarly to farmers for fallen stock); and normally pay meat processors (ie the gate fee is negative) for the Category 3 material which meat processors supply. The renderer receives income from the sale of MBM and tallow.

2.18 The Parties told us that gate fees are based on the following factors:

(a) Processing costs.[16]

(b) Transport costs, usually paid by the renderer (see paragraphs 2.20 to 2.24).[17]

(c) Current and expected future output prices.[18]

(d) The quality of the inputs (eg freshness)[19] and the different output yields which may be achieved from different inputs.[20]

(e) Input prices charged to other customers of a similar size and similar type.[21]

(f) Competitors' input prices if known (ie the prices rival renderers charge or pay for animal by-products).

2.19 While these factors affect the input price to a customer (that is, a meat processor), they may not do so in a pre-determined/mechanical or transparent way, as input prices tend to be determined in bilateral negotiations between the renderer and meat processor. The renderer will also take account of the relationships the renderer has with customers, its technology, levels of capacity use, the mix of types of materials it already processes, and so on.

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[16] Linergy has outlined that [✂].
[17] This is consistent with evidence from Foyle Proteins (Foyle), which noted that 'transport & energy costs were very important drivers of price in rendering.'
[18] Output prices are the prices at which tallow and MBM are sold by the renderer.
[19] A renderer told us that it could not compete for Category 3 material from NI because the material would deteriorate before reaching its facilities and, therefore, it could not generate as much value from that material as renderers closer to meat plants in NI. This affected its ability to offer a competitive input price.
[20] Input prices vary by material type and one of the reasons for this is because different types of material yield different levels of outputs and therefore affect the level of revenue generated from selling outputs.
[21] [✂]

Transport costs

2.20 For the majority of volumes, we understand that transport costs incurred in taking materials from a meat processor to a renderer are paid by the renderer. The extent to which differences in transport costs are reflected in gate fees depends on the relative bargaining strength of the renderer and the meat processor.[22]

2.21 Although not the renderer's most important cost in either Category 1 rendering or Category 3 rendering, transport costs are a significant component of both a renderer's variable costs and its total costs. The Parties told us that:

(a) for Linergy, Category 1 transport costs account for approximately [✂]% of its Category 1 variable costs and [✂]% of its total Category 1 costs; and

(b) for UFBP, Category 3 transport costs account for approximately [✂]% of its Category 3 variable costs and [✂]% of its total Category 3 costs.

2.22 In relation to each meat processor, the greater the distance between that meat processor's plant and a renderer, the higher the costs of transporting material from one to the other. However, transport costs are determined not only by the distance travelled but also from the volume of material being supplied (ie whether or not it fills the capacity of a truck).[23] Accordingly, transport costs per tonne of material are likely to depend partly on the volume of material that the meat processor is able to supply and the frequency of collections. In particular, when transport costs are paid on a per load basis, the cost of travelling a particular distance, per tonne of material, will be higher the lower the load use.[24] Therefore, a meat processor that increases its load use will be relatively more attractive to renderers as distance becomes less important relative to the overall transport costs.

2.23 We have received a mixed picture from third party renderers and customers on the importance of transport costs and their impact on competition. We see substantial volumes of animal by-products travelling further than their nearest renderer, although, at least in part, choice of renderer may be influenced by the shareholding relationships between meat processing plants and renderers. Shareholding meat processors will have an incentive to keep

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[22] For example, a renderer may be willing to absorb a higher proportion of transport costs for some customers which are seen as more valuable, and less willing to absorb transport costs for customers providing lower volumes (particularly of Category 1 material rather than Category 3), or lower quality volumes.
[23] For a given distance, smaller volumes supplied may lead to higher transport costs because the cost per tonne may be higher when the truck is not filled.
[24] Conversely, the higher a customer's load utilisation, the lower the cost of travelling a particular distance.

volumes within their group,[25] both to contribute to the throughput of a plant with excess capacity and because there may be a wish not to help rivals. Other explanatory factors may also be significant.[26]

2.24 We consider that, at least for some meat processors, transport costs are likely to be an important factor in determining their choice of renderer. In particular, this seems to be the case for meat processors with smaller volumes[27] and which do not have their own rendering facilities.

Alternatives to rendering Category 3 material

2.25 Category 1 and Category 2 materials are classified in EU and national legislation (see paragraph 2.5). Meat processors decide in relation to material not used for standard human consumption and that does not fall within Category 1 and 2, whether to send it for rendering as Category 3 animal by-product material or, instead, for other uses for which the material is not rendered. These potential commercial options include alternative routes for human consumption (eg edible fat, bones used to make stocks, and export markets for certain animal parts that are not normally eaten in the UK but may be in demand in other parts of the world). Alternatively, it might be sent for use (unrendered) in pet food or for non-food purposes (eg hides for leather, for fertilisers, or for use in anaerobic digestion plants).

2.26 Meat processors therefore decide whether and to what extent material is separated and sold for uses other than rendering, taking account of the costs of separation.

2.27 Once a meat processor has designated material as Category 3, this choice is irreversible, and it must be rendered using an authorised process. The volume of Category 3 animal by-products rendered varies depending on the level of demand for other uses of Category 3 material. We were told that a high proportion of revenue which comes from materials which might be classified

[25] For example, Linden stated 'as regards Linergy, Linden are a shareholder, so it is preferable to keep the business within the Group.'
[26] For example, the renderer chosen may have special technology and expertise in dealing with poultry by-products; or the volumes may travel a greater distance due to two renderers (with associated meat plants) making a reciprocal arrangement in order to exchange volumes of by-products when one has a Category 1 plant and the other has a Category 3 plant.
[27] A customer's volumes may also affect the input price a renderer offers a customer based on the extent to which it helps the renderer cover its fixed costs (see paragraph 2.11). In particular, a customer with larger volumes will contribute more towards a renderer's fixed costs, and therefore that customer is likely to have more bargaining power, than a customer with smaller volumes.

as Category 3 (and are not normally used for human consumption) is derived from uses other than rendering.[28]

Renderers

2.28 In NI, there are currently four licensed rendering (or disposal) services. Linergy operates a Category 1 facility at Dungannon. UFBP operates a Category 3 facility at Glenavy, County Antrim, and previously also operated a Category 1 plant at the same site. These companies are described in paragraphs 3.1 to 3.8. The other two rendering facilities are described below.

2.29 Foyle Proteins (Foyle) is part of the Foyle Food Group (FFG), which also owns a number of abattoirs as part of its meat processing business. It has a Category 1 plant at Campsie in County Londonderry. Foyle processes all of the Category 1 material produced by FFG, approximately [✂] tonnes per week, and also receives Category 1 material from other meat processors that are not part of FFG. In 2014, 60% of the material Foyle processed was Category 1 material from meat processors, with the remaining 40% coming from fallen stock. Foyle's capacity is [✂] tonnes per week, and its peak and average weekly volumes in 2014 were [✂] and [✂] tonnes respectively. Foyle receives material from both NI and the RoI.

2.30 Envirocare is a small company based at Derrylin in County Fermanagh that processes fallen stock and animal by-products through incineration and does not produce tallow or MBM from the material it receives from customers. We were told by the Parties that it has a licensed capacity of up to [✂] tonnes per day.

2.31 We estimate that the average weekly volumes of Category 1 material processed in NI in 2014 was [✂] tonnes for Linergy and [✂] tonnes for Foyle. UFBP is the sole Category 3 processor; it handled a weekly average of [✂] tonnes. In relation to fallen stock, we estimate that Linergy processed [✂] tonnes per week and Foyle [✂] tonnes per week in 2014. These figures include material originating in the RoI. We do not have figures for Envirocare's volumes.

2.32 Besides the companies based in NI, we are aware of four other companies that currently provide rendering services to meat processors in NI. These are Dundas, based in Scotland, and three RoI-based renderers (College

[28] For example, in 2014 by volumes [✂]% and by absolute values [✂]% of [✂] material that could go to Category 3 rendering went to alternatives to rendering (this includes pet food, fat, blood, grass and sludge). Source: CMA analysis of [✂] data.

Proteins/Farragh Proteins, Munster Proteins/Waterford Proteins and Western Proteins).

2.33 Dundas, based in Scotland, has capacity of [✂] tonnes per week for each of its Category 1 and Category 3 plants, and has average spare capacity of around [✂] tonnes per week between the two plants. Dundas started serving customers in NI six years ago, collecting materials from [✂] and from [✂]. [✂] terminated its agreement with Dundas in 2015 and Dundas subsequently acquired business from additional customers in the RoI and NI, including [✂].

2.34 College Proteins is an independent renderer with a Category 1 plant located at Meath. It also owns Farragh Proteins, which operates a Category 3 plant at Cavan in the RoI. College Proteins supplies rendering services to a number of customers in NI: [✂]. It also currently processes material for one of Linergy's customers, [✂]. It also processes material for [✂].

2.35 Munster Proteins (which operates a Category 3 rendering plant) and Waterford Proteins (which operates a Category 1 rendering plant) are both owned by the ABP Group, a vertically integrated meat processor that is a major producer of meat products on the island of Ireland and in GB. The only material originating from NI that is processed by these plants is from the ABP Group's own two meat processing operations.

2.36 Western Proteins is a Category 3 renderer based in County Mayo in the RoI and is part of the same group as the meat processor, Dawn Meats. [✂]

2.37 Other renderers in the RoI that do not currently serve any customers in NI are Dublin Products, which has both a Category 1 and Category 3 plant located in Dunlavin, County Wicklow; and Slaney Proteins, which has a Category 3 plant located in Enniscorthy, County Wexford.

Share of rendering in NI

2.38 Paragraph 2.31 sets out estimates by tonnage of volumes rendered in NI. In Tables 2.1 and 2.2, we also present the volumes of material originating in NI that are processed in all rendering plants whether in NI, the RoI or Scotland (and excluding material sourced from outside NI). However, estimates for 2015 are based on a variety of sources and assumptions (and time periods) and are therefore likely to contain some errors; therefore they must be considered only as indicative.

Table 2.1: Estimated volumes of Category 1 renderers serving customers in NI

	Linergy	*Foyle Proteins*	*College Proteins*	*Dundas*	*ABP Group*	*Total*
Average weekly volumes processed (of Category 1 material and fallen stock originating in NI) (tonnes)	[✂]	[✂]	[✂]*	[✂]	[✂]†	1,806
Share of average weekly volumes from NI (%)	[40–50]	[20–30]	[5–15]	[0–10]	[10–20]	100

Source: CMA analysis based on estimates from various renderers and meat processors.
*We have assumed that the volumes from NI processed by College Proteins are [✂].
†Volume of material from NI processed by ABP Group is based on information provided by UFBP on the volumes it received from ABP Group's two NI based meat processors (in Newry and Lurgan) in 2011.

Table 2.2: Estimated volumes of Category 3 renderers serving customers in NI

	UFBP	*Western Proteins**	*College / Farragh Proteins†*	*Dundas‡*	*ABP Group*	*Total*
Average weekly volumes processed (of Category 3 material originating in NI) (tonnes)§	[✂]	[✂]	[✂]	[✂]	[✂]¶	1,471
Share of average weekly volumes from NI (%)	[30–40]	[0–10]	[30–40]	[10–20]	[0–10]	100

Source: CMA analysis based on estimates from various renderers and meat processors.
*We have assumed that the volumes from NI processed at Western Proteins are [✂].
†The volumes from NI processed at Farragh Proteins are from [✂]. It told us that this figure substantially overstated its market share due to weaknesses in volume estimates and exclusion of in-house rendering. College Proteins' own estimate of its market share was 5–15%.
‡The volumes from NI processed at Dundas are [✂].
§We have assumed that [✂].
¶Volume of material from NI processed by ABP Group is based on information provided by UFBP on the volumes it received from ABP Group's two NI-based meat processors (in Newry and Lurgan) in 2011.

Customers

2.39 The great majority of Category 1 and 3 material is produced in slaughter houses and meat processing plants.[29] Category 3 material waste is also derived from other food factories and retail premises such as butchers and supermarkets, but the volumes involved tend to be very small. The Parties told us that, generally, material from such premises is collected in small vans or lorries in rounds from several similar premises, with loads then delivered to the rendering site. We have focused on all types of meat processors including slaughter houses. For simplicity, throughout this report, we refer to all meat processors and other suppliers of both Category 1 and 3 material as 'customers', whether the gate fees paid to or by renderers are positive or negative.

Meat processors

2.40 A relatively small number of meat processors use rendering services in NI. A number of these customers are vertically integrated with a supplier of

[29] Including boning and cutting halls.

rendering services. Some large meat processors, including FFG, ABP Group, Dawn Meats and Moy Park, own their own rendering facilities located on the island of Ireland. In addition, several rendering customers have some shareholder or similar relationship with Linergy.

2.41 There are several independent meat processors in NI which, to the CMA's knowledge, are not vertically integrated with a renderer. These range in size from WD Meats, the largest independent meat processor, which had approximately [✂] tonnes of Category 1 and Category 3 materials processed by Linergy and UFBP per week on average during 2014, to very small customers that had 5 tonnes or less per week on average rendered in 2014. Further information on some of Linergy and UFBP's current and former customers for rendering services is provided in Appendix F.

Fallen stock

2.42 There is a legal obligation on farmers to have fallen stock disposed of in an appropriate manner. This can include: rendering, incineration at a licensed plant, or through a hunt kennel (which can harvest meat for dog feed, following which the hunt kennel will dispose of any remaining material either through rendering or incineration). There are businesses that provide a collection/disposal service to farmers for fallen animals. These collectors generally work under contracts with the renderers; farmers contact renderers, which then arrange for the fallen stock to be collected from farms and delivered to the rendering plants. Linergy also allows farmers to bring fallen stock to its site themselves, which entitles them to a discount on the standard disposal fee.

