Completed acquisition by Boparan Holdings Limited of Vion Poultry Limited (now 2 Sisters Poultry Limited)

ME/6013/13

The OFT's decision on reference under section 22(1) given on 18 June 2013. Full text of decision published 19 July 2013.

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. **Boparan Holdings Limited (BHL)**: BHL is the holding company for 2 Sisters Food Group Limited (**2SFG**) and owns a range of businesses including Northern Foods Limited. BHL supplies a range of food products in the UK including, through 2SFG, primary and processed chicken to retailers, caterers and other industrial food processors in the UK and Europe. BHL is controlled by Ranjit Singh Boparan and his family interests (**Mr Boparan**). BHL's turnover in the financial year 2012 was £2.3 billion of which [ ] was generated in the UK. 2SFG's UK turnover in financial year 2012 was £778 million.

2. [A related party to BHL]

3. **Vion Food Group Limited:** Vion N.V. a Dutch company active in a wide range of food production, owns a number of companies who operate in the UK under the holding company Vion Food Group Limited. Vion Poultry UK (**Vion**), a wholly owned subsidiary of Vion Food Group Limited, is active in the poultry sector in the UK. Vion N.V. operates a fully integrated poultry infrastructure covering agriculture (feed mills, rearing and growing) and processing activities in the UK. Vion UK's turnover for the year ending 31 December 2012 was [ ].

TRANSACTION

4. The transaction completed on 8 March 2013. BHL and [A related party to BHL] paid a consideration of [ ] for the entire issued share capital of a number of Vion N.V. companies operating in the poultry and red meat sectors of the UK market. BHL acquired Vion N.V.'s businesses active in poultry and red meat trading; [A related party to BHL] acquired Vion N.V.'s businesses comprising Vion N.V.'s poultry and red meat agriculture assets.[1]

5. The administrative deadline for OFT to make its decision is Tuesday 18 June 2013.

JURISDICTION

6. As a result of the transaction 2SFG and Vion have ceased to be distinct.

7. The UK turnover of the businesses involved in the transaction in the calendar year 2012 was approximately [over £70m]. Consequently the turnover test contained in section 23(1)(b) of the Enterprise Act 2002 (the Act) is met.

8. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

COUNTERFACTUAL

9. The OFT assesses the competitive effects of a merger by comparing the prospects for competition with the merger against the competitive situation absent the merger. The description of the latter, the counterfactual, is affected by the extent to which events or circumstances are foreseeable. In practice, the OFT generally adopts the prevailing conditions of competition as the counterfactual against which to assess a merger. 2SFG submitted that, absent the acquisition, Vion would have exited the market.

10. 2SFG also submitted that if the OFT were not to consider that Vion meets the conditions for the exiting firm scenario, Vion was nevertheless in decline and therefore, going forward, it should be considered as a much

[1] [ ].

weakened competitor.

11. The OFT therefore considered whether, based on the evidence available, the acquisition should be measured against an alternative counterfactual

12. The OFT may adopt an alternative counterfactual where there is compelling evidence to show that the exiting firm scenario is met. The OFT has therefore considered in the present case whether Vion would inevitably exited the supply of poultry in the UK, absent the merger. As is set out below, the OFT has not considered the less anti-competitive purchaser or outcome tests given that it does not consider that the exit of Vion was inevitable for financial or other reasons.[2]

Would Vion have exited the UK?

13. 2SFG submitted that its acquisition of Vion resulted from the decision of Vion N.V. to exit the UK due to poor financial performance. It submitted that, absent the acquisition, Vion would have failed financially. In particular 2SFG submitted that:

- Vion lost a large value contract with Sainsbury's in March 2012. This contract accounted for [30 – 40 per cent] of Vion's total business.[3] The loss of this contract was unlikely to be offset by alternative contract awards and, absent the merger, Vion would have suffered substantial financial loss in 2013

- Vion had unsuccessfully sought to win replacement business

- Vion was unable to raise the necessary resources from its parent company to restructure its commercial operations, and

- in early 2013, Vion was being put under additional financial pressure. A retender of a further large value contract with [C1] had been

[2] Merger Assessment Guidelines, paragraph 4.3.10.

[3] Sainsbury's awarded a contract for [ ] birds/week, at that time held by Vion, to 2SFG and Moy Park in March 2012. The contract had a 12 month transition period where supply was planned to move from Vion to 2SFG and Moy Park [ ]. The contract was due to be fully transferred in March 2013.

announced, whilst [C2] was also known to be considering retendering its large value contract with Vion.[4,5]

14. The parties calculated that, taking all the above actual and potential contract losses together, Vion's share in the supply of all chicken in the UK would have declined from [10 – 20] per cent to [0 – 10] per cent in the period between March 2012 and March 2013. 2SFG submitted that Vion would be left with an unsustainable volume of under-utilised processing assets which, in turn, would serve to further reduce its working capital.

15. The OFT considers, based on the available evidence, that it cannot predict with reasonable confidence that Vion would have inevitably have exited the market. The OFT has reached this conclusion for the following reasons.

16. First, Vion's submissions demonstrate that it considered a range of options, absent the sale. At the time of the transaction, Vion was considering three key scenarios for taking the Vion business forward including reducing the number of shifts at the [ ], or closure of [ ]. Specifically, Vion submitted that, absent a sale, by around mid-2013 it would have sought to restructure the Vion business and then seek to resell the reconfigured business. For the purposes of assessing the exiting firm scenario, it is necessary for the OFT to be convinced that exit is inevitable. The evidence provided may well be consistent with a strategic decision to exit the UK market, but if the steps towards exit included restructuring, the OFT cannot be confident that following a successful restructuring Vion would have inevitably exited the market rather than continuing to operate the business. The OFT also notes, Vion submitted that, absent a sale, their preferred medium-term option was reducing the number of shifts at its plants rather than plant closure.

17. Second, Vion continued to win business (that is, bid for other contracts to supply poultry to retailers) following the loss of the Sainsbury's contract. Likewise, no compelling evidence was provided to demonstrate that Vion would have lost the [C1] and [C2] contracts (or other contracts) absent the merger. In this regard, the evidence available to the OFT demonstrates that:

[4] [ ].
[5] Both contracts represent approximately [ ] birds/week.

- The impetus for [C2] to retender its contract with Vion appears to have been directly related to the acquisition and the need for security of supply.[6]

- The [C1] retender was announced prior to the transaction completing and the parties have retained the contract. 2SFG contend that they have only retained the contract because of the stability that the transaction has brought to the business and that absent the transaction, Vion would have lost the contract. However, there is no compelling evidence that the acquisition of Vion by 2SFG was the only way that Vion could have retained this contract.

18. Thirdly, as noted by 2SFG, Vion were actively tendering for new business up until the time of the transaction in March 2013. In particular, in late 2012 Vion were actively engaged with [C3] to try to secure a contract for [ ] birds/week.[7] This contract was of sufficient size to replace a significant portion of the Sainsbury's contract that was due to end in March 2013 and, Vion submitted, would have prevented the need for Vion to be restructured (see paragraph 16) and aided the sale of the business. This action may not necessarily be entirely consistent with the behaviour of a firm about to exit the market.

19. On the evidence available, the OFT has not reached a sufficient level of belief that Vion N.V. would have exited the supply of poultry in the UK if it had been unable to sell Vion. Given the OFT does not consider that limb 1 of the exiting firm test is met it has not found it necessary to go on to consider limbs 2 and 3.

Alternative counterfactual based on Vion's financial performance

20. 2SFG submitted that, an alternative counterfactual to inevitable exit, would be a significantly reduced competitor. 2SFG submitted the following evidence in support of this alternative counterfactual:

    - The weakening of the Vion business due to the loss of the Sainsbury's contract. This resulted in Vion processing [ ] fewer chickens per week (from [ ] million to [ ] million). It was submitted that this reduction

[6] For example, in other circumstances, such as Vion restructuring the business, or the sale to a different third party, the uncertainty surrounding Vion may have been reduced.
[7] [ ].

would accelerate Vion's overall losses as its non-variable costs were spread over less processing activity.

- Vion's attempts to aggressively compete on price for contracts (particularly in actively seeking the [C3] contract) in the period from the loss of Sainsbury's contract to the transaction were largely unsuccessful. 2SFG contended that this demonstrates that customers had lost confidence in Vion. Indeed, the parties submitted that for the [C3] Contract, Vion offered [C3] a more attractive retail margin on fresh primary chicken than 2SFG offered ([ ] per cent versus [ ] per cent) and yet could not win the contract (and indeed 2SFG was able to [ ]).

- The lack of investment within the Vion business leading to production and processing inefficiencies which had led to poor customer service and customer dissatisfaction. Moreover, the parties told the OFT that Vion's use of the trading desk to sell surplus chicken portions was poorly managed and damaged the business' profitability.

21. The bidding data submitted by the parties covering January 2012 – March 2013 demonstrate that Vion was struggling to retain contracts, or, to win new business over this period. Set against this evidence, is the fact that Vion were successful in a number of contracts over this period, and there is no indication that Vion would not have been able to win new business in the future.

22. The papers submitted by Vion also demonstrate that it was well aware that it needed to take action to address the structural issues it faced at the time of the transaction. The potential bidders approached by OFT were also aware of the structural issues faced by Vion. There is no evidence that, absent the transaction, Vion, or a potential other buyer, would not have taken action to address Vion's structural weaknesses allowing it to compete effectively for new business. This is likely to have involved restructuring the business to be better positioned to deliver the level of output that Vion needed to deliver meet its existing contractual commitments.

23. The OFT has carefully considered the evidence put to it on Vion being a weakened competitor, absent the merger. In its view the OFT considers the

evidence is indicative of how strong a competitor Vion was pre-merger (which the OFT has examined in its competitive assessment) but it does not demonstrate that Vion's business would have declined further absent the merger. On balance, the evidence shows that Vion had a range of options available to it including restructuring and was continuing to bid for contracts in order to use unutilised capacity. In any event, the OFT does consider it appropriate to take account of Vion's competitive position as at the date of the acquisition, that is, the prevailing conditions of competition.

Conclusion on Counterfactual

24. The OFT therefore considers the relevant counterfactual to be the prevailing conditions of competition at the time of the transaction,[8] with Vion remaining as an independent supplier.

MARKET DEFINITION

25. The purpose of market definition is to provide a framework for the OFT's analysis of the competitive effects of the merger. The OFT will identify the market within which the merger may give rise to a substantial lessening of competition (SLC). This market contains the most significant competitive alternatives available to the customers of the merging parties. Market definition is a useful tool, but not an end in itself, and the boundaries of the market do not determine the outcome of the OFT's analysis of the competitive effects of the merger.[9]

26. The parties overlap in the supply of chicken and chicken by-products in the UK. The parties submitted that there is a single market for the processing and supply of chicken. They contended that chicken is a homogenous product with high levels of demand-side[10] and supply-side[11] substitution. The parties further submitted that chicken producers will focus on securing a sustainable profit margin across all the products of the whole chicken. If there were a situation where profit margins could be increased (for

[8] That is with Vion in the position of having lost the Sainsbury's contract.
[9] Mergers Assessment Guidelines paragraph 5.2.1.
[10] For example