

Anticipated acquisition by Adams Foods Limited of the business for the sale and marketing of hard cheese in the UK of the First Milk Cheese Company Limited and Scottish Milk Products Limited

ME/6327/13

The OFT's decision on reference under section 33(1) given on 3 February 2014. Full text of decision published 3 March 2014.

---

**Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.**

## **PARTIES**

1. **Adams Foods Limited ('Adams')** is a UK subsidiary of the Irish Dairy Board ('IDB'). Adams supplies cheese to UK food retailers and to UK wholesale and foodservice customers. Its main UK brands are Pilgrims Choice, MU, and Kerrygold which are supplied in the retail sector, and Horlicks Farm and Adams which are sold in the foodservice sector. Adams has a processing and packing facility at Leek, Staffordshire. Most of the bulk cheese which Adams processes is sourced from the IDB in Ireland, although it does have supply arrangements for some British cheese with smaller British creameries.
2. The IDB is an Irish co-operative society, owned by Irish dairy farmers. The IDB buys, markets, and sells consumer dairy products and dairy food ingredients internationally. It procures dairy products from member co-operatives in Ireland, and its UK subsidiaries, including Adams, pack, distribute and market dairy products in the UK.
3. **First Milk Limited** is a British farmer-owned cooperative. It procures milk directly from its members and processes it into various bulk dairy products. First Milk Limited and its subsidiaries (together, '**First Milk**'), including First Milk Cheese Company Limited and Scottish Milk Products Limited, supply

cheese to UK food retailers and to UK wholesale and foodservice customers, and for export. First Milk's main UK brands are Lake District Dairy, Mull of Kintyre, Kingdom Cheese Company, Pembrokeshire, Isle of Arran, Scottish Pride, and CNP Professional. First Milk processes milk into hard cheese at four creameries<sup>1</sup> and packs cheese at a facility in Maelor, Wrexham.

## TRANSACTION

4. Adams proposes to acquire certain assets which form the First Milk business for the supply of hard cheese in the UK (the '**FM Hard Cheese Business**'), currently being carried on by First Milk Limited's subsidiaries the First Milk Cheese Company Limited and Scottish Milk Products Limited (the '**Merger**'). The UK turnover of the FM Hard Cheese Business is estimated as being equivalent to the hard cheese sales by First Milk to retail and foodservice, which totaled £[ ] million for the financial year ended 31 March 2013.
  
5. Adams signed an Asset Purchase Agreement ('**APA**') on 30 October 2013. The following assets are to be acquired by Adams under the terms of the APA:
  - goodwill, together with the exclusive right of Adams to represent itself as carrying on the business in succession to First Milk
  - stock in trade of packed cheese owned by First Milk
  - customer contracts and sales relationships ongoing as at the date of completion
  - business IP
  - business confidential information, including in relation to products, processes and operations, customer, client and supplier lists, price lists, contractual arrangements, marketing and business plans and know-how and trade secrets
  - personnel information and other matters concerning the business, and
  - business and accounting records.
  
6. In addition, employees associated wholly or predominantly with the target business are to be transferred to Adams under the TUPE Regulations.

---

<sup>1</sup> Wigton, Cumbria (Lake District Creamery); Campbeltown, Argyll (Campbeltown Creamery); Kilmory, Isle of Arran (Torrylinn Creamery); and Merlin's Bridge, Haverfordwest (Haverfordwest Creamery)

7. As part of the transaction, the parties have entered into a [ ] year agreement for the supply of hard cheese by First Milk to Adams. Under this agreement, First Milk will supply Adams with the hard cheese necessary to service the acquired customer contracts plus certain amounts of additional hard cheese.
8. The parties notified the Merger to the OFT on 29 November 2013. The OFT's administrative deadline is 3 February 2014.

## **JURISDICTION**

9. Under the merger provisions of the Enterprise Act 2002 (the '**Act**') a relevant merger situation is created when two or more enterprises cease to be distinct or arrangements are in progress or contemplation which, if carried into effect, will lead to enterprises ceasing to be distinct and either the UK turnover of the enterprise being acquired exceeds £70 million or after the merger the enterprises which have ceased to be distinct together supply or acquire at least 25 per cent of a particular good or service within a substantial part of the UK. The requisite test for the OFT is that it has to reach a belief that it is or may be the case that a relevant merger situation will be created (section 33(1)(a) of the Act).

### **Enterprises ceasing to be distinct**

10. For the reasons set out below, the OFT's investigation has confirmed that enterprises will cease to be distinct as a result of the Merger.
11. The term 'enterprise' is defined in the Act as the activities, or part of the activities, of a business. The OFT will have regard to the substance of the arrangement and make an assessment based on the totality of all relevant considerations.<sup>2</sup>
12. An enterprise may comprise a number of components, most commonly: the employees working in the business, the assets and records needed to carry on the business and the benefit of existing contracts and goodwill.<sup>3</sup> In particular:

---

<sup>2</sup> OFT, *Mergers: Jurisdictional and Procedural Guidance*, June 2009, OFT527, paragraph 3.9

<sup>3</sup> OFT, *Mergers: Jurisdictional and Procedural Guidance*, June 2009, OFT527, paragraph 3.10

- The transfer of 'customer records' is likely to be important in assessing whether an enterprise has been transferred.
- The application of the TUPE regulations would be regarded as a strong factor in favour of a finding that the business transferred constitutes an enterprise.
- The OFT would normally (although not inevitably) expect a transfer of an enterprise to be accompanied by some payment for the goodwill obtained by the purchaser.<sup>4</sup>

13. In the present case, customer records and other confidential information is being transferred to Adams and the employees associated with the target business will be transferred under the TUPE Regulations, which the OFT considered strong evidence that the target business constitutes an enterprise under the Act.
14. Given that the Merger involves the permanent transfer of confidential information, customer contracts and employees, the OFT considered that the existence of the long term cheese supply agreement between Adams and First Milk as the seller of its hard cheese business did not preclude a conclusion that the target business is an enterprise. Rather, the OFT considers the combination of this supply agreement, together with the transfer of assets, rights and employees in the present case, to form part of the evidence supporting its belief that it is or may be the case that a relevant merger situation will be created.
15. For the reasons set out above, the OFT considers that as a result of the Merger Adams and the FM Hard Cheese Business will cease to be distinct. The UK turnover of the FM Hard Cheese Business exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

---

<sup>4</sup> *Ibid.*

## COUNTERFACTUAL

16. The OFT generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the OFT will assess the merger against an alternative counterfactual where, for example, the OFT believes that one of the merger firms would inevitably have exited from the market.<sup>5</sup>
17. In this case, the parties submitted that the prevailing conditions of competition will not continue, due to the following:
- In [ ] 2013 First Milk was informed that it had lost the contract for supplying hard cheese to Asda with effect from March 2014. The Asda contract amounts to [ ] per cent of First Milk's cheese production and more than [ ] per cent of its retail sales.
  - First Milk announced on 15 October 2013 that it had taken the decision to close its Maelor cheese packing site (although the site is still at present operational). First Milk submitted that this decision was taken since [ ].
  - In addition, First Milk has in the last 12 months taken the decision [ ] in the foodservice sector.
18. The parties submitted that these factors are relevant to the appropriate counterfactual since they indicate that, even absent the Merger:
- First Milk will have a diminished presence in the sector due to the loss of the Asda contract, and
  - First Milk is in any event exiting cheese packing due to the closure of its Maelor site.
19. The OFT therefore considered whether there was compelling evidence that the closure of the Maelor site was inevitable and that hence First Milk would inevitably have exited from cheese packing absent the Merger. In such circumstances, the OFT would consider that the prospect of prevailing conditions continuing was not realistic.
20. A number of third parties agreed that First Milk's presence in cheese packing was likely to be unsustainable following the loss of the Asda

---

<sup>5</sup> OFT *Mergers Assessment Guidelines* 1254, September 2010, paragraph 4.3.5.

contract. In addition, internal documents provided to the OFT suggest that First Milk would have considered closing the packing site even if the Merger had not been agreed. In particular, an internal planning document dated July 2011 (well before the Merger was in contemplation) notes First Milk's concerns that its contract with Asda was at risk and that if First Milk were to lose its contract, the Maelor packing site would be untenable.

21. However, it is not clear on the basis of compelling evidence<sup>6</sup> that the decision to close the Maelor site was inevitable and would have occurred absent the Merger. Adams's internal documents dated 11 January 2013 state that, in the earliest stages of the contemplation of the Merger, it was [ ]. Further, the decision to close the site was announced on 15 October 2013, a very short time before the APA was signed on 30 October 2013.
22. In addition, the OFT considered it at least possible that First Milk may have found another customer for 2014 and therefore reversed its decision to close the site which currently remains operational.
23. For these reasons and taking a cautious approach, the OFT has assessed the Merger against the prevailing conditions of competition and has therefore taken account of First Milk's Maelor cheese packing site as part of the Merger. However, the OFT has also examined the extent to which First Milk's Maelor cheese packing site may have provided a weaker competitive constraint as part of its competitive assessment of the Merger.

## **FRAME OF REFERENCE**

24. Adams and the FM Hard Cheese Business overlap in the supply of cheese to retail and foodservice sectors in the UK. Adams and First Milk also overlap in the supply of cheese packing services.<sup>7</sup> There is no overlap between the parties in the production or supply of other dairy products or in the procurement of raw milk, so the OFT has not considered these products further in its assessment of the Merger.

---

<sup>6</sup> OFT *Mergers Assessment Guidelines* 1254, September 2010, paragraph 4.3.10

<sup>7</sup> First Milk's cheese packing business is not being acquired by Adams and First Milk's packing site is intended to be when the Asda contract ceases. However, as set out above, the OFT has, on a cautious basis, assessed the Merger based on the prevailing conditions of competition.

## Supply of cheese

### Product scope

25. The parties submitted that the correct frame of reference may be the supply of all cheese, without any further segmentation by type. However, recent OFT decisions found that not all types of cheese are sufficiently close demand-side and supply-side substitutes to be considered in the same market.<sup>8</sup>
26. The OFT considered whether the appropriate frame of reference is 'hard cheese', which the parties submitted includes:
- Cheddar (UK produced and imported)
  - British territorial hard cheese such as Red Leicester and Double Gloucester
  - low fat hard cheeses with a lower milk-fat content than cheddar, which cannot legally be sold as cheddar
  - 'analogue' hard cheese, which is very similar to cheddar but with vegetable fat substituted and sold as value cheese or blended in grated products
  - continental hard cheeses made through similar processes to cheddar and with similar taste characteristics,<sup>9</sup> and
  - US-style hard cheeses, such as Colby and Monterey Jack.
27. Both parties supply limited amounts of mozzarella on an ad hoc basis but none of Adams, the IDB or First Milk produce mozzarella, instead sourcing it from third party producers to meet customer demand. Mozzarella is a semi-hard or soft cheese and neither the parties nor third parties have not suggested that it should be included in the frame of reference for hard cheese.
28. Given the parties' limited activities in the supply of mozzarella<sup>10</sup> and the fact that no third parties raised concerns regarding the supply of

---

<sup>8</sup> For example, anticipated merger between First Milk Limited and Milk Link Limited, 12 December 2007 ('**First Milk/Milk Link**'), paragraph 16 (this merger was subsequently abandoned); acquisition by Lactalis McLelland Limited of Lubborn Cheese Limited, 6 August 2009, paragraph 52.

<sup>9</sup> For example, Edam, Gouda, Emmental, Maasdam, Gruyere, Jarlsberg, Leerdammer and Cantal

<sup>10</sup> The parties estimated that their combined market share in the supply of mozzarella is no more than [ ] per cent, with an increment of [ ] per cent.

mozzarella, the OFT has not considered the market for the supply of mozzarella further in its decision.

Type of cheese – cheddar and British territorial hard cheese

29. Most third parties did not think that there is demand-side substitution between cheddar and British territorial hard cheeses. Third party retailers were unanimous in their view that retailers would not switch their purchases from cheddar to British territorial hard cheeses. Two competitors submitted that their retail customers would switch between cheddar and British territorial hard cheese, but one competitor agreed with retailers that customers would not switch.
30. The boundaries of the relevant product market are usually determined by reference to demand-side substitution alone. However, the OFT may take suppliers responses to changes into prices into account when deciding whether to aggregate several narrow markets when:
- production assets can be used by firms to supply a range of different products that are not demand-side substitutes, and the firms have the ability and incentive quickly (usually within a year) to shift capacity between these different products depending on demand for each, and
  - the same firms compete to supply these different products and the conditions of competition between the firms are the same for each product.<sup>11</sup>
31. The OFT did find evidence of supply-side substitution between cheddar and British territorial hard cheeses. Those third party competitors who commented on this point stated that they have the incentive and ability to switch production quickly between cheddar and British territorial hard cheeses. The OFT also noted that, in First Milk/Milk Link, the OFT accepted arguments that there would be sufficient supply-side substitution between cheddar, Red Leicester and Double Gloucester.<sup>12</sup> The OFT has therefore considered that cheddar and British territorial hard cheeses form part of the same frame of reference.

---

<sup>11</sup> OFT *Mergers Assessment Guidelines* 1254, September 2010, paragraph 5.2.17.

<sup>12</sup> First Milk/Milk Link, paragraph 16.

#### Types of cheese – cheddar and low-fat or 'analogue' hard cheese

32. The majority of third parties did not consider there to be demand-side substitution between cheddar and low-fat or 'analogue' cheese. Nearly all third party retailers and competitors agreed that retailers and end-consumers would not switch between them. As regards supply-side substitutability (assessed with regard to the considerations set out at paragraph 30 above) competitors' views were mixed. Two of the three competitors who commented on this point stated that there could be supply-side substitution. One competitor submitted that low-fat cheese is processed on identical equipment to full-fat, but using milk with a lower fat content. Another competitor stated that it can be more complex to produce good quality low-fat cheddar than regular cheddar. On balance and on a cautious basis, the OFT has assessed low-fat and 'analogue' hard cheese separately from cheddar. However, given that no concerns arise even on a narrower frame of reference, it was not necessary to conclude on the product scope in this respect.

#### Types of cheese – cheddar and other hard cheese

33. The majority of third parties did not consider there to be demand-side substitution between cheddar and continental or US-style hard cheeses. Nearly all third party retailers and competitors agreed that retailers and end-consumers would not switch between them. Further, two out of the three competitors who commented on this point stated that there would be no supply-side substitution. Since neither of the parties produce these other types of hard cheese, the OFT has not considered other hard cheeses in its competitive assessment though it has not needed to conclude on whether they should be included in the same frame of reference.

#### Conclusion on type of cheese

34. On a cautious approach, for the reasons set out above the OFT assessed the Merger on the basis of the supply of cheddar together with Red Leicester and Double Gloucester (together referred to for convenience as 'cheddar') and the supply of low-fat and 'analogue' hard cheese. However, the OFT did not need to conclude on the precise delineation of the product scope as regards to the type of cheese since no competition concerns arise on this narrow frame of reference.

## Branded and private label cheddar

35. In the First Milk/Milk Link decision, the OFT accepted that there was demand-side substitution between private label and branded cheese, at both the consumer level and by retailers.<sup>13</sup>
36. The EU Commission in its Friesland/Campina decision also concluded that branded and private label/unbranded cheese are in the same product market for the sale of Dutch cheese.<sup>14</sup>
37. The parties submitted that branded and private label cheddar should be part of a single product market because:
- On the demand-side, retailers regularly adjust their mix of shelf space and/or prominence for branded and private label cheese. Consumers will switch between the two. Branded and private label products both sit across the price/value spectrum, without any obvious price premium applying to branded over private label.
  - On the supply-side, many domestic cheese producers supply both branded and private label products, and there is little difference in the production process between the two.
38. The OFT has found that third party views are mixed on the demand-side substitution between branded and private label cheese. Four retail customers believed that there would be switching by end consumers from private label to branded cheddar, whilst four others did not think there would be any switching by end consumers, in response to a five per cent increase in the retail price of private label cheddar.
39. On the supply-side, all of the parties' competitors who responded to the OFT agreed with the parties that suppliers can switch between these different market segments.
40. The OFT also considered evidence on pricing and margins for private label and branded cheddar, but this evidence was not conclusive on the extent to which the two may constrain each other.

---

<sup>13</sup> First Milk/Milk Link, paragraph 17.

<sup>14</sup> Case no. M.5046 – Friesland Foods/Campina, 17 December 2008, paragraph 529

41. Since, as set out above, the evidence obtained in the present case for the extent to which private label and branded cheddar constrain each other is mixed, the OFT has, on a cautious basis, considered the supply of private label and branded cheddar separately in its assessment of the Merger. However, as no competition concerns arise regardless of the frame of reference in this respect, it was not necessary for the OFT to reach a conclusion as to whether private label and branded cheddar form part of the same product scope.

#### Retail and foodservice customers

42. The parties submitted that retail and foodservice customers should be considered part of the same frame of reference. Based on the considerations set out at paragraph 30, and the evidence obtained in this case, the OFT believes that supply-side substitution is possible since production assets can be used to supply both channels (it is fundamentally the same product). There are no differences in the cheese production process, and many existing cheese producers and importers currently supply cheese to both retail and foodservice customers.

43. In the present case there is no need to conclude on a product scope segmented by customer type, since the Merger does not raise competition concerns even if retail and foodservice customers are considered separately.<sup>15</sup>

#### Geographic scope

44. The parties submitted that there were reasons to believe that the correct geographic frame of reference was EEA-wide due to the significant levels of international trade in cheese and the high volumes of cheese imports into the UK.

45. In First Milk/Milk Link the OFT considered that the geographic frame of reference was the UK, which included substantial imports from the Republic of Ireland and, to a lesser extent, from other countries.<sup>16</sup>

46. Imports accounted for around 30 per cent of UK consumption of hard cheese in 2012, estimated to be around 344,162 tonnes.<sup>17</sup> Approximately

---

<sup>15</sup> This was also the approach taken in the OFT's First Milk/Milk Link decision (paragraph 18).

<sup>16</sup> First Milk/Milk Link, paragraph 22.

80,134 tonnes of this originated in Ireland.<sup>18</sup> Notwithstanding these not insignificant levels of imports, some third parties indicated that customers increasingly place importance on food provenance, which could point to the geographic scope being limited to British-produced cheddar. This was confirmed by the majority of retailers, which stated that they would be unwilling to switch from British to Irish cheddar in the event of a five per cent price increase. However, other third party views on whether end consumers would be willing to switch were mixed.

47. Since Adams/IDB mostly sells Irish cheese and First Milk sells British cheese, the OFT has considered the effects of the Merger on the supply of all cheddar in the UK, including imports from the Republic of Ireland, while taking into account the potential requirements and preferences for British cheese in its competitive assessment. However, the OFT has not found it necessary to conclude on the geographic frame of reference in the present case since no competition issues arise on any basis.

## **Cheese packing**

### Product scope

48. The vast majority of cheese producers also pack their own cheese. However, some cheese producers and retailers do enter into separate packing agreements with third party cheese packers. For example, Tesco sources cheese for its private label block requirements directly from a number of suppliers (including Adams) but has an arrangement with Adams to undertake the majority of packing. [ ] also currently buys cheese in bulk from First Milk for packing at its own packing facility, demonstrating that packing may be undertaken separately.
49. In First Milk/Milk Link the OFT considered cheese packing as a separate product frame of reference, rather than viewing cheese packing as part of a wider food packaging services market.<sup>19</sup> The OFT received no evidence to depart from its approach in First Milk/Milk Link, and has therefore considered cheese packing services as a separate frame of reference. In its assessment the OFT has also taken account of those cheese producers that pack their own cheese, as the OFT understood that most of these

---

<sup>17</sup> This is based on estimated UK production of hard cheese of 287,000 tonnes in 2012

<sup>18</sup> Provision Trade Federation data.

<sup>19</sup> First Milk/Milk Link, paragraph 24.

producers will also provide cheesepacking services to third parties, given there is no difference in the process.

#### Geographic scope

50. In First Milk/Milk Link, the OFT found that the majority of hard cheese consumed in the UK is packed in the UK, and therefore adopted a cautious approach by considering the UK as the relevant geographic frame of reference for cheese packing.<sup>20</sup>
51. The parties submit that there are good arguments for considering the EEA, or at least the UK and several Northern European countries, as the relevant geographic frame of reference, as cheese can be cost-effectively packed for the UK market in facilities in nearby countries.
52. However, the OFT has taken a cautious approach and considers the UK as the relevant geographic frame of reference for cheese packing services. The OFT has, however, taken account of the level of constraint that packing outside the UK may impose on UK cheese packing in its competitive assessment.

#### Conclusion on frame of reference

53. The OFT considers that the relevant frames of reference for consideration are:
- the supply of, separately, branded and private label cheddar (including Red Leicester and Double Gloucester) and low-fat and 'analogue' hard cheese to retail customers in the UK, including imports from the Republic of Ireland, and, separately, the supply of cheddar of British origin, and
  - the supply of cheese packing services in the UK.

---

<sup>20</sup> First Milk/Milk Link, paragraph 25.

## HORIZONTAL ISSUES

### Unilateral effects – supply of cheddar

#### Shares of supply

54. The parties' combined share for the supply of cheddar to retail and foodservice customers in the UK is approximately [40-50] per cent by volume, with an increment of approximately [10-20] per cent.<sup>21</sup> However, due to the loss of First Milk's Asda contract, which will not form part of the Merger, the parties' combined share of supply will fall to approximately [40-50] per cent.
55. In regards to foodservice customers the parties do not overlap to any material degree (the parties' combined share of supply is approximately [10-20] per cent with an increment of only approximately [0-10] per cent<sup>22</sup>). On this basis the OFT considered that the Merger will not raise any competition concerns in regards to foodservice customers and has focused its competitive analysis on retail customers. Further, as the OFT has found no reason to believe that the parties' shares in low-fat or 'analogue' hard cheese are materially different from their shares in the supply of cheddar or that the Merger will raise specific competition concerns for these types of hard cheese, the OFT has focused its competitive analysis on cheddar.
56. As mentioned in paragraph 41 above, the OFT has on a cautious basis considered whether any competition concerns arise when considering the supply of private label cheese separately from branded.
57. The parties' combined share in the supply of branded cheese to retail customers is approximately [20-30] per cent by volume, with an increment of approximately [0-10] per cent.<sup>23</sup> The parties have a significantly higher combined share in the supply of private label cheddar at approximately [50-60] per cent, with an increment of approximately [20-30] per cent.<sup>24</sup>

---

<sup>21</sup> OFT analysis based on Kantar and parties' data for the year ending 18 August 2013 and Euromonitor data for calendar year 2012.

<sup>22</sup> Based on the parties' sales data in 2012 and Euromonitor International data for total hard cheese volume in foodservice.

<sup>23</sup> OFT analysis based on Nielsen data, year ending 14 September 2013.

<sup>24</sup> OFT analysis based on Nielsen data, year ending 14 September 2013.

58. Since the product in question is relatively homogenous the OFT considered the parties' combined share in the supply of private label cheddar to be relatively informative. However, the OFT considers for the reasons below that there will be sufficient competitive constraint post-Merger to prevent Adams from having the ability and incentive to raise prices or otherwise worsen the terms of its competitive offer for private label cheddar.

Strong and credible competitors will remain with sufficient spare capacity

59. Post-Merger there will remain at least three significant competitors in the supply of cheddar (Dairy Crest, Arla, and Lactalis McLelland) with significant market shares, as well as two medium sized competitors (Dale Farm and Wyke Farms) and a number of smaller competitors.

60. As shown in Table 1 below, the OFT estimates that the parties will have a combined cheddar production capacity<sup>25</sup> of between [30 – 40] per cent, with an increment of between [10 – 20] per cent.

---

<sup>25</sup> The OFT considers that production capacity may be a significant determinant of a firm's competitive strength and may be an appropriate basis for assessment where suppliers make the same or similar products (OFT *Mergers Assessment Guidelines*, paragraph 5.3.3).

**Table 1: Estimated shares of cheddar production capacity by volume**

<b>Supplier</b>	<b>Volume (tonnes per annum)</b>	<b>Share (%)</b>
First Milk	[ ]	[10 - 20]
Adams/IDB	[ ]	[20 - 30]
<b>Combined</b>	[ ]	<b>[30 - 40]</b>
Arla	[ ]	[15 - 25]
Dairy Crest	[ ]	[10 - 20]
Lactalis McLelland	[ ]	[0 - 10]
Dale Farm	[ ]	[5 - 15] <sup>26</sup>
Wyke Farms	[ ]	[0 - 10]
Others <sup>27</sup>	[ ]	[5 - 15]
<b>Total</b>	[ ]	<b>100</b>

**Source: Parties and third-party reports and estimates**

61. There is also substantial spare capacity in cheddar production. The parties estimated that current total spare capacity in the industry is between 80,000 and 110,000 tonnes per annum, whilst a competitor estimated that 130,000 tonnes per annum of spare capacity currently exists.<sup>28</sup> Based on third party reports and estimates, the OFT was able to confirm that there is at least 52,000 tonnes per annum of confirmed spare British cheddar production capacity in the hands of third-parties.<sup>29</sup>

<sup>26</sup> According to information provided by Dale Farm production capacity is increasing from 20,000 tonnes per annum to over 45,000 tonnes per annum in 2014.

<sup>27</sup> Others consists of Alvis Brothers, Ashley Chase Estate, Barber's Farmhouse, Belton Garm, Bradbury's, Butlers, Cricketer Farm, Dewlay, Eurlait, Fayrefield Foods, Joseph Heler, Norseland, Orkney Cheese, Parkham Farms, Singleton's, South Caernarfon Creameries, Tom Walker and Sons, ULN Bongrain, and Wensleydale. It excludes the volumes currently supplied by Parkham Farms and South Caernarfon Creameries to Adams. The parties also submit that there is 40,000 tonnes pa of capacity in cheese producers that only supply foodservice customers. On a cautious basis, this has been not included in the volume for 'Others'.

<sup>28</sup> Of which 45,000 is held by Irish producers (for example, Dairygold, Glanbia, Carberry, Kerry and Wexford).

<sup>29</sup> This takes into account the transfer of the Asda private label contract from First Milk to Arla.

62. Finally, the parties submitted that retailers are able to split their cheese supply requirements between a number of smaller suppliers which will continue to provide a competitive constraint on the parties post-Merger. Several retailers agreed with this. For example, one retailer stated that it would be willing to multi-source its supplies should prices increase with little impact on its business or customers. Many retailers already source private label cheddar from a number of suppliers.

#### Parties are not close competitors for retailers' private label requirements

63. As set out at paragraph 57 above, the parties have a relatively high combined share in the supply of private label cheese. However, there is limited overlap in the customers currently supplied by each party; only two retail customers are currently supplied with private label cheese by both of the parties.

64. In addition, there is limited overlap in the contracts the parties have bid for. The OFT understood this to be mainly due to the fact that [ ]. The parties submitted that many retailers are demonstrating a preference for British cheddar as opposed to cheddar from other sources such as Ireland. Nearly all third party retailers confirmed that they would not consider Irish cheddar for their standard or premium private label cheddar.

65. According to the parties, this means that Adams is unable to effectively compete to supply large retailers as it cannot meet their requirements for British cheddar because:

- It sources the majority of its cheese from Ireland via the IDB.
- It is only able to source limited amounts of British cheese from small creameries [ ].
- Adams' only other option for obtaining British cheese is to try to procure ad hoc amounts on the spot market or through short term contracts without guaranteed quantities sufficient to compete for large contracts. The parties submit that sourcing ad hoc supply arrangements has become increasingly difficult due to the difficulty in securing volumes sufficient to meet retailer demands.

66. However, Adams currently supplies approximately 27,000 tonnes of British cheddar and IDB and its other subsidiaries currently supply another 10,600

tonnes. Although the significant majority (over [ ] tonnes) of the British cheese Adams supplies is that which it supplies to [ ], the OFT could not rule out that Adams was competing with the FM Hard Cheese Business for the supply of British cheddar even in the event that British and Irish cheddar were not seen to be close substitutes.

67. The OFT did however consider that Adams provides a relatively weaker constraint on the FM Hard Cheese Business due to its lack of secure access to British cheddar, which the parties submit will decline further from 2013 onwards. In particular, Adams' lack of control over a source of British cheddar is likely to mean that it cannot bid for large, long-term contracts with retailers.
68. The OFT also noted that branded cheddar may continue to provide a constraint on private label cheddar due to the demand-side and supply-side substitutability that the parties and third parties identified to at least some degree (see paragraph 38).
69. One third party did raise a concern regarding the supply of private label cheddar but the OFT considered that its supply requirement was at a level which could be easily supplied by alternative suppliers. In addition, another third party considered it likely that prices would fall as a result of the Merger due to efficiencies that it believed could be enjoyed by the merged party and that would make it a more effective competitor to suppliers such as Arla.

#### Sufficient competition in the supply of branded cheddar

70. The OFT also assessed the impact of the Merger on the supply of branded cheddar. It considers that private label cheddar is likely to provide at least a degree of constraint on branded cheddar in light of some of the factors relating to demand-side substitutability identified by the OFT in First Milk/Milk Link and confirmed by third parties in the present case.<sup>30</sup>
71. Further, the parties submitted that brand loyalty in cheddar is weak compared to other food products and retailers did not consider any particular brand to be 'must stock', with the possible exception of Dairy Crest's Cathedral City brand which is the market leader.

---

<sup>30</sup> First Milk/Milk Link, paragraph 17.

72. In any case, the parties' most successful cheddar cheese brands (Adams's Pilgrims Choice and First Milk's Lake District Dairy, the number 2 and 5 brands respectively) would only have a combined share of approximately [20-30] per cent by volume and similar by value, with an increment of approximately [0-10] per cent and there are a number of other strong alternative brands, including Cathedral City (Dairy Crest), Seriously Strong (Lactalis) and Wyke Farms (Wyke Farms).
73. Finally, no third parties raised concerns about the impact of the Merger on the retail branded cheddar segment.

#### Conclusion on supply of cheddar

74. For the reasons above, the OFT did not find a realistic prospect of a substantial lessening of competition arising from unilateral effects in the supply of either private label or branded cheddar.

#### **Conglomerate effects – branded cheddar**

75. One third party raised concerns that Adams may have the ability and incentive to 'tie' its brands, making the supply of one brand contingent on the supply of another. However, the OFT considered that that there was no realistic prospect of conglomerate effects in the supply of branded cheddar, in particular given that:

- the third party also told us that tying was not a common practice in the industry
- the Merger combines only the number 2 and number 5 brands and retailers did not consider any brand to be 'must stock'
- given the parties' relatively low market shares in branded cheddar and the presence of strong alternative brands (see paragraph 72 above) it is unlikely that Adams would have the ability or incentive to tie its brands.

#### **Supply of cheese packing services in the UK**

##### Shares of capacity

76. The OFT considers it appropriate to consider the parties' shares of capacity in cheese packing to determine the level of constraint the parties represent

to one another and the constraint posed by the parties' competitors.<sup>31</sup> Based on evidence available to the OFT, the parties' combined share of cheese packing capacity in the UK is approximately [40 – 50] per cent. The OFT considered that this share is relatively large given the smaller shares of the parties' competitors as set out in Table 2. However, for the reasons set out below it does not consider that the Merger gives rise to competition concerns as regards to cheese packing.

**Table 2: Estimated shares of cheese packing capacity, by volume**

	Packing capacity	Share (%)
Adams	[ ]	[30 – 40]
First Milk	[ ]	10 – 20]
<b>Combined</b>	[ ]	<b>[40 – 50]</b>
Arla	[ ] <sup>32</sup>	[10 – 20]
Dairy Crest	[ ]	[10 -20]
Lactalis	[ ]	[0 – 10]
Wyke Farms	[ ]	[0 – 10]
Dale Farm	[ ]	[0 – 10]
Fayrefield	[ ]	[0 – 10]
Joseph Heler	[ ]	[0 – 10]
Others <sup>33</sup>	[ ]	[0 – 10]
<b>Total</b>	[ ]	<b>100</b>

**Source: information provided to the OFT by the parties and third parties**

<sup>31</sup> As per OFT Mergers Assessment Guidelines, paragraph 5.3.3.

<sup>32</sup> Arla has confirmed to the OFT that they have invested £11m to increase packing capacity by [ ] tonnes pa. They may be able to do a separate [ ] expansion in 2014 (unclear if this is additional).

<sup>33</sup> Butlers, Belton, South Caernarfon, Alvis Brothers, Barbers, Cricketer Farm, Ashley Chase Estate and Parkham Farms.

## Spare capacity in cheese packing

77. Based on information provided to the OFT, the OFT estimated on a cautious basis that there is currently around [ ] tonnes of total spare capacity for cheese packing in the UK. On the basis of the current conditions of competition continuing (that is, that the Maelor packing site would remain open notwithstanding the Merger), the OFT estimated that, as set out at Table 3 below, the parties would account for approximately [60 – 70] per cent of the known spare capacity. Further, the OFT noted that the capacity currently available to any one competitor was not enough to handle a large cheese packing contract.

**Table 3: Current estimated shares of spare cheese packing capacity, by volume**

	<b>Spare packing capacity (tonnes per annum)</b>	<b>Share of known spare capacity (%)</b>
Adams	[ ]	[40 – 50]
First Milk	[ ]	[10 – 20]
<b>Combined</b>	[ ]	<b>[60 – 70]</b>
Arla	[ ]	[0 – 10]
Dairy Crest	[ ]	[0 – 10]
Lactalis	[ ]	[10 – 20]
Wyke Farms	[ ]	[0 – 10]
Dale Farm	[ ]	[0 – 10]
Fayrefield	[ ]	[0 – 10]
Joseph Heler	[ ]	[0 – 10]
Others <sup>34</sup>	[ ]	[0 – 10]
<b>Total</b>	[ ]	<b>100</b>

**Source: information provided to the OFT by the parties and third parties**

78. No smaller customers raised concerns and since there are a number of suppliers with capacity to handle smaller volumes of cheese the OFT focussed on the availability of capacity for customers wishing to pack relatively large volumes (that is, 20,000 to 30,000 tonnes per annum) of cheese.
79. Two retailers raised concerns that the Merger may give rise to unilateral effects in cheese packing due to a reduction in the number of alternative suppliers for large packing requirements. In addition, given that retailers

<sup>34</sup> Butlers, Belton, South Caenarfon, Alvis Brothers, Barbers, Cricketer Farm, Ashley Chase Estate, Parkham Farms.

often use the same supplier to supply cheddar as well as pack it, the Merger may lead to a reduction in the number of potential suppliers of private label cheddar. The concerns relate to the fact that post-Merger, Adams and Arla will control the two main packing plants in the UK which [ ] have spare capacity of approximately [ ] tonnes (taking into account Adams' increase in packing following the Merger and Arla's investment). One third party therefore considered that post-Merger it would have a lack of alternative suppliers which may reduce its ability to run a competitive tender.

80. While customers may prefer to source packing services from a single supplier, the OFT considered that a retailer with a large packing requirement may be able to consider splitting its contracts between a number of suppliers in order to utilise the available capacity in the market. One third party considered that this would not be as commercially desirable as using a single supplier as well as there being a potential loss of cost efficiencies. However, this third party confirmed that it had considered this multi-sourcing option in the past (though in the event was able to contract with a single supplier with sufficient capacity). The OFT also understood that some retailers already split their total cheese and packing requirements between different suppliers. A smaller competitor of the parties confirmed that it would be willing to bid at levels of around 10,000 tonnes in order to secure part of a retailer's larger requirement, and (as also noted below) other competitors will also be able to provide cheese packing services..

81. The OFT also received evidence of recent and planned investment by competitors in cheese packing and third party competitors confirmed that they would consider investing in their packing sites in order to win a larger contract than they were currently able to service. The OFT understood that such investment can be completed relatively swiftly. For example, Arla has invested £11 million [see endnote 1] to increase packing capacity by [ ] tonnes per annum in order to meet their recently won contract with Asda. The additional capacity was achieved in approximately nine months. Arla confirmed to the OFT that they would be willing to do so again in order win a [ ] contract. In addition:

- [ ] have invested in [ ].
- Fayrefield, currently Adams's contract-packing customer, have decided to self-supply cheese packing and will open a new facility with 10,000 tonnes per annum capacity in 2014.

- Helers plan to invest in [ ] per annum packing capacity over the next three years.

82. The OFT considered that this suggested that current spare capacity levels may not be a strong indicator of actual competitive constraint as suppliers are able to compete by expanding to meet demand as and when they win contracts.

#### Other factors regarding cheese packing

83. In addition, the OFT considered that, for the reasons set out below, the spare capacity of First Milk in Table 3 above is likely to overstate the actual level of competitive constraint that would be provided by the FM Hard Cheese Business going forward due to the limitations of the Maelor packing site.

84. According to internal documents of First Milk from July 2011 (pre-dating the Merger by some time) [ ]. Third parties confirmed the view that the Maelor site often struggled to meet retailers' requirements and [ ] de-listed products packed there by First Milk in 2009/2010.

85. Several third parties (both customers and competitors and including the third party complainant) believed that the FM Hard Cheese Business was becoming less competitive in recent years and that its operations were likely to be unsustainable in the near future.

86. The OFT therefore considered that the competitive constraint provided by the FM Hard Cheese Business was overstated and going forward was not likely to provide a strong constraint on Adams. The merger effects are therefore likely to be limited.

87. Finally, the OFT considered that packing sites outside of the UK may provide a constraint on Adams post-Merger since some third parties told the OFT that sites in, for example, the Netherlands may be available to pack British cheese.

#### Conclusion on cheese packing

88. The OFT considered that there is no realistic prospect of horizontal unilateral effects in cheese packing due to the levels of spare capacity and the ability and incentives of cheese packing suppliers to invest in order to

create new capacity to service additional contracts. In addition, the OFT considered that the competitive constraint exercised by the FM Hard Cheese Business was overstated by spare capacity figures given that its difficulties in recent years meant that it was generally considered by customers not to be a viable supplier.

## **VERTICAL ISSUES**

89. The OFT considered two possible vertical theories of harm, relating to foreclosure in each of the following areas:
- the provision by Adams of some limited cheese packing services to downstream competitors, and
  - the supply by the FM Hard Cheese Business of bulk cheese to downstream competitors.
90. The OFT considered whether the Merger may give rise to a substantial lessening of competition by allowing the merged firm to raise its downstream cheese rivals' costs, by raising the price of (or refusing to supply) cheese packing or bulk cheese, such that the parties are able to profitably raise prices to customers.
91. With regards to cheese packing, the OFT considered that Adams will not have the ability or incentive to foreclose downstream competitors as most UK dairy companies have their own packing facilities and Adams only packs modest volumes of cheese for downstream competitors (approximately [ ] tonnes) and these volumes should be easily available from other cheese packers.
92. With regards to bulk cheese supply, First Milk currently supplies small volumes of bulk cheese to [ ] customers, and smaller volumes from time-to-time on an ad hoc basis to various customers under short-term supply contracts. Post-Merger, the OFT considered that Adams would not have the ability or incentive to foreclose downstream competitors since there are alternative suppliers available that customers would be able to switch to.
93. Consequently, the OFT concluded that there was no realistic prospect of a substantial lessening of competition in relation to foreclosure of cheese packing services or bulk cheese supply.

## **THIRD PARTY VIEWS**

94. The OFT sought views on the Merger from customers and competitors of the merging parties. Third party comments have been given due consideration by the OFT, and have been referenced in this decision where relevant.
95. Two retail customers raised a concern that alternatives for cheese packing would be limited post-Merger due to the lack of capacity in the market. This was considered by the OFT at paragraphs 77 to 88 above. Most customers and competitors were not concerned about the Merger.

## **ASSESSMENT**

96. The parties overlap in the supply of cheddar and cheese packing services. In regards to the supply of cheese, the parties supply branded and private label cheddar to retail and foodservice customers.
97. The parties have relatively modest shares of supply of branded cheddar. The Merger will combine the number 2 and number 5 brands in the UK and there are a number of other strong alternative brands.
98. The parties' combined share in the supply of private label cheddar is not at a level that concerns over unilateral effects can be necessarily ruled out. However, the OFT considers that Adams provides a relatively weak constraint on the FM Hard Cheese Business due to its lack of secure access to British cheese (the majority of its cheese is sourced from the Republic of Ireland through its parent, the IDB) which may decline further from 2013 onwards, while the cheese supplied by the FM Hard Cheese Business is British. In addition, although the OFT did not need to reach a conclusion on the relevant frame of reference, it considers that demand-side and supply-side substitutability indicates that branded and private label cheddar each pose at least some constraint on the other and hence branded cheddar supplies by their competitors will continue to constrain the parties' private label cheddar supply post-Merger.
99. For these reasons the OFT did not find a realistic prospect of a substantial lessening of competition arising from unilateral effects in the supply of cheddar.

100. As regards to cheese packing, the OFT estimated that the parties would account for the majority of the current known spare capacity in cheese packing in the UK. However, the OFT considered that there is no realistic prospect of horizontal unilateral effects in cheese packing due to the remaining and expanding levels of spare capacity of competing cheese packing suppliers, and the ability and incentive of cheese packing suppliers to invest in order to create new capacity to service additional contracts. In addition, the OFT considered that the competitive constraint exercised by the FM Hard Cheese Business was overstated by spare capacity figures given that its difficulties in recent years meant that it was generally considered by customers not to be a viable supplier.

101. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

102. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

## **ENDNOTES**

- I. In regards to paragraph 81, Arla notes that the actual investment figure was £9 million rather than the £11 million previously stated.