2.43 A scheme operated by the National Fallen Stock Company (NFSCo) provides an administrative service to both farmers and renderers concerning the collection of payments and a platform for publishing each renderer's prices, which are set annually and apply to all farmers in NI.

Purchasers of outputs

2.44 As noted in paragraph 2.13, renderers sell the outputs of the rendering process, MBM and tallow, to customers for a range of different end-uses.

2.45 Third parties told the CMA that there was little demand for tallow from customers located in the UK and the RoI, but rather that most tallow was exported to mainland Europe. Indeed, one customer indicated that it had around 120 suppliers at any one time and sourced tallow from all across Europe. We received no evidence to suggest that the Parties' market positions in relation to tallow or MBM are significant. Some parties also

indicated that tallow competes with other types of fuels and raw materials for use as biofuels, as well as substitutes for oleo-chemicals. We were told that MBM was an internationally traded commodity product, with substitutes available. In particular, it was poorly regarded as a fuel for incineration because of its chemical and abrasive properties.

2.46 For these reasons, we have not considered any theories of harm in relation to the supply of tallow and MBM in this inquiry.

3. The companies

Linergy

3.1 Linergy operates an animal waste rendering facility in Dungannon, County Tyrone, NI. This plant renders raw material deemed to be Category 1 (or rendered as Category 1) and produces Category 1 tallow and MBM. During 2011 and 2012, Linergy considered building a Category 3 plant but decided against this investment in late 2012 (see paragraphs 6.46 to 6.78).

3.2 Prior to the Merger, Linergy had nine shareholders. Three of these shareholders together own Linden, a meat processor which also owns shares directly in Linergy. The two shareholders of Dunbia, another meat processor, also own shares directly in Linergy while the remaining three shareholders are directors of Linergy. Consequently, prior to the transaction with SAPI, 85% of Linergy's share capital was owned by shareholders of meat processing operators. These various shareholdings are summarised in Table 3.1 below.

Table 3.1: Pre-Merger shareholders in Linergy

Shareholder	*Other shareholdings/interests in related companies*	*Size of shareholding in Linergy*
		%
Linden Foods		12
Fane Valley Co-op	Linden Foods	27.5
William Waugh	Linden Foods	9
Gordon Waugh	Linden Foods	9
James Dobson	Dunbia	13.75
Robert Dobson	Dunbia	13.75
Sean McShane	n/a – management team	6
Richard Moore	n/a – management team	6
Gerry Maguire	MD of Linden Foods	3

Source: Linergy.

3.3 Linergy's Category 1 facility was established in 2005 and commenced operating in 2007. The meat processing shareholders established Linergy so they would gain certainty and appropriate value in relation to their disposal of

animal by-products.[30] In 2014, these meat processors accounted for [✂]% of Linergy's revenue from processing Category 1 material, [✂] from [✂]% in 2011, when Linergy used to process Category 3 material in its Category 1 plant, as explained in paragraph 6.50.

3.4 Linergy's revenue was £6.7 million in 2014 (2013: £7.6 million) and as at 30 September 2014, its net assets were £6.4 million (30 September 2013: £5.4 million).

UFBP

3.5 UFBP was established in 1952 by a co-operative of farmers, Glenfarm Holdings Limited (Glenfarm), to create a farmer-owned and controlled company to process fallen livestock in NI.[31]

3.6 UFBP currently operates a Category 3 animal waste rendering plant in Glenavy, County Antrim, NI. This Category 3 line has been operational since 2009, producing Category 3 tallow and MBM, having previously been one of two dedicated Category 1 lines at UFBP. UFBP's other Category 1 line was closed in October 2012. UFBP's intake of Category 3 material was approximately [✂] tonnes per week in 2014.

3.7 As set out in paragraphs 2 to 10 of Appendix E, UFBP's financial performance began to decline in 2010 [✂].[32] As explained in paragraphs 4.4 and 4.5, Linergy sought to purchase UFBP in 2011. However, the Office of Fair Trading (OFT) referred this merger to the CC, at which point Glenfarm decided not to pursue the transaction because it did not believe that UFBP would be able to stay in business for the time needed for the CC to complete a phase 2 review. In June 2012, Glenfarm sold UFBP to SAPI.

3.8 UFBP's revenue was £8.6 million in 2014 (2013: £5.6 million) and its net assets were £0.8 million as at 31 December 2014 (2013: £2.3 million).

SAPI

3.9 SAPI was established in 1964 in Modena, Italy, where it operates a rendering business. SAPI said that its focus is on the value of the end products

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[30] Linden and Dunbia both have substantial meat processing operations in Dungannon, close to Linergy's plant. We understand the intention was to reduce the costs to meat processors of disposal of material through rendering. At the time of establishment, more material was classified as Category 1 than now applies, and so it was not necessarily worthwhile to separate out Category 3 material. Following reclassification of some Category 1 material to Category 3 in 2009, Category 3 became more significant.
[31] See the UFBP Our History webpage.
[32] [✂]

produced by the rendering business.[33] Its business in Italy is to collect and process Category 3 raw material producing tallow and MBM.

3.10 SAPI's strategy has been to acquire rendering businesses outside Italy. SAPI purchased its first subsidiary outside Italy, in Uruguay, around 12 years ago, which was followed by acquisitions in Brazil and New Zealand. SAPI told us it aims to purchase companies in countries where agricultural business is considered to be an important part of the economy.

3.11 Outside Italy, SAPI's preferred investment policy is to seek local partners to take over the operational side of the animal by-products processing businesses in which SAPI invests.[34]

3.12 However, SAPI told us that this is more of a long term preference but it is not essential as SAPI has demonstrated by having significant majority stakes in three subsidiaries based in Spain.

3.13 SAPI also told us it purchases Category 3 MBM from across Europe in order to supply its extraction plant in Italy.

3.14 Between 2011 and 2014, SAPI purchased on average [✂] tonnes of Category 3 MBM per year from companies based in the RoI. Following its acquisition of UFBP in 2012, it has purchased most, if not all, of UFBP's Category 3 MBM.

3.15 SAPI's consolidated revenue was €[✂] million in 2014, with earnings before interest, tax, depreciation and amortisation (EBITDA) of €[✂]. Net assets as at 31 December 2014 were €[✂].

4. The completed merger and relevant merger situation

Outline of the merger

Linergy's proposed purchase of UFBP in 2011

4.1 UFBP's previous parent company, Glenfarm, told us that the volumes of raw materials UFBP received began to fall around 2010 as its customers started sending their materials to Dundas, a renderer based in Scotland. This competition also prevented UFBP from increasing gate fees to compensate for these lost volumes, and UFBP began to incur significant losses.[35]

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[33] Parties' initial submission, p1.
[34] Parties' initial submission, question 2.
[35] Glenfarm hearing summary, paragraph 11.

4.2 [✂] and higher operating costs, partly due to the environmental problems at its site, resulted in a worsening of UFBP's financial performance (see Appendix E).

4.3 Glenfarm told us that, by 2011, it could not see the situation at UFBP improving and so it approached Linergy mid-way through 2011 to see whether it would be interested in purchasing UFBP.[36] Glenfarm said that it knew that the business value would be based on its volumes and so tried to keep volumes up despite the losses it was making.[37]

4.4 Glenfarm and Linergy entered into negotiations and, on 23 November 2011, Linergy signed an agreement to acquire UFBP from Glenfarm conditional on clearance by the OFT. The purchase price agreed by the parties was £[✂] (after deductions).[38]

4.5 On 15 March 2012, the OFT referred the merger to the CC for a phase 2 investigation.[39] The acquisition was abandoned after this referral[40] and Glenfarm started a new sales process for UFBP, described as 'simplified and accelerated', managed by PricewaterhouseCoopers (PwC).

SAPI's acquisition of UFBP and UFBP's merger with Linergy

4.6 Ten potential purchasers, not including SAPI, were approached by PwC. Three of these, as well as SAPI, which had learned of the sale through its agent responsible for sourcing Category 3 MBM in the RoI, made indicative offers, with three submitting final offers.[41] Following submission of these final offers, SAPI was selected as Glenfarm's preferred bidder[42] on 30 April 2012 and entered into an exclusivity agreement on 11 May 2012, committing to pay a non-refundable deposit of £500,000. On 6 June 2012, SAPI acquired UFBP for a consideration of £[✂].

4.7 SAPI told us that it approached Linergy during the week commencing 1 May 2012 to explore the possibility of future areas of co-operation between the Parties.

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[36] Glenfarm hearing summary, paragraph 12.
[37] Glenfarm hearing summary, paragraph 12.
[38] OFT decision of 15 March 2012 on the anticipated acquisition by Linergy Limited of Ulster Farm By-Products Limited, CASE ME/5294/11.
[39] See the OFT decision.
[40] The Parties told us Glenfarm pulled out as it did not believe UFBP would financially survive for the duration of a CC review. The CC did not undertake a competitive assessment of the proposed Linergy acquisition of UFBP in 2012 as the merger was abandoned.
[41] These three bidders were SAPI, [✂] and ABP.
[42] Glenfarm told us that if the sale to SAPI had fallen through [✂].

4.8 This approach led to negotiations which culminated in the signing of an MoU between SAPI and Linergy on 31 May 2012 regarding a possible merger between Linergy and UFBP conditional, amongst other things, on clearance from the regulatory authorities. This MoU is discussed in further detail in paragraphs 5.1 to 5.20.

4.9 SAPI also entered into a contract with Linergy to provide certain engineering services on a temporary basis at UFBP, particularly 'on the ground' and 'interim' services. A six-month services agreement was signed on 4 July 2012. Nevertheless, SAPI brought its own engineers to provide the services necessary in order to operate UFBP's facilities.

4.10 In May 2013, Linergy instructed its lawyers to advise on the competition issues that could arise if a merger between Linergy and UFBP was to be attempted. An economic consultant was also appointed to review the competition and economic issues.[43]

4.11 In early 2014, Linergy contacted SAPI to discuss the possibility of a merger. In May 2014, the Parties met and agreed in principle to merge. Further discussions took place and Heads of Terms (HoT) were signed on 19 September 2014.[44]

4.12 On 14 May 2015, the transaction was completed. The MoU Parties signed a Share Sales Agreement (SSA) and Linergy's shareholders and SAPI signed a Share Purchase Agreement (SPA). Pursuant to the SSA, Linergy acquired all of UFBP's issued share capital (the Merger) for a consideration of £[✂], which was satisfied by SAPI receiving [✂] shares in Linergy. This shareholding equated to [✂]% of the entire issued share capital of Linergy. Pursuant to the SPA, SAPI acquired an additional [✂] shares in Linergy for a cash consideration of £[✂]. This equates to [✂]% of the entire issued share capital of Linergy.[45]

Jurisdiction

4.13 Under section 35 of the Act, and pursuant to our terms of reference (see Appendix A), we are required to investigate and report on certain statutory questions, the first being whether a relevant merger situation has been created. Section 23 of the Act provides that a relevant merger situation has been created if two or more enterprises have ceased to be distinct within the

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[43] Parties' initial submission.
[44] Parties' initial submission.
[45] UFBP was valued at being worth [✂]% of the combined entity. Therefore, SAPI paid a further £[✂] for the additional [✂]% shares so that its shareholding totalled 30% of the combined entity.

statutory period for reference and either the turnover test or the share of supply test (or both) specified in the Act is satisfied.

4.14 As required by our terms of reference, we considered this statutory question in relation only to the Merger, namely the acquisition by Linergy, under the SSA, of the entire issued share capital in UFBP.

4.15 Our assessment of jurisdiction is set out in Appendix C. We considered that both Linergy and UFBP are enterprises since each operates a business which supplies animal rendering services. The Merger brought these enterprises under common ownership and control as Linergy acquired 100% of the share capital of UFBP.[46] Further, we considered that the businesses ceased to be distinct within the statutory period for reference.[47]

4.16 Since UFBP's turnover is less than £70 million (which is the turnover test in section 23(1)(b) of the Act), we considered that the turnover test is not satisfied.[48] For the share of supply test to be satisfied, the merger must result in an increase in the share of supply (or acquisition) of goods or services of a particular description and the resulting share must be 25% or more. We considered that this test is satisfied, with the Merger having resulted in both an increase in the Parties' share of supply and in them having a combined share of over 25% in the supply of mammalian by-product rendering services in NI.[49]

4.17 In view of this, we consider that the Merger has created a relevant merger situation.

5. The Memorandum of Understanding

The rationale for the MoU

5.1 The Parties told us that, in May 2012, SAPI approached Linergy after SAPI became involved in the sale process for UFBP. The Parties told us that SAPI explained to Linergy that it wanted to find out if Linergy would be interested in the possibility of becoming a partner with SAPI in UFBP at some stage in the future if SAPI was successful in acquiring UFBP. The Parties told us (see paragraph 3.11) that this was in line with SAPI's investment policy outside

[46] See paragraph 4.12.
[47] See paragraphs 3–8 of Appendix C.
[48] See paragraph 9 of Appendix C.
[49] See paragraphs 10–15 of Appendix C.

Italy, whereby it seeks local partners to take over the operational side of animal by-product processing businesses in which it invests.[50]

5.2 According to SAPI, the MoU was intended to help SAPI explore over a two year period whether Linergy could be a suitable long-term partner. [✂]

5.3 According to Linergy, the MoU was an opportunity to explore the possibility of obtaining ownership of UFBP. Linergy told us that the MoU should be seen in the context of the decision by Glenfarm to abandon its proposed sale of UFBP to Linergy following the OFT's decision of 15 March 2012 to refer the transaction to the CC. Linergy still wanted to own UFBP, and the MoU gave Linergy the opportunity to explore a way in which it might do so.

5.4 This is supported by the minutes of a general meeting of Linergy's shareholders of 21 May 2012, which state the following: [✂].

5.5 Linergy submitted that, when it was approached by SAPI in May 2012, it expressed an interest in pursuing the matter because it believed the OFT's competition concerns were unfounded. It had abandoned its previous attempt to acquire UFBP because Glenfarm had withdrawn anticipating that UFBP could not stay in business for the time needed for the CC to complete a phase 2 review. Linergy and SAPI entered into the MoU on 31 May 2012.[51]

5.6 SAPI told the CMA that it entered into the MoU after taking legal advice on the competition issue, and the advice was that a merger in the future could be possible. It had previously visited Linergy's new plant and considered Linergy a good local partner. SAPI believed Linergy's shareholders were impressed by its knowledge, worldwide presence and skills in relation to rendered by-products. SAPI therefore thought that Linergy wanted to explore the possibility to co-operate with SAPI.

Overview of the key provisions

5.7 As noted in paragraph 4.8, Linergy and SAPI (the MoU Parties) entered into an MoU on 31 May 2012. This MoU preceded SAPI's acquisition of UFBP, which took place on 6 June 2012. The terms of the MoU were amended in two respects on 18 June 2012. Further detail on the MoU is provided in Appendix D.

5.8 In the MoU, the MoU Parties agreed that, subject to regulatory approval, it was 'their intention to complete a merger' between Linergy and UFBP by

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[50] Parties' initial submission, p2.
[51] Parties' initial submission, pp2–3.

30 June 2014 (ie within approximately two years). They also agreed that SAPI would acquire 30% of the shares in the combined Linergy/UFBP entity. In Appendix D, we set out the arrangements in the MoU (and our assessment of them) both if the envisaged merger went ahead and if it did not. We also set out the implications of the HoT (see paragraph 4.11) in Appendix D.

5.9 The arrangements for the merger set out in the MoU included the valuations of Linergy and UFBP. Linergy's valuation was based on a multiple of its earnings (EBITDA) and would be adjusted if [✂] between October 2009 and completion of SAPI's acquisition of UFBP [✂], or if [✂][52] on the date of completion of SAPI's acquisition of UFBP [✂]

5.10 The MoU provided that, [✂]. The terms set out in the MoU were reflected in the SPA for the transfer of shares in Linergy to SAPI and the SSA in respect of the sale of the entire issued share capital of UFBP to Linergy. The valuations were also carried through into the SSA and the SPA.

5.11 The MoU also included arrangements that would apply if the merger between Linergy and UFBP did not go ahead in the form envisaged in the MoU. These arrangements provided that, if both MoU Parties agreed not to go ahead with the envisaged merger or one of the MoU Parties unilaterally decided not to go ahead by serving an abort notice during a specified period, [✂]. If the envisaged merger was prevented by regulatory obstacles, the MoU [✂] that unilaterally decided not to proceed with the merger by serving an abort notice. This [✂] if completion of the merger was prevented by regulatory obstacles and SAPI decided to continue operating UFBP.

5.12 In the event that Linergy could not acquire UFBP due to a regulatory obstacle and SAPI decided to exit UFBP [✂]. If, following a regulatory obstacle, SAPI decided not to exit UFBP but to continue operating it, [✂].

Assessment

5.13 The MoU Parties made several submissions about the impact of the MoU, partly in response to the CMA's phase 1 decision on the MoU's effect on the MoU Parties' incentives.[53] The MoU Parties submitted that the MoU 'was not an expression of intent but rather a framework under which a merger could take place if the parties decided to seek to proceed with one at some point in the two year period following the signing of the MoU'.[54] They also stated that

[52] This was defined in the MoU as consisting of '[✂]'.
[53] For example, Parties' initial submission, pp3 & 41–43.
[54] Parties' initial submission, p40.

the MoU had 'too many possible outcomes, dependent on too many events, to be taken into account by the MoU Parties in important strategic decisions' (including several outcomes in which a premium and profit sharing element did not apply) and that in any case there is evidence that indicates competition took place between the MoU Parties.[55]

5.14 The MoU Parties said that the MoU was no more than 'writing down and putting together something where the parties were relatively unknown and had no relationship and understanding' and was intended 'to put something in place, to frame the discussions'. The MoU Parties said that there was no certainty regarding the outcome given the way the MoU was framed. Linergy said that 'it was another avenue, which was, in our view at that stage, worthy of exploring to see what may develop or could develop from it in the longer term'.

5.15 SAPI told us that it had instigated the provisions relating to the [✂] to protect itself from the situation in which the merger did not proceed but it had already transferred some SAPI know-how to Linergy.[56]

5.16 However, while the MoU was subject to regulatory approval and included arrangements in case the envisaged merger did not proceed, we considered that it showed that the MoU Parties intended to merge Linergy and UFBP at the time they signed the MoU. This is based on the clauses in the MoU that state that the 'parties acknowledge that subject to regulatory approvals it is their intention to complete a merger of UFBP and Linergy',[57] and that each MoU Party had to [✂] to the other if it unilaterally decided not to go ahead. This view is also supported by the minutes of the general meeting of Linergy's shareholders on 21 May 2012, which, in relation to a discussion of the draft MoU, stated that '[✂]'.

5.17 We considered that, following the signing of the MoU, each MoU Party acquired a stake in the other MoU Party's financial performance pending either completion of the envisaged merger or, at least in a number of situations, a decision not to proceed with the merger. Even if this was not the intention of the MoU (as submitted by the Parties), we were satisfied that this was its effect. If the merger did not go ahead as envisaged in the MoU, each MoU Party would (at least in a number of situations) share in the other MoU Party's financial results in proportion to its envisaged shareholding in the combined entity, ie 30% for SAPI and 70% for Linergy. This would also apply

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[55] Such as Linergy's decision to '[✂]' set out in Linergy's Board minutes of 27 September 2012 (referred to in the Parties' initial submission, p54).
[56] SAPI told us 'In 24 months, if you have, let us say, daily conversations, our risk [was] that we were bringing in, in our opinion, skill on sales, commercial'. The Parties also told us that '[✂]'.
[57] Clause 2.1 of the MoU.

if the envisaged merger did go ahead. We considered that this created an incentive for each of the MoU Parties to take account of the impact of its commercial decisions on the other and that this would be the case in a sufficiently large number of scenarios that it could affect the MoU Parties' incentives (even if, as the MoU Parties submitted, it would not have affected matters in all scenarios that could have arisen after the signing of the MoU).[58]

5.18 We considered that the HoT (see paragraph 4.11) that the MoU Parties and Linergy's then-shareholders signed on 19 September 2014[59] did not change the impact of the MoU on the MoU Parties' incentives. Although the approximate two-year period envisaged in the MoU had expired when the HoT were agreed, the HoT stipulated that the terms of the MoU would continue to apply (apart from the terms that provided for the arrangements that would apply if the envisaged merger did not go ahead).

5.19 In assessing the MoU's importance for the counterfactual (see paragraph 6.1), we were mindful of the fact that the SLC analysis involves a comparison of the situation following a merger with the situation which, on the balance of probabilities, would have developed in the market in the absence of the merger. The immediate pre-merger situation is not in all cases a good predictor of this.[60]

5.20 Given our assessment that the MoU created an incentive for each of the MoU Parties to take account of the impact of its commercial decisions on the other, we considered it was appropriate to examine the impact of the MoU on the decisions taken by the Parties after they entered into it. This applies, in particular, to SAPI's decision to close UFBP's Category 1 plant and Linergy's decision not to build a Category 3 plant. The incentives created by the MoU do not in themselves mean that the situation that developed after the MoU would have been different absent the MoU. We therefore assessed the evidence available in relation to each of these decisions, as set out in paragraphs 6.20 to 6.78.

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[58] Under the MoU, the sharing in the other MoU Party's financial results applied in any case if (i) the envisaged merger went ahead as intended when the MoU was signed, (ii) the envisaged merger was abandoned but [✂], and (iii) the envisaged merger was blocked by a regulatory obstacle and SAPI decided to continue operating UFBP. The Parties said this sharing would not apply if the merger did not go ahead for a reason other than a regulatory obstacle and SAPI decided to continue operating UFBP. The MoU is unclear on this point, but we considered that, even if the Parties' submission on this was correct, each MoU Party nonetheless acquired a stake in the other MoU Party's financial performance in a sufficiently large number of scenarios that the MoU could affect the MoU Parties' incentives.
[59] See paragraphs 31–33 of Appendix D.
[60] *Stagecoach Group plc v Competition Commission* (2010), CAT 14, paragraph 20.

6. The counterfactual

Introduction

6.1 Before we turn to the effects of the Merger, we need to assess what we believe would have been the competitive situation in the absence of the Merger. This is called the 'counterfactual'.[61] It provides a benchmark against which the expected effects of the Merger can be assessed. As set out in our guidelines, the CMA typically incorporates into the counterfactual only those aspects of scenarios that appear likely on the basis of the facts available to it and the extent of its ability to foresee future developments.[62]

6.2 In relation to our competitive assessment of the merger between Linergy and UFBP, we note two key decisions: in 2012, UFBP closed its Category 1 plant and Linergy decided not to build a Category 3 plant.

6.3 The Parties submitted that the counterfactual position would be the same conditions of competition as those that currently prevail.[63] This would be that SAPI would have acquired UFBP, closed UFBP's Category 1 plant, and only operated UFBP's Category 3 plant. Linergy would have continued to operate its Category 1 plant and would not have built a Category 3 plant. Therefore, in the counterfactual, UFBP would be operating a Category 3 plant and Linergy a Category 1 plant.

6.4 Given that we believe the MoU had the potential to alter the Parties' incentives (see paragraph 5.17), we have taken SAPI's decision to purchase UFBP as the starting point for our consideration of the counterfactual, before assessing whether we believe the same key decisions taken by the Parties would have been adopted in the absence of the MoU.

6.5 In order to determine the most likely counterfactual scenario, we look in turn at:

(a) the sale of UFBP in 2012 and what would have been the most likely alternative situation in the absence of the MoU between SAPI and Linergy; and in the light of that situation;

(b) whether UFBP's Category 1 plant would have closed; and

(c) whether Linergy would have built a Category 3 plant.

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[61] *Merger Assessment Guidelines*, paragraph 4.3.1.
[62] *Merger Assessment Guidelines*, paragraph 4.3.6.
[63] Parties' initial submission, Section 10.1.

SAPI's acquisition of UFBP

6.6 For the reasons outlined in paragraphs 4.1 to 4.5, Glenfarm decided to put UFBP back on the market in 2012 and chose SAPI as its preferred bidder. As noted at paragraphs 4.7 and 4.8, prior to the date of its acquisition of UFBP, SAPI entered into the MoU with Linergy. In the following section we look at whether SAPI's acquisition of UFBP was reliant on the MoU with Linergy, ie whether SAPI would have acquired UFBP if the MoU had not been signed.

Events leading up to the acquisition of UFBP and the signing of the MoU

6.7 SAPI told us that it would have purchased UFBP without the MoU and that the price paid for UFBP was not linked to the MoU. It provided details of the key events leading up to its acquisition of UFBP and the agreement of the MoU with Linergy. These events were the following:

(a) In April 2012, SAPI discovered that UFBP was for sale. SAPI approached PwC to register its interest in UFBP and request the available documentation about the sale.

(b) By 6 April 2012, SAPI made an indicative bid for UFBP.

(c) On 27 April 2012, SAPI submitted its final offer and a marked up SPA for UFBP.

(d) In the week commencing Tuesday 1 May 2012, SAPI approached Linergy and said that it was interested in exploring potential areas of co-operation between the two parties.

(e) On 7 May 2012, Linergy met its legal advisers, Arthur Cox, to discuss SAPI's approach.

(f) On 8 May 2012, Arthur Cox contacted SAPI's lawyers, LCA.

(g) On 11 May 2012, SAPI entered into an exclusivity agreement with Glenfarm in relation to the purchase of UFBP and committed to pay a non-refundable deposit of £500,000.

(h) On 15/16 May 2012, Linergy and Arthur Cox met SAPI and LCA in Arthur Cox's offices in Belfast.

(i) At the 21 May 2012 Linergy board meeting, Linergy's board members [✂] approved Linergy entering into an MoU with SAPI.

(j) Between 21 and 31 May 2012, meetings took place between Linergy and SAPI and their advisers to discuss and negotiate the terms of a possible MoU.

(k) On 31 May 2012, the MoU was signed by SAPI and Linergy.

(l) On 6 June 2012, SAPI completed its purchase of UFBP.

6.8 We note from the dates of the events shown in paragraph 6.7 that SAPI had put in a final offer with a marked up SPA (in accordance with the requirements of the UFBP sale process) prior to the time that it told us it approached Linergy. Furthermore, although discussions between SAPI and Linergy had been initiated, no agreement on the MoU had been reached when SAPI agreed to pay a substantial non-refundable deposit to the vendors of UFBP.

6.9 However, the payment of the deposit did not create a contractual obligation on SAPI to acquire UFBP. Between the date of the exclusivity agreement and SAPI's acquisition of UFBP, SAPI signed the MoU with Linergy. SAPI therefore had a signed MoU with Linergy in place at the point at which it completed its acquisition of UFBP.

SAPI's rationale for acquiring UFBP and entering into the MoU with Linergy

6.10 SAPI told us in October 2015 that it started purchasing Category 3 MBM from renderers in the RoI five years ago and consequently was aware of developments in this market. SAPI told us it was attracted by UFBP's position as operating the only Category 3 plant in NI, a country where agriculture is an important part of the economy.

6.11 SAPI also told us it considered that there was significant potential to add value to UFBP's business. [✂][64]

6.12 SAPI stated that its decision to acquire UFBP and to enter into the MoU with Linergy were not mutually dependent. [✂]

6.13 However, SAPI told us that obtaining a local partner immediately was not essential and, when bidding for UFBP, it considered UFBP as a standalone business, not a joint venture with Linergy. SAPI told us that whether or not Linergy agreed to enter a future partnership did not affect its negotiations in relation to the purchase of UFBP.

6.14 In SAPI's view, its willingness to purchase UFBP without any agreement with Linergy is demonstrated by the offer it made for UFBP which it submitted

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[64] [✂]

before initiating discussions with Linergy and by the non-refundable deposit of £500,000 it committed to pay before Linergy's board had agreed in principle to enter into an MoU.

Our assessment of whether SAPI would have acquired UFBP absent the MoU

6.15 SAPI's strategy, as described in paragraphs 3.10 to 3.14, is to invest in rendering businesses and to focus on the end value of Category 3 outputs. In view of SAPI's confidence that it could improve the performance of UFBP and UFBP's position as the only Category 3 renderer located in NI, the purchase of UFBP was in line with SAPI's strategy.

6.16 SAPI had visited UFBP's site and put in a final offer and a marked up SPA prior to starting discussions with Linergy. Although it had initiated discussions with Linergy, it entered into a contract to pay the non-refundable deposit before Linergy's board agreed to enter into the MoU.

6.17 Since SAPI's final offer was made before SAPI had an expectation that the MoU would be signed, we considered that the size of SAPI's bid would have been the same without the MoU. As such, it would still have been the highest bidder for UFBP. While there is little hard evidence, dating from the time that the decisions were made, to corroborate what we have been told by SAPI about its rationale for the acquisition and the timing of the MoU discussions with Linergy, we have not seen any evidence that suggests otherwise. We therefore considered that, in the counterfactual, the most likely purchaser of UFBP would have been SAPI.

6.18 As part of our assessment of the counterfactual, we also considered whether SAPI would have reached an agreement with an alternative partner that would have affected SAPI's behaviour. However, we saw no evidence that any other potential partner was lined up by SAPI, and we considered that it was not foreseeable that a specific agreement would have been reached which would have affected SAPI's decision to close its Category 1 plant.

6.19 We conclude that SAPI would have acquired UFBP, irrespective of whether or not it entered into the MoU with Linergy.

The operation of UFBP's Category 1 plant under the counterfactual

6.20 Based on this conclusion, we now consider whether, under the counterfactual, SAPI would have closed UFBP's Category 1 plant.

6.21 In the following section we first set out SAPI's evidence with regard to its closure of the Category 1 plant. We then assess the evidence in respect of

the financial performance of the Category 1 plant, the environmental issues and the investment required at the plant, as well as the strategic reasons for having both a Category 1 and a Category 3 plant. We then conclude on whether UFBP would have closed the Category 1 plant under the ownership of SAPI in the absence of the MoU.

SAPI's reasons for closing its Category 1 plant

6.22 SAPI told us that at the time that it purchased UFBP, the Category 1 plant was working and the severity of the problems at this plant (see paragraphs 6.30 to 6.34) was not yet clear to SAPI. SAPI told us that, although the Category 1 business was not SAPI's main focus, its presence gave UFBP the ability to offer a full service to customers, which increased its ability to attract Category 3 material. [✂]

6.23 SAPI told us that, after it acquired UFBP, it undertook a review of the Category 1 plant, which lasted a number of months. SAPI stated that its review concluded that the site required significant upgrades and capital investment in order to resolve the substantial environmental problems it was facing. SAPI stated that this investment could not be justified commercially as the plant was loss-making.[65]

6.24 Furthermore, SAPI stated that there were reputational risks for SAPI associated with the continued operation of the Category 1 plant given its environmental issues. SAPI told us that it did not want its reputation to be damaged because of one operation in NI.[66]

6.25 In October 2012, there was a fire in the meat cooler of the Category 1 line, which resulted in the shutdown of the Category 1 plant. SAPI told us that, after the fire, it considered that the Category 1 plant was not worth re-opening and, accordingly, this incident accelerated SAPI's decision to close the Category 1 plant.

Financial performance of UFBP's Category 1 plant

6.26 UFBP's Category 1 plant was losing an average of £[✂] per month at an EBITDA level between October 2010 and its closure in October 2012. After accounting for depreciation costs, these losses increased to £[✂] per month, or £[✂] in total.

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[65] Parties' initial submission, Section 2.
[66] Parties' initial submission, Section 10.2.2.

6.27 [✂]

6.28 SAPI submitted that the main commercial problem at UFBP's Category 1 plant was a lack of volumes.[67] [✂] Figures submitted by UFBP also show that, as well as low volumes, it was costing UFBP more to render Category 1 material than it was receiving in revenue.

6.29 In 2011, UFBP's Category 1 average variable costs were calculated to be £[✂] per tonne. Compared with the average Category 1 price it charged to its customers of £[✂] per tonne, UFBP was making an average [✂] of £[✂] per tonne of Category 1 material it rendered. Consequently, in order to become profitable, UFBP would have had to improve its efficiency very significantly.

Environmental issues

6.30 Glenfarm told us that it had been contacted by NIEA several times in the period 2005 to 2012 regarding the state of UFBP's Category 1 plant, and was receiving lots of complaints from its neighbours.[68] NIEA confirmed to us that it visited UFBP frequently at this time due to these reasons. [69]

6.31 Glenfarm told us that the effluent system had been the cause of most of the problems and had necessitated major expenditure over the years. Glenfarm also stated that, although it considered the thermal oxidisers[70] to be fit for purpose, Linergy's due diligence in 2011 concluded that these would have to be replaced.[71]

6.32 In 2005, UFBP was granted a Pollution Prevention and Controls permit allowing it to discharge water effluent into the nearby river but requiring improvements in the plant's environmental performance. By 2009, failures to adhere to the discharge conditions culminated in NIEA issuing an enforcement notice based on five breaches of ammonia limits in its discharge consent conditions. UFBP pleaded guilty and was fined £24,000. UFBP made an investment in its water treatment system in 2009 which enabled it to comply with the relevant standards.

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[67] Parties' initial submission, Section 10.2.1.
[68] Glenfarm hearing summary, paragraphs 6 & 7.
[69] NIEA and DARD hearing summary, paragraph 1.
[70] Thermal oxidisers are used to control or eliminate odours resulting from rendering activities.
[71] Glenfarm hearing summary, paragraph 8.

6.33 However, in 2012, NIEA brought a new case against UFBP regarding both water and odour concerns. UFBP pleaded guilty to seven charges and was fined £35,000.[72]

6.34 The Parties submitted that the number of complaints that UFBP received about its Category 1 plant ranged from 45 to 110 per year between 2006 and 2012 and that no complaints had been received since its closure.[73]

6.35 SAPI's full review of the Category 1 plant concluded that many assets would need to be replaced, at a significant cost, in order to resolve the environmental problems.[74] SAPI believed that it would have cost in the region of £[✂] million to enable it to operate the Category 1 plant effectively.[75] [✂] Finally, the buildings needed significant repair work in order to bring them up to standard, costing around £[✂].

6.36 However, other parties interested in purchasing UFBP in 2012 said that the environmental problems at UFBP's Category 1 plant could have been addressed and rectified. Site visits and due diligence performed by these parties concluded that, although the condition of the Category 1 plant was poor and investment plans had not been fully developed, they expected to be able to fix these problems. According to these parties, the required investment to fix these problems was reflected in the amounts of their bids for UFBP.

6.37 NIEA believed that the UFBP Category 1 plant was not 'fit for purpose' and needed replacement thermal oxidisers. NIEA thought that the UFBP Category 1 plant was probably beyond repair after the fire and the only way it could have remained in business would have been for the owners to demolish it and build a new one.[76]

Strategic reason for keeping UFBP Category 1 plant open

6.38 The Parties submitted that, since a Category 1 plant and a Category 3 plant must operate as two stand-alone operations, the opportunities for production synergies are limited. In addition, all material must be transported separately and in designated containers; therefore, no transport savings can be made by operating two plants with different classifications.[77]

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[72] Sniffer (March 2013), *Review of odour monitoring and control techniques at rendering plants*, paragraph 7.3.5.
[73] Parties' initial submission, Section 10.2.1.
[74] Parties' initial submission, Section 10.2.2.
[75] Parties' initial submission, Section 10.2.2.
[76] NIEA and DARD hearing summary, paragraphs 7 & 12.
[77] Parties' initial submission, Section 10.4.3.

6.39 Furthermore, they submitted that, as renderers typically collect material from the sites of their customers, meat plant operators do not have to carry out any additional work if they use two different renderers.[78] Consequently, few cost savings can be made by operating both a Category 1 and a Category 3 plant.

6.40 SAPI and a number of third parties[79] told us, however, that there is a strategic benefit from operating both a Category 1 and a Category 3 plant in that customers would be dealing with just one supplier. After it closed UFBP's Category 1 plant, SAPI continued to take Category 1 material. This material was sent to the remaining renderers in NI that provide Category 1 rendering services.

Our assessment of whether UFBP's Category 1 plant would have remained open in the counterfactual

6.41 At the time of its closure, UFBP's Category 1 plant was making significant losses. The [✂] (see paragraph 3.7) had had a significant adverse effect. In addition, the operational performance of the plant was poor and the opportunity to improve performance by producing more value from the outputs was limited since, unlike Category 3 outputs, Category 1 MBM must be incinerated, and the Category 1 tallow was being used by UFBP to power the plant itself.

6.42 The environmental issues were also significant [✂] at the time it acquired UFBP. Significant investment was required both to fix these problems and to increase efficiencies. SAPI was reluctant to make this investment given the lack of opportunity to increase volumes [✂].

6.43 Furthermore, given the close proximity of two other Category 1 plants in NI, operated by Foyle and Linergy, UFBP had the ability to send material to these plants and, therefore, to offer a full service to its customers and continue to attract their Category 3 materials.

6.44 We note that alternative purchasers said that they would have kept the Category 1 plant open, but we considered SAPI's rationale to be reasonable, in light of the problems it discovered, the fire and its focus on the value of the end products that are produced as a result of rendering.

6.45 We conclude, for the reasons set out above, that, in the counterfactual, SAPI would have closed the Category 1 plant. We considered that this closure

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[78] Parties' initial submission, Section 10.4.3.
[79] This benefit of dealing with just one supplier was also supported by WD Meats and Dundas, which said that it was an advantage for a renderer to operate both a Category 1 and a Category 3 plant.

would have been likely to have occurred at a similar time to that of the actual closure in October 2012 as a result of the review undertaken by SAPI, irrespective of whether the fire had or had not occurred under this scenario.

Linergy's decision in relation to building its own Category 3 plant

6.46 Prior to its proposed purchase of UFBP in 2011, Linergy's board had approved plans to build its own Category 3 plant at its site in Dungannon. The possibility of purchasing UFBP and therefore gaining access to a Category 3 plant more quickly superseded these plans, but they were revisited and rejected in December 2012 (see paragraph 6.62). This was after Linergy had signed the MoU with SAPI.

6.47 In the following section we look at whether, in the counterfactual scenario where SAPI has acquired UFBP but has not agreed an MoU with Linergy, Linergy would have come to a different decision with regard to building its own Category 3 plant.

6.48 We first considered the background to Linergy's initial decision to approve the building of a Category 3 plant, running chronologically through the key decisions made, up to the final decision not to proceed. We then considered the market conditions in December 2012 to assess whether Linergy would have taken the same decision not to build a Category 3 plant if there had been no MoU in place between SAPI and Linergy.

Background to Linergy's interest in building a Category 3 plant

6.49 Linergy submitted that, in 2009, new markets began to develop for Category 3 end products which were being sold at significantly higher prices than Category 1 end products. Consequently, Category 3 animal by-products became more valuable than Category 1 animal by-products[80] (see paragraph 2.15).

6.50 Linergy stated that, as a Category 1 rendering facility, all its outputs were classified as the lower value Category 1 outputs and so it could only offer Category 1 prices to its customers for their raw material. Linergy said that this threatened to result in a reduction in the volumes processed by Linergy, as the Category 3 material it processed at the time would be switched to a renderer that could offer Category 3 prices.[81]

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[80] Parties' initial submission, Section 10.3.2.
[81] Parties' initial submission, Section 10.3.2.

6.51 Linergy's largest customers were also major shareholders, Linden and Dunbia. These shareholders had entered into agreements with Linergy to send all their animal by-products from their meat processing facilities on the Granville Industrial Estate site in Dungannon, exclusively to Linergy. Linden and Dunbia, as Linergy shareholders, had also [✂] to have all their animal by-products processed by Linergy [✂]. This meant that, [✂].

6.52 As a result of the factors set out above, Linergy decided to explore the possibility of building a Category 3 rendering plant at its site in Dungannon.

Timeline of Linergy board discussions

6.53 Linergy said that the first board discussion regarding the building of a Category 3 plant took place in May 2009. At this meeting, the project was ruled out as a 'non-starter' due to the expected low volumes of available Category 3 materials.[82]

6.54 In September 2009, an alternative design for the plant was discussed by the board and it was agreed that this should be explored in greater detail.[83]

6.55 Linergy's management presented a business plan for building a Category 3 plant to its board on 3 May 2010. Linergy's management stated that the threat to gate fees [✂] and that the output prices for Category 3 MBM and tallow justified the proposed investment. At this meeting, it was [✂] decided by the board to go ahead with building a Category 3 plant.

6.56 [✂]

6.57 On 10 December 2010, a new model was presented to the board based on capital expenditure [✂]. At this stage, the shareholders agreed in principle to proceed with preparations for the investment.

6.58 At the 24 January 2011 board meeting, the board expressed a view that Linergy would be placed at a major disadvantage if it did not invest in a Category 3 plant. The board minutes state that [✂] board members were in favour of the investment. [✂] The board minutes noted some reservations expressed [✂] over securing sufficient volumes but the board agreed to proceed with the investment.

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[82] Parties' initial submission, Section 10.3.2. Linergy did not state what these volumes would have been.
[83] Parties' initial submission, Section 10.3.2.

6.59 The minutes of the Linergy board meeting held on 4 May 2011 noted that the then current bank proposals would require a cash contribution [✂] by shareholders. This requirement was accepted [✂].

6.60 At its 5 September 2011 board meeting, Linergy's chairman informed the board that it had been approached by Glenfarm with regard to the potential sale of UFBP. The board minutes noted that the acquisition of UFBP would provide Linergy with a Category 3 facility immediately and that the bank had been made aware that Linergy might enter the Category 3 market through acquisition rather than a new-build. Linergy pursued the acquisition of UFBP until Glenfarm withdrew from the transaction following the OFT's referral to the CC in March 2012.

6.61 In April 2012, Linergy sold a part of the land at its site for £[✂], and consequently had sufficient funds to repay the bank loan if required to do so by [✂]. We were told that, in consequence, Linergy's shareholders were therefore able to send their Category 3 material to renderers other than Linergy. On 5 July 2012, Linden, one of Linergy's shareholders, entered into an agreement with UFBP, agreeing to supply to it all of its Category 3 bovine/ovine material arising from normal business activities.

6.62 In December 2012, Linergy's board reconsidered the case for building a Category 3 plant. This was based on a revised model. The revised model showed an increase in the payback period from [✂] years to [✂] years. The amount of shareholder funding required also increased, from £[✂] million to £[✂] million due to increased capital requirements. On the basis of the revised plan, Linergy's board [✂] agreed not to proceed with the Category 3 investment plans.

Linergy's decision not to build a Category 3 plant in December 2012

6.63 Linergy identified three principal factors that affected its decision on whether to build a Category 3 plant. These are set out below.

Strong Category 3 competitor in NI

6.64 Linergy told us that, compared to 2010/11, the key change in circumstance when it decided not to proceed with a Category 3 plant in December 2012 was SAPI's position as owner of UFBP. According to Linergy, SAPI immediately demonstrated its ability to derive value from Category 3 products that the previous owners, Glenfarm, could not and, accordingly, began to pay significantly higher prices for Category 3 material. This had two main effects on Linergy's view of a new Category 3 plant.

6.65 First, it meant that Linergy's meat processing shareholders could immediately obtain higher prices for their Category 3 materials without financing an investment by Linergy.

6.66 Second, Linergy's shareholders considered UFBP to be a much stronger competitor under SAPI's ownership than under Glenfarm's. This significantly increased the risk profile of the new-build project as it would become more difficult and costly for Linergy to attract customers away from UFBP.

6.67 Linergy submitted that a clear demonstration of the worsening commercial conditions for building a Category 3 plant in December 2012 was provided by SAPI's decision to increase the price UFBP paid for Category 3 material [✂]. When Linergy's board had previously approved the decision to build a Category 3 plant, its financial models estimated that it would have to pay £[✂] per tonne to obtain Category 3 material. In the new circumstances, the presence of SAPI as a competitor in the market would make it significantly more expensive to secure material. This factor alone added [✂] to the estimated payback period shown in the Category 3 investment proposal which was discussed in December 2012.

6.68 In addition, Linergy stressed the high costs and risks that already existed when it originally decided to build a Category 3 plant, which are discussed below.

Funding requirement for the new plant

6.69 Linergy submitted that building a new rendering plant would cost up to £[✂], including the land and building costs, depending on scale and design.[84]

6.70 The cost of the plant is supported by evidence from Haarslev, a manufacturer and installer of rendering equipment, which quoted Linergy £[✂] million[85] for the total cost of building a rendering plant with the capacity to process 1,440 tonnes per week. Linergy had budgeted [✂] to construct an additional building to house the Category 3 plant.[86] This estimate was based on a quote Linergy obtained from a construction company. Linergy told us that, had the project progressed, it would have considered putting the building works out to tender.

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[84] Parties' initial submission, Appendix 6.
[85] Estimate based on quote of €[✂], converted using FX rate of €1.24/£, provided by OANDA as of 10 December 2012.
[86] Parties' initial submission, Appendix 13.

6.71 In December 2012, the financial model presented to Linergy's board suggested that the payback period for this investment would be [✂].

Planning permission

6.72 Linergy told us that it had planning permission for a gasification plant for MBM that it no longer intended to build. Linergy hoped that the existing permission would enable it to fit certain Category 3 rendering processes into the footprint of the same building.

6.73 However, in order fully to exploit the Category 3 output market, Linergy wanted its Category 3 plant also to offer gel bone facilities which its existing planning permission would not be able to accommodate. Consequently, Linergy would have had to apply separately for permission for this add-on which would have delayed construction.

6.74 Linergy estimated that this separate application process would have taken up to 18 months to complete and added considerable uncertainty regarding what the final costs and timings of this project would be.

Our assessment of whether Linergy would have built a Category 3 plant in the counterfactual

6.75 In May 2010, Linergy's board unanimously approved a business plan to build a Category 3 plant. The building of its own Category 3 plant was seen as strategically important for Linergy and its shareholders (see paragraphs 6.38 to 6.40). The board minutes show that, whilst the design of the plant changed and the cost of the plant increased in the period prior to Linergy seeking to acquire UFBP in 2011, the board still agreed that a Category 3 plant should be built. Consistent with this, in this period Linergy approached its existing bank ([✂]) for loan finance and its shareholders agreed in principle to raise additional equity to fund part of the cost of the project. However, during this period, Linergy's board did not agree on a final design for the plant or obtain loan finance from [✂]. When the opportunity to acquire UFBP came about, Linergy's project to build its own Category 3 plant was put on hold.

6.76 Linergy's unsuccessful attempt to acquire UFBP and the subsequent sale of UFBP to SAPI led to Linergy reassessing the Category 3 plant project. Given the conclusion that SAPI would have acquired UFBP in the counterfactual (paragraph 6.17), we consider that this reassessment on the basis of market conditions at that time would have resulted in the same conclusion in the counterfactual.

6.77 We consider that SAPI's presence in the market would have increased the cost of operating a Category 3 plant, which would increase the payback period of the investment, making it less attractive to both shareholders and external providers of finance. SAPI's ownership of UFBP also reduced the incentives of Linergy's meat processing shareholders to build a Category 3 plant as their Category 3 material could now be sold for attractive prices to an efficient renderer located nearby.[87] It also meant that these shareholders did not need to tie themselves into a long-term exclusive supply agreement, [✂]. We also note that, at the time of the review, Linergy's meat processing shareholders were already having their Category 3 material rendered elsewhere.

6.78 We therefore conclude that, in the counterfactual, Linergy would not have built its own Category 3 plant.

Conclusions on the counterfactual

6.79 We conclude that, in the counterfactual:

(a) SAPI would have acquired UFBP (paragraph 6.19);

(b) SAPI would have closed UFBP's Category 1 plant (paragraph 6.45); and

(c) Linergy would not have built its own Category 3 plant (paragraph 6.78).

7. Assessment of the competitive effects of the Merger

Market definition

7.1 As discussed in paragraph 2.6, Category 1 material cannot be processed in a Category 3 rendering plant. Therefore, suppliers of Category 1 material could not have that material processed by suppliers of Category 3 rendering services. This implies that Category 1 rendering services are a separate product market from Category 3 rendering services. Similarly, fallen stock is processed in Category 1 rendering plants or incinerators.

7.2 If Category 3 material is processed in a Category 1 rendering plant, the outputs cannot be treated as Category 3 outputs. There is normally a substantial difference in the price of Category 1 and Category 3 outputs (see

[87] We note that Linergy's shareholders were [✂] an average £[✂] per tonne to have their Category 3 materials rendered at Linergy. Under SAPI's ownership, UFBP [✂] these shareholders £[✂] per tonne for their Category 3 materials.

paragraph 2.14).[88] Therefore, suppliers of Category 3 material would not normally use Category 1 rendering services. This implies that Category 3 rendering services are a separate product market from Category 1 rendering services.

7.3 The Parties were in agreement that there are separate product markets for the rendering of Category 1 material, Category 3 material, and for fallen stock. We received no evidence to contradict this. Given regulatory restrictions, the Parties' agreement on product market definition and the absence of any contradictory evidence, we conclude that there are separate product markets for the rendering of Categories 1 and 3 materials, and for fallen stock.[89]

7.4 Renderers in the top part of the island of Ireland, and those in Scotland are able to, and do, compete for material in NI. Willingness to transport over large distances depends on: *(a)* the volumes involved; *(b)* the specific type of material a customer offers; and *(c)* the relationship the renderer has with the customer (and whether a particular customer is independent of any renderer). This implies that the strength of outside options is likely to vary amongst the different independent meat processors. This is considered in more detail in paragraphs 7.18 to 7.30. For the reasons set out in those paragraphs, we conclude that the geographic market extends at least to NI, and extends beyond this for some customers but this may not be the case for all.

Horizontal theories of harm – unilateral effects

7.5 Horizontal theories of harm relate to whether the loss of rivalry as a result of a merger would be sufficient to allow the merged firm profitably to raise prices, lower quality, reduce the range of the services provided and/or reduce innovation.[90] We set out a potential horizontal effects theory of harm in our issues statement.[91]

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[88] The difference between Category 1 and Category 3 prices may depend on the type of Category 3 and Category 1 (or fallen stock) material considered. Some Category 3 material, such as fat, is considerably higher in value than other Category 3 material. Renderers tend to charge suppliers of animal by-products for the disposal of Category 1 materials, but to pay these suppliers for Category 3 materials (with the appearance of charging negative prices). This difference in input prices derives from the higher value of Category 3 outputs relative to Category 1 outputs, particularly because the latter are required by regulation to be incinerated in most circumstances. Based on Linergy's data for 2014, the weighted average price (ie gate fee) for Category 1 is £[✂] per tonne. Based on UFBP's data for 2014, the weighted average price for Category 3 is –£[✂] per tonne, ie a negative gate fee.
[89] Hunt kennels (see paragraph 2.42) are a partial substitute to renderers for fallen stock, and they can collect and use some parts of fallen stock.
[90] Unilateral effects can arise in a horizontal merger when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices on its own and without needing to coordinate with its rivals. See paragraph 5.4.1 of the *Merger Assessment Guidelines*.
[91] Issues statement.

7.6 Given our conclusions on the counterfactual and the relevant product markets, the Parties do not overlap, and would not have overlapped under the counterfactual, in the supply of rendering services for Category 1 material, Category 3 material or fallen stock. The number of options available to customers and the way in which Linergy and UFBP would be expected to compete does not differ in the counterfactual from the actual outcome. In either case, farmers would not have had a choice of using either Linergy or UFBP for the disposal of fallen stock as only one plant would have remained open to serve them. Similarly, meat processors would only have had the option of one of these two renderers for Category 1 material, and one of the two for Category 3 material. Therefore, we conclude that the Merger does not give rise to horizontal unilateral effects in relation to these services.

Vertical foreclosure theory of harm

7.7 A vertical merger refers to a merger between an upstream supplier and a downstream customer that purchases the supplier's goods, either as an input into its own production or for resale. In this case, our interest lies in the newly established vertical relationship between meat processors owned by Linergy's shareholders and UFBP's Category 3 activities as a result of the Merger. The relationship exists irrespective of the Merger in relation to Category 1, because Linergy is a renderer of Category 1 material. Linergy could in theory in the absence of the Merger offer independents worse terms for Category 1 rendering services due to Linergy's relationship with Linden and Dunbia. However, to the extent this incentive exists, it is unchanged by the Merger. We received no evidence to suggest that Linergy has engaged in a policy of attempting to foreclose rivals.[92]

7.8 Dunbia and Linden are meat processors. Linden has a post-Merger shareholding of 8.4% in Linergy. While Dunbia does not itself have a shareholding in Linergy, as noted in paragraph 3.2, Dunbia's owners, Jim Dobson and Jack Dobson, each have a 9.63% shareholding in Linergy.[93] We have therefore assumed for the purposes of this section that the Dobsons' combined shareholding could be used to represent the interests of Dunbia (so

[91] It is possible that the incentive to foreclose could be greater when it can be achieved by denying rivals both Category 1 and Category 3 rendering services, rather than only one of these services. For example, foreclosing access to both services may sufficiently increase the costs of a rival to cause them to pass through these costs or to force them out of business, whereas foreclosing access to only Category 1 or only Category 3 rendering services may be insufficient to achieve this. However, we have not seen evidence to support such a theory of harm. Indeed, much of the evidence presented below in relation to Category 3 foreclosure would be similar in relation to an assessment of Category 1 foreclosure. Therefore, we do not believe that the assessment of the Merger's effect on the ability and incentive to foreclose both Category 1 and Category 3 rendering services would lead us to a different conclusion to that which we reach on Category 3 rendering services alone.
[93] Dunbia is owned by Jim Dobson (50%) and Jack Dobson (50%).

for simplicity refer to Dunbia as a shareholder). Additionally, Fane Valley, a farmer-owned co-operative, has a 19.25% shareholding in Linergy and is a shareholder in Linden.[94]

7.9 Vertical input foreclosure refers to a theory of harm whereby the merged firm harms the ability of its rivals to compete following the merger, for example by raising effective prices to its rivals or its shareholders' rivals (also known as partial foreclosure), or by refusing to supply them at all (total foreclosure). Such actions may harm the ability of the merged firm's rivals to provide a competitive constraint, to it or to its shareholders.[95] Therefore, we considered whether rival meat processors in NI may be disadvantaged due to a foreclosure strategy, in order to benefit meat processors owned by Linergy's shareholders (ie those owned by Linden and Dunbia).

7.10 In particular, we considered whether the Merger would make it more likely that the Parties would refuse to supply, or reduce the supply of, Category 3 animal rendering services (or charge significantly more) to rival meat processors which do not have their own rendering facilities, which we refer to as independent meat processors.

7.11 [✂] Linden and Dunbia might in principle benefit from a foreclosure strategy in two different ways:[96]

(a) If the foreclosure strategy led to independents incurring higher costs for rendering services (partial foreclosure), and as a result they sought to pass these higher costs through in the prices they charged retailers for meat products, independents might lose business from their customers (eg UK supermarkets). Linden and Dunbia might benefit by capturing some of this displaced demand, allowing them to increase their margins, or sell more product, or both. The same logic applies if independents were unable to secure rendering services (total foreclosure), and this led them to stop slaughtering livestock.

(b) If foreclosure meant that independents were less able to compete in the meat processing market, they would reduce their demand for livestock that they purchase from farmers in NI. This could reduce the number of meat processors seeking to procure livestock and, under certain

[94] Fane Valley is a co-operative society owned by approximately 1,800 local farmers. This society operates extensively in the dairying and meat processing sectors, and has shares, among other companies, in Linergy, Slaney Foods, Linden, Irish Country Meats, Hilton Meats, Duncrue Food Processors, and Kettyle.
[95] *Merger Assessment Guidelines*, paragraph 5.6.5.
[96] Both of the potential effects are important in assessing the potential incentive of the Parties to foreclose.

circumstances, reduce demand for farmers' livestock, resulting in lower costs of livestock to Linden and Dunbia.

7.12 However, any such gains would need to be balanced against any profits foregone by not supplying rendering services to some meat processors (or losing custom as a result of charging substantially more for these services).

7.13 Whether the merged entity would seek to foreclose rival meat processors would depend on its ability and incentive to do so. Therefore, in the following analysis we first assess whether the Parties have the ability to foreclose rivals and, second, whether the Merger has enhanced their incentive to foreclose.

Ability to foreclose

7.14 Given that we do not find that the Merger has led to any overlap between UFBP and Linergy in Category 3 rendering services, the Merger does not enhance the ability of Linergy/UFBP to foreclose rival meat processors by removing an outside option. Nevertheless, it is still important to assess the Parties' ability to foreclose.

7.15 We examined three factors: first, whether meat processors can switch to alternative Category 3 renderers such that they would not be dependent on the Parties; second, the cost (and revenue) of the foreclosed input in relation to other costs of meat processors; and third, the ability of meat processors to have their potential Category 3 material used for purposes other than rendering.

7.16 In considering the outside options available to larger meat processors, we did not consider that the Parties would have the ability to foreclose these customers. We note that many of the large meat processing groups in NI, such as ABP and FFG, have access to their own rendering facilities ([✂]).[97] We considered it highly unlikely that these meat processors would be materially harmed by any policy of foreclosure. This is for two reasons. First, these meat processors generally use their own rendering facilities (so are not customers of the Parties). Second, their size means that they would be attractive customers for alternative renderers in the RoI, or Scotland.

7.17 Therefore, we have concentrated on independent meat processors, which include Ballymena Meats, C&J Meats, Doherty & Gray, Oakdale Foods, Topping Meats and WD Meats. We estimate that independents account for

[97] For more discussion of ABP and FFG, see Appendix F.

approximately 40% by volume of the red meat animal by-products produced in NI (with similar shares for both Category 1 and Category 3).[98]

Availability to independents of alternative renderers

7.18 The Parties are unlikely to be able to foreclose independents if there are other renderers to which independents can easily switch without incurring material additional costs. Therefore we assessed the 'outside options',[99] particularly alternative Category 3 renderers, available to independent meat processors. Customers choose renderers on the basis of prices (which are bilaterally negotiated) and their relationship with the renderer (for example formal vertical relationships, or long term informal relationships). Renderers negotiate prices taking into account transport costs (which are in part influenced by distance between the customer and renderer), the mix and volume of material a customer is sending, the yield from that material, and the price of the outputs.

7.19 The Parties told us that there are competitive constraints from renderers in the RoI and GB. In the RoI, they identified the Category 3 rendering facilities of College Proteins, Dublin Products, Western Proteins, Slaney Proteins and Munster Proteins.[100] They also referred to Dundas, based in Scotland, which currently provides Category 3 rendering services to [✂] independent customers in NI, and raised the possibility that other plants in GB could also serve NI. The Parties told us that the great majority of meat processors based in NI currently have material rendered outside NI.

7.20 We are aware of several examples of switching to and away from UFBP. These include independent and vertically integrated meat processors which switched to rendering facilities in the RoI (either part of the same group or unrelated). We are also aware of several examples of independent meat processors in NI switching volumes to Dundas.[101,102]

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[98] This estimate includes large independent meat processors from NI, such as Karro Food Group and WD Meats. We have used the list of red meat processors in NI – see Food Standards Agency, *Approved red, poultry, and game meat establishments*. This list excludes rendering material from poultry establishments. We do not have Category 1 and Category 3 volumes for all independent meat processors, particularly the smallest. To estimate these volumes, we assumed that the Category 1 and Category 3 volumes sent to Linergy and UFBP in 2014 by [✂] (a collector) approximately represent the volumes from these small independent meat processors for which we do not have available information. Source: CMA analysis.
[99] In economic terms, the outside option is the next best alternative or business proposition of buyers in case their negotiations with a given supplier break down.
[100] Parties' initial submission.
[101] [✂]
[102] [✂]

7.21 We have also been told of examples of UFBP customers having conversations with alternative renderers to UFBP, and that the threat of switching has been used as a negotiating tool to negotiate better prices with UFBP.[103]

7.22 We have explored the options perceived by different customers.[104] The relatively large meat processors, which are often vertically integrated with renderers, typically consider that they have the ability to turn to alternative renderers (eg in the north of the RoI), and their own rendering facilities. Most of the largest customers have rendering facilities of their own and this, along with the large volumes they produce, appears to give these customers a strong negotiating position. Either they did not rely on UFBP's Category 3 facility, or were Linergy shareholders.[105] Accordingly, these customers were unconcerned about the Merger.[106]

7.23 The independent customers vary considerably in size, but tend to be smaller than the vertically integrated meat processors discussed above. The alternatives available to smaller independent customers appear to be more limited for the following reasons:

(a) Smaller volumes make business with these customers less attractive to renderers.[107] Additionally, as discussed in paragraphs 2.22 and 2.23, transport costs are likely to be more significant on a per tonne basis and, therefore, renderers may not be interested in taking volumes from customers with smaller volumes.[108]

(b) Even though some customers are/may be able to use renderers in GB and/or the RoI, there was a concern expressed by some customers that this did not offer a sustainable alternative either due to potential problems with ferry transport or crossing borders[109] or because the prices being

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[103] [✂]
[104] The views of suppliers of animal by-products are provided in more detail in Appendix F.
[105] As noted previously, our focus is on the ability and incentive to foreclose smaller independents. However, we have also presented the position of the larger vertically-integrated meat processors for clarity and completeness.
[106] In particular, [✂], [✂] and [✂] indicated that they were not concerned by the Merger, as did Linergy's shareholder meat processors, Dunbia. Linden said that it did not expect the Merger would have an impact on the factors it considered necessary to keep its rendering costs competitive. Linden also felt that there was an opportunity for the service levels it received for rendering to improve following the Merger. These are all major suppliers of animal by-products, including Category 3 material in NI.
[107] A number of renderers told us that small volumes influenced the attractiveness to them of suppliers of material for rendering. This is explained in more detail in Appendix F.
[108] Some smaller independent customers indicated that they felt they had limited ability to negotiate deals given their small volumes.
[109] Concerns have been raised about the ability to send materials outside NI to GB because of transport costs, but also due to perceived barriers such as due to the odour of animal by-products. This may be particularly problematic if bad weather prevents ferry crossings. One party, [✂], has provided examples of when ferries have not run to schedule. However, two other parties, Dundas and [✂], reported that no difficulties had occurred in

offered by Dundas, which is based in Scotland, were not sustainable given the ferry transport costs incurred.[110]

7.24 The strength of outside options appears to vary amongst the different independent meat processors. Some smaller customers did not appear to have fully explored the alternative options available to them for the rendering of their Category 3 material, and if they have not used a particular renderer, this may be because they have not been able to reach agreement on commercial terms, rather than any more structural factor limiting their options. Some appeared to presume that their alternatives would be limited without having explored whether other renderers would offer better terms, while others seemed to consider that they had reasonable alternatives without having costed these. The views of independent meat processors on the options they perceive are available to them are set out in more detail in Appendix F.

7.25 We also explored the views of alternative Category 3 renderers, in the RoI or GB, on whether they compete for customers in NI.[111] Renderers in the south of the RoI, particularly Dublin Products, Slaney Proteins, and ABP[112] considered that they were too far south to compete for customers in NI, given the transport costs involved and/or potential material degradation. In contrast, Western Proteins and College Proteins, both based in the top part of the island of Ireland, considered that they competed for customers in that part of the island, including customers in NI. Indeed, both serve customers based in NI. For example, College Proteins told us that it serves [✂] which are based in NI.

7.26 Dundas told us that it competes for customers in NI and has been serving customers there since 2011. It currently serves [✂] independent customers in NI – [✂] – and has had conversations with other potential customers about taking their volumes. However, it also said that it was not currently seeking additional volumes from NI given that output prices are very poor and the remaining independent meat processors are small and so transport costs would be significant.

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sending materials to Scotland by ferry. Also, one party told us of a perceived risk that cross-border movements of materials may be restricted due to public health concerns, such as incidences of BSE.

[110] This is consistent with the views of some renderers.

[111] The views of these renderers are provided in more detail in Appendix F.

[112] ABP's rendering plants served ABP's meat processing plants in NI, but it did not see that as implying that it would be competitive for independent customers in NI. ABP has recently opened a bone gel plant in Tipperary in the RoI that may take Category 3 volumes. We consider it plausible that this could lead ABP to seek additional Category 3 volumes on the island of Ireland. [✂] However, the new ABP plant has only recently opened and we do not yet know what impact if any it will have on the rendering market on the island of Ireland. See ABP hearing summary.

7.27 Another renderer in GB, Saria, indicated that transport costs would be prohibitive in serving customers in NI, given the distance between NI customers and its plant and the need to transport the materials by ferry. However, Dunbia told us that it had shipped material from its plants in the RoI to GB for processing.

7.28 Alternative renderers also highlighted that, in specific cases, the type of material supplied by a customer was important, as a renderer may find certain material unattractive given that renderer's end markets.

7.29 We were also told that size was important in relation to transport costs; for small meat processors which may not be able to fill a truck load, transport costs may be a more significant factor in choosing a renderer.

7.30 In summary, while Category 3 renderers in the RoI and Scotland take Category 3 materials from customers in NI, they are more likely to be seen as a potential option and used by larger customers (including the larger independent customers) than by smaller customers. While concerns have been raised about using renderers outside NI, this does not appear in practice to have prevented at least some (but not all, particularly the smallest) customers from using these options. This indicates that, for at least some meat processors, transport costs are not prohibitive and that there are not significant obstacles or risks in relying on ferry transport of materials.[113]

7.31 We have also considered whether alternative renderers have spare capacity, should independent meat processors seek to switch to them. Table 7.1 shows the volumes and capacities (for all material, not just from NI) of the Category 3 rendering plants that we know are currently serving customers in NI and sets out our understanding of the spare capacity of these different rendering plants.[114] It shows that, overall, there is substantial spare capacity available [✂]. Western Proteins told us that it has [✂] spare capacity currently [✂]. College Proteins has [✂] spare capacity. Dundas has about [✂]% spare capacity.

[113] We also note that meat processors are reliant on the same ferries to ship their meat products to GB, albeit in refrigerated vehicles, and this does not seem to impede their activities.
[114] We do not include here renderers which serve only related customers based in NI.

Table 7.1: Weekly volumes and capacities (tonnes per week) of the Category 3 renderers serving NI*

	UFBP	*Western*	*College/ Farragh*	*Dundas*
Weekly volumes	[✂]‡	[✂]	[✂]	[✂]
Effective weekly capacity	[✂]	[✂]	[✂]	[✂]
Effective spare capacity†	[✂]	[✂]§	[✂]	[✂]

Source: CMA analysis based on information from Renderers.
*The renderers shown here are those which serve at least some independent meat processors in NI.
†Effective spare capacity is defined as the difference between the effective maximum weekly capacity (which allows for necessary maintenance, seasonal and weekly fluctuations) and the maximum weekly volumes of material. If a rendering plant is at full capacity during peaks in the volumes of materials being processed, then any spare capacity during troughs is considered to be temporary spare capacity.
‡This figure is the estimated maximum volume processed in a week in the course of 2014. The average weekly volume for UFBP in 2014 is [✂]. Note, however, that these figures were calculated using monthly volumes and so, they are approximations.

7.32 We compared the spare Category 3 rendering capacity with our estimate of the total Category 3 volumes supplied for rendering by the independent meat processors in NI; see Table 7.2.[115]

7.33 In 2014, UFBP rendered about [✂] tonnes per week of Category 3 material for independent meat processors in NI. We have incomplete information on how much other material was produced by independents other than those served by Dundas. However, the aggregate spare capacity of the rendering plants currently serving NI customers ([✂] tonnes per week, including UFBP) is substantially greater than the total volumes supplied by the independent meat processors located in NI. The spare capacity of rivals to UFBP is about [✂] tonnes per week, which could still [✂] absorb the current average weekly volumes that UFBP renders for independent customers.

[115] The latter comparison has a double-counting issue, in that some of the currently utilised capacity of the rendering plants is due to volumes from independent meat processors in NI. Nevertheless, the comparison can still provide some useful indication of spare capacity against volumes of independent meat plants in NI.

Table 7.2: Comparison of spare Category 3 capacity and volumes of independent meat processors in NI (2014/2015 figures)

	Tonnes per week
Aggregate volumes of independent customers served by UFBP	[✂]
Estimated aggregate volumes of independent customers in NI*	[✂]
Aggregate spare capacity of renderers serving NI	[✂]
Difference between aggregate volumes of independents and aggregate spare capacity	[✂]

Source: CMA analysis.
*These independent customers include Ballymena Meats, WD Meats, C&J Meats, Doherty & Gray, Domestic Sheepskins, Eurostock Foods, FC Robinson, Finnebrogue Venison, Galgorm Meats, Hewitt Meats, K&G McAtamney, Lakeview, Oakdale Meats, Topping Meats, Crosskey Meats and Crossgar Poultry. We have not included [✂]. If we were to include [✂], based on Linergy's estimate, the estimated aggregate volumes of independent customers in NI would [✂] tonnes per week. The difference between aggregate volumes and aggregate spare capacity would [✂] tonnes per week.

7.34 This suggests that alternative renderers serving customers based in NI have sufficient spare capacity such that, if the Parties tried to foreclose independents, the latter could respond by switching to other renderers. However, the plants of alternative renderers may be further away from an independent than the UFBP Category 3 facility, and smaller meat processors may be less attractive to some renderers due to the type of material they produce as well as their smaller volumes.

7.35 Nonetheless, it appears that many meat processors in NI have reasonable alternatives to the Parties in the provision of Category 3 rendering services such that the Parties would be likely to have limited ability to foreclose these customers.

The relative costs of rendering Category 3 material

7.36 We now consider whether foreclosure of Category 3 rendering services would be likely to have a significant impact on the operations of the independents, ie whether the Parties would be able to foreclose their rivals effectively.

7.37 This depends partly on whether the input accounts for a significant proportion of the costs of sale of downstream rivals.[116] If the costs of rendering account for a small proportion of the independents' costs of producing meat products, even a significant increase in the costs of rendering may have little impact on independents' prices to retailers, even when keeping their margins constant

[116] Paragraph 5.6.10 (a) of the *Merger Assessment Guidelines* states, in relation to partial foreclosure, that one of the factors that may be considered by the CMA is 'The cost of the input relative to all costs of the final product. All else being equal, if the input accounts for only a small part of the total costs incurred, the merged firm will be less able to harm its rival manufacturers' ability to compete than if the input accounts for a greater part of the total costs'.

(ie assuming that they pass through all of the input price increase).[117] In the case of Category 3 material, it is actually a source of revenue as gate fees are generally negative, but foreclosure to reduce an independent's revenues is analytically identical.

7.38 We were told that independent meat processors typically operate on low profit margins. We have estimated that typical margins may be as low as [✂]%.[118] In this situation, the ability of a vertically integrated third party rival to increase costs or reduce revenues could make foreclosure more effective.

7.39 A large meat processor, Linden, submitted a cost analysis (based on figures for June 2015) that showed that rendering and disposal costs account for [✂]% of its total costs. An independent, [✂], estimated that rendering costs account for [✂]%[119] of its total costs.

7.40 However, Category 3 material generally provides revenues for meat processors.[120] An independent processor provided us with estimates; the revenues of rendered Category 3 material as a proportion of the independent's turnover was low at just [✂]%.[121]

Alternatives to rendering for Category 3 material

7.41 As discussed in paragraphs 2.25 and 2.26, some of the materials that could be sent for Category 3 rendering are instead purchased by alternatives to renderers, which process them further or use them in their raw form. Certain types of Category 3 material may be used for alternative human consumption uses or non-food use. This suggests that, were Linergy/UFBP to seek to foreclose independents, it might not be able to do so with respect to certain potential Category 3 materials as independents would not be dependent on renderers for processing this material.[122]

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[117] The importance of the relative cost of rendering may be reduced in a total foreclosure assessment relative to a partial foreclosure assessment if the total foreclosure of an essential input is likely to lead to the downstream rival being forced to exit because it cannot find an alternative source for the input.
[118] Estimate based on figures from [✂].
[119] This figure refers to the cost of rendering and therefore, includes cost of rendering Category 1 material and, if any, a small cost of Category 3 rendered material.
[120] In the case of Category 3 materials, where normally gate fees are negative, we are considering a reduction in revenues earned by independents due to the Parties reducing their payments for Category 3 material as part of a foreclosure strategy.
[121] CMA analysis of [✂].
[122] It has been put to us that the major alternative purchaser of Category 3 fat in NI, Duncrue, has Fane Valley as one of its shareholders, and that Fane Valley is also a shareholder in Linergy. The implication is that Duncrue could join Linergy/UFBP in a foreclosure strategy. However, we have seen no evidence to support this contention and we have been told that Duncrue is run independently of the interests of Fane Valley.

7.42 However, it has been suggested to us that the additional constraint from alternatives to rendering may be limited because the value offered is sufficiently high that, wherever possible, meat processors are already taking full advantage of such opportunities, ie opportunities to switch to alternatives to rendering in response to relative price changes may be limited. The Parties and one independent meat processor ([✂]) disagreed with this, stating that such uses were continually being developed.[123] A number of meat processors told us they currently have to evaluate whether alternative options are worthwhile, which suggests that there is likely to be some degree of choice in response to changing price incentives rather than a fixed volume of materials being sold for these uses.

7.43 We have also looked at an independent's revenues (or costs) from rendered Category 3 materials relative to its revenues from selling potential Category 3 material for these other uses. In particular, one independent gave us details of its revenues for these different uses, and the proportion of revenue from Category 3 rendering (compared with sales of blood, edible fats etc) was low at just [✂]%.[124] Therefore, as most of the value of Category 3 materials is derived from alternatives to rendering, the impact on the independent's costs of higher prices for Category 3 rendering services is likely to be small.

7.44 The ability to foreclose is limited by the ability of customers to switch to alternatives to rendering for Category 3 materials. These materials account for a very high proportion of the value of material which would otherwise be rendered. Moreover, the cost of rendering accounts for a very small proportion of the total costs of meat processors. We have been told that the meat processing business operates on relatively small margins, suggesting that a reduction in revenue or increase in costs due to foreclosure could harm independents despite rendering accounting for a small share of independents' total costs and revenues. However, even if there were some ability to foreclose independents, as the reasoning in paragraphs 7.45 to 7.63 sets out, we do not consider that the Parties have sufficient incentive to engage in this strategy.

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[123] According to the Parties, 'There is no evidence that the meat plants are actually operating at this point. […] the possibility of selling what was previously Category 3 material to such customers has only recently emerged […] Thus, the likelihood is that such entities will increasingly exercise a competitive constraint in the Category 3 market. New technologies such as anaerobic digestion plants may provide an additional outlet for Category 3 material'.

[124] [✂] of [✂] material that could go to Category 3 rendering went to alternatives to rendering (this includes pet food, fat, blood, grass and sludge). The proportion of total value of potential Category 3 material (rendered and other animal by-products sold to alternatives to rendering) of the independents' turnover was [✂]%. Source: CMA analysis of [✂] data.

Incentive to foreclose

7.45 We now consider the extent of the incentives on Linergy/UFBP to foreclose on behalf of Linden and Dunbia (which between them have a 27.66% share-holding in Linergy post-merger, see paragraph 7.8).

7.46 We begin by noting that a foreclosure strategy would be likely to reduce the profits of the UFBP Category 3 rendering facility, as it would process lower volumes from independents. This potential loss of profits may be enough to outweigh any benefit captured in associated markets due to the foreclosure strategy. However, we consider that this potential loss of profits is particularly significant given the position of SAPI.

7.47 SAPI holds a 30% shareholding in the merged entity, but has no shareholding in meat plants in NI.[125] Therefore, SAPI would, through its investment in Linergy, incur the costs of foregone rendering services (we note that rendering is a high fixed cost industry where capacity use is very important). It would also lose the potential benefit it derives by sending the Category 3 material to Italy for further processing, while gaining none of any benefit in the downstream markets due to independents losing demand for their products or being unable to operate.[126] It is clear that a major driver for SAPI's purchase of the UFBP facility was to acquire the Category 3 materials processed there [✂]. Therefore, it would appear unlikely to be willing to allow foreclosure of customers providing Category 3 volumes. While in theory Linden and Dunbia could seek an arrangement with the other shareholders on this point, we considered that SAPI's incentives mean that a foreclosure strategy is unlikely to be adopted. Moreover, other direct and indirect shareholders in Linergy might not have the same incentives to foreclose (for example we note Fane Valley is a farmers' co-operative with a shareholding in Linden, but whose members will have an interest in maintaining livestock prices).

7.48 We now consider the incentive to foreclose in relation to two associated markets: first, the supply of meat products; and second, the procurement of livestock.

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[125] To the extent that Linergy's management and others hold shares in Linergy and UFBP, and do not have a share interest or similar commercial interests in associated meat processors (Dunbia and Linden), then their incentives to support a foreclosure strategy may be limited.

[126] To the extent that Linden and Dunbia captured demand lost by independents, then SAPI would not forego all the revenues it earns from rendering the materials of independents. It appears unlikely that UFBP would be used by the other large meat processors which might capture demand from the independent meat processors, due to the foreclosure strategy, given they primarily rely on their own related rendering options.

Supply of meat products

7.49 We have been told by meat processors in NI that a large proportion of the meat products they produce is sold to UK supermarkets. We have also been told that there is generally no particular cachet or even identification of this meat as coming from NI; it tends to be labelled as British meat. Therefore, it seems unlikely that any sales to British supermarkets lost by independents would be more likely to shift to other NI-based meat processors than to other meat processors supplying this market (particularly meat processors in the RoI and GB, but also suppliers from other European countries or the rest of the world).

7.50 Therefore, while Linden and Dunbia might benefit from a reduction in demand for meat products from independents, they may only benefit in line with their share of the downstream UK meat market. In any case, there must be considerable uncertainty around the potential benefit.

7.51 Table 7.3 shows estimates, provided by a large meat processor, [✂], of the turnover of the main meat companies in the UK and the RoI.[127] These estimates excluded small meat companies and international meat companies (ie companies outside the UK and the RoI) that export meat products to the UK.[128] Therefore, these estimates are likely to overstate the position of the meat processors in Table 7.3. Nevertheless, the estimates provide a good indication of the relative size of major meat companies in the UK and the RoI.[129] Table 7.3 indicates that Linden accounts for a small proportion (about [✂]%) and Dunbia accounts for about [✂]% of sales (to GB, the island of Ireland and mainland Europe) of the companies [✂]. Further, WD Meats, one of the largest independent meat processors in NI, has a [✂]% share. Therefore, we expect that other independent meat processors in NI would each have a share of no more than [✂]%.[130] This suggests both that the relative value of sales by independents in NI is small and that Dunbia and

[127] [✂] told us that it did not know what proportions of the turnover figures in Table 7.3 were attributable to sales within the UK and the RoI and to sales elsewhere. [✂]

[128] [✂] estimates that around 20% of meat consumed in the UK was produced in countries other than the UK and the RoI.

[129] One independent meat processor, [✂], provided estimates of annual cattle slaughter in the UK and the RoI, which might be expected to be similar to the shares of turnover of meat processors supplying UK and RoI retailers. Based on these estimates, ABP has a share of [✂]%, Dawn has a share of [✂]%, FFG has a share of [✂]%, Dunbia and Linden have a collective share of [✂]%, [✂]. This is consistent with the position of meat processors in Table 7.3 because it shows that ABP and Dawn are the main meat processors, followed by Linden and Dunbia [✂]. Similarly, we considered the shares of turnover estimated in the Key Note Report on Meat and Meat products (2014, pp40–41). This showed Dunbia accounting for [✂]% of the turnover of meat processors in the UK and the RoI, and Linden accounting for [✂]%. Similar to Table 7.3, this source also identifies ABP and Dawn as being larger than Dunbia or Linden.

[130] Based on these estimates it is not possible to say whether the Northern Irish independents in aggregate have a share greater than [✂]%.

Linden could not be confident of capturing sales lost by these independents. These points limit the incentive to foreclose.

Table 7.3: Estimate of turnover and shares of meat processors in the UK and the RoI

	£m	%
Competitor	*Turnover*	*Share*
ABP	[✂]	[30–40]
Dawn	[✂]	[20–30]
Dunbia	[✂]	[10–20]
Kepak	[✂]	[10–20]
Linden	[✂]	[0–10]
FFG	[✂]	[0–10]
Scotbeef	[✂]	[0–10]
2 Sisters Red Meat	[✂]	[0–10]
Liffey Meats	[✂]	[0–10]
Kildare Chilling	[✂]	[0–10]
WD Meats	[✂]	[0–10]
Total	[✂]	100

Source: Estimates supplied by [✂], based on information contained in both the public domain and secondary sources (eg *The Irish Times*).

7.52 If independents were to accept lower margins, and so did not attempt to increase their prices, Dunbia and Linden would not benefit and so there would be no incentive to foreclose. If independents were forced to exit the market due to higher rendering costs, it would only be if the retailers used Dunbia or Linden to some extent as alternative suppliers that they would benefit from foreclosure. This appears highly uncertain as supermarkets and other customers may, instead, choose to source meat products from suppliers other than Linden and Dunbia.[131]

7.53 Moreover, if profit margins are only about [✂]% in meat processing, and are unchanged by foreclosure, we estimate that the additional profit to Dunbia and Linden of a total foreclosure strategy against independent competitors would be low. This small potential gain would then need to be off-set against any loss of profit from rendering for Linergy/UFBP due to no longer serving these customers.[132] It appears unlikely that there is an incentive for Linergy/UFBP to engage in a foreclosure strategy.

Livestock procurement

7.54 We have been told that Dunbia and Linden might benefit from a foreclosure strategy if their costs of procuring were lower as a result of farmers having fewer meat processors to sell to in NI. This might be the case if the

[131] It is also possible that Dunbia might benefit considerably more than Linden, or vice-versa, in capturing additional sales of meat products due to foreclosure. This may then undermine the incentive of the meat processor which benefits less to support the foreclosure strategy.

[132] The additional profit would be less again to the extent that the independents were not totally foreclosed, but were only partially foreclosed. This would mean that Linden and Dunbia would gain fewer additional sales from the independents, although this could be balanced by Linergy/UFBP foregoing less rendering profit when engaging in partial foreclosure relative to total foreclosure.

independents were unable to slaughter animals due to difficulties in disposing of Category 3 materials or because their demand for livestock reduced due to lower meat sales resulting from higher rendering costs. This may, then, provide another way in which the Parties have an incentive to foreclose rendering services.

7.55 There are two reasons why the Parties would be unlikely to have an incentive to foreclose independent meat processors. First, there are a number of meat processors in NI, in particular FFG and ABP. These meat processors would continue to procure livestock in NI such that any foreclosure of smaller independents would be unlikely to have an impact on livestock prices. Second, farmers in NI are able to export their livestock outside of NI. This implies that they are not dependent on meat processors within NI, which in turn means livestock prices are unlikely to be affected.

7.56 Independent meat processors are estimated to account for around 21% of livestock procured in NI in 2014, ie they account for a material proportion of livestock purchases.[133] However, this also indicates that a far larger proportion is accounted for by meat processors (particularly FFG and ABP) which have their own rendering facilities. Large rivals to Dunbia and Linden may be well-placed to purchase livestock which would otherwise (absent a foreclosure strategy) have been purchased by independents.[134] Demand for livestock from these meat processors is likely to mean that livestock prices would be unaffected by a foreclosure strategy.

7.57 Table 7.4 shows estimated shares of the meat processors in procuring cattle from NI for slaughter.[135] ABP is probably the biggest competitor, having two facilities close by, and FFG and ABP together account for [✂]% of the livestock slaughtered in NI.

Table 7.4: Estimate of shares of NI meat processors of livestock slaughtered in NI

Company	*Livestock share of NI kill*
	%
ABP	[20–30]
Dunbia	[10–20]
FFG	[20–30]
Linden	[10–20]
WD Meats	[10–20]
Small processors	[0–10]

Source: Estimates supplied by [✂].

[133] CMA analysis of [✂].
[134] Any independents that were not subject to foreclosure would also continue to bid for livestock.
[135] Source: [✂].

7.58 In addition, if one of the alternative vertically integrated meat processors acquired this livestock in place of independents and Linden/Dunbia, this would mean that Linergy would forego profits by not rendering the by-products of these animals.

7.59 The second reason why the Parties would be unlikely to have an incentive to foreclose independent meat processors is that farmers in NI are able to export their livestock outside of NI to both the RoI and GB. This implies that farmers are not dependent on meat processors within NI, which in turn means livestock prices are unlikely to be affected by any foreclosure strategy.[136]

7.60 Around 12% of NI-based livestock is not slaughtered in NI.[137] We also note that there appears to be a high degree of transparency about the prices of livestock.[138] Awareness of better prices being available elsewhere, and the high value of livestock to farmers, would create a strong incentive to move livestock to achieve a better price. We therefore consider that farmers would be likely to export their cattle in order to achieve better livestock prices, should their options be reduced.

7.61 Looking at estimates of shares of livestock slaughtered in the island of Ireland (to account for potential cross-border trade in livestock), Table 7.5 indicates, for cattle only, that independents in NI, such as Ballymena Meats, Oakdale Foods and WD Meats, collectively account for less than [✂]% of procured volumes, which is similar to the estimated shares of Linden and Dunbia (both [✂]%). This suggests that livestock prices are unlikely to be affected by any foreclosure strategy, thus providing Linden and Dunbia with little incentive to foreclose. Furthermore, if the Parties did seek to foreclose independents, it is unclear that Linden and Dunbia would pick up a large share of displaced livestock sales, and so the benefits of a foreclosure strategy would be very uncertain. Even if these independents were eliminated, and their volumes allocated according to current shares (across the island of Ireland) of procurement, the volumes of Dunbia and Linden would increase very little.

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[136] It has also been suggested that farmers which supplied independents in NI prior to foreclosure by Linergy/UFBP would be particularly unlikely to supply livestock to a processor if they thought that this meat processor was behind the exit of independents and farmers being offered lower prices.
[137] Livestock & Meat Commission data.
[138] See, for example, the pricing information available on the Livestock & Meat Commission website for NI and the Irish Cattle and Sheep Farmers' Association website for the RoI.

Table 7.5: Estimated number of cattle slaughtered per year in NI and the RoI

			'000	%
Region	*Procurer*	*Number of plants*	*Estimated number of cattle per year*	*Estimated share of cattle per year*
NI	ABP	[✂]	[✂]	[✂]
	Ballymena	[✂]	[✂]	[✂]
	Dunbia	[✂]	[✂]	[✂]
	FFG	[✂]	[✂]	[✂]
	Linden	[✂]	[✂]	[✂]
	Oakdale	[✂]	[✂]	[✂]
	WD Meats	[✂]	[✂]	[✂]
	Total	[✂]	[✂]	[✂]
RoI	ABP	[✂]	[✂]	[✂]
	Dawn	[✂]	[✂]	[✂]
	FFG	[✂]	[✂]	[✂]
	Liffey	[✂]	[✂]	[✂]
	Linden	[✂]	[✂]	[✂]
	Kepak	[✂]	[✂]	[✂]
	Others	[✂]	[✂]	[✂]
	Total	[✂]	[✂]	[✂]
NI and RoI	ABP	[✂]	[✂]	[✂]
	Ballymena	[✂]	[✂]	[✂]
	Dawn	[✂]	[✂]	[✂]
	Dunbia	[✂]	[✂]	[✂]
	FFG	[✂]	[✂]	[✂]
	Kepak	[✂]	[✂]	[✂]
	Liffey	[✂]	[✂]	[✂]
	Linden	[✂]	[✂]	[✂]
	Oakdale	[✂]	[✂]	[✂]
	WD Meats	[✂]	[✂]	[✂]
	Others	[✂]	[✂]	[✂]
	Total	[✂]	[✂]	
Number of cattle in NI as a proportion of total cattle in island of Ireland				[✂]

Source: CMA analysis of [✂] estimates.

The potential effect of vertical input foreclosure

7.62 In relation to the supply of meat products it is unlikely that the foreclosure of independent meat processors in NI would materially affect meat product prices. In particular, as outlined above, these meat processors appear to have a very low share of supply in relation to all meat processors in the UK and the RoI.

7.63 Therefore, we did not consider it likely that vertical input foreclosure would have a significant effect on related markets.

Findings on vertical effects

7.64 We have considered the ability, incentive and effect of a potential vertical input foreclosure strategy whereby Linergy/UFBP would refuse to supply (or selectively reduce prices for materials in relation to) Category 3 rendering services to independent meat processors in NI. We have not taken account in this assessment of any potential efficiencies to which the vertical nature of the Merger might give rise.

7.65 The Merger between Linergy and UFBP does not lead to an overlap in either Category 1 or Category 3 rendering services. Therefore, the Merger does not enhance the ability to foreclose independents by reducing their outside options. We have found that alternative renderers in the RoI and Scotland have been used by independents, and the availability of these alternatives is likely to limit the ability to foreclose or substantially increase costs to independents. However, the option of using these alternatives may be more limited for small customers. Their small volumes, and, therefore, higher transport costs per tonne, or the nature of their materials, may make them unattractive to these alternative renderers.

7.66 The ability to foreclose is also limited by the ability of customers to switch to alternatives to rendering for Category 3 materials. These alternatives account for a very high proportion of the value of material which would otherwise be rendered. Moreover, the cost of rendering accounts for a very small proportion of the total costs of meat processors. This suggests that the ability to foreclose independents would be limited. We have been told that the meat processing business operates on small margins, suggesting that a reduction in revenue or increase in costs due to foreclosure could harm independents despite rendering accounting for a small share of independents' total costs and revenues. However, even if there were some ability to foreclose independents, we did not consider that the Parties had sufficient incentive to engage in this strategy.

7.67 Successful foreclosure appears unlikely materially to strengthen the market positions of Linden and Dunbia in the sale of meat products to supermarkets in the UK and other customers. Even if independents in NI passed through a loss of Category 3 revenues into higher prices to their customers, it is unlikely that Linden and Dunbia would be able to capture a significant share of displaced demand, given there are many other actual and potential suppliers to UK supermarkets and other customers.

7.68 Similarly, if independent meat processors were to compete less intensively for livestock due to a foreclosure strategy, it is likely that a large proportion of livestock, which would otherwise have been purchased by independents, would be purchased by meat processors other than Dunbia and Linden, limiting the benefit which these shareholder companies would derive from foreclosure. In addition, livestock might be moved outside NI if prices fell in NI.

7.69 This suggests that Linden and Dunbia would have only very limited ability and incentive to attempt to foreclose independents. In any event, their gains would need to be evaluated against the loss of profitability from rendering independents' material. Indeed, SAPI (and any other Linergy shareholders without interests in meat processing) would not appear to gain from a

foreclosure strategy, but would suffer the loss of revenues associated with processing less Category 3 material. This would make it less likely that they would agree to Linergy/UFBP implementing a foreclosure strategy.

7.70 We have not seen evidence of Linergy having engaged in a total or partial foreclosure strategy in relation to either Category 1 or Category 3 rendering, despite the MoU being signed in 2012 and the MoU appearing to align the incentives of Linergy and SAPI. This may indicate that, even if it had the ability, Linergy does not have the incentive to foreclose independents.[139]

7.71 Finally, due to the relative size of the independent meat processors in NI and the number of competitors, it appears unlikely that vertical input foreclosure would have a significant effect on either the supply of meat products or of livestock.

7.72 For these reasons, we conclude that an SLC has not arisen and may not be expected to arise in relation to the vertical aspects of the Merger.

Coordinated effects

7.73 Coordination can occur where potential competitors choose not to compete with each other, in the expectation that rivals are likely to respond in a similar way.[140] The concern under this theory of harm is that the Merger may make coordination more likely if it does not already take place, or more effective/stable, if it does take place.

7.74 We have not seen persuasive evidence of pre-existing coordination. Furthermore, given our conclusion in relation to the counterfactual, we find that there is no overlap in relation to rendering services for Category 1 material, Category 3 material, or fallen stock. Therefore, we have not identified any reasons to believe that the effect of the Merger will be to facilitate the development of coordination.

Horizontal effects in relation to the supply of tallow and MBM

7.75 We have neither found nor received any evidence to suggest that the Merger is likely to raise the possibility of an SLC in relation to the supply of tallow and MBM. The absence of an overlap between the Parties in relation to Category 1 material, Category 3 material and fallen stock also supports our

[139] One independent, [✂], suggested that this might be because Linergy was waiting for merger clearance before implementing a foreclosure strategy, but for the reasons set out above we consider this unlikely to occur.
[140] *Merger Assessment Guidelines*, section 5.5.

conclusion that the Merger does not give rise to an SLC in relation to the supply of tallow and MBM.

8. Conclusions on the SLC test

8.1 For the reasons set out in paragraphs 7.6 and 7.65 to 7.72, we conclude that the Merger has not resulted, and may not be expected to result, in an SLC in the markets for the rendering of Category 1 material, Category 3 material and fallen stock, each having a relevant geographic market extending at least as far as NI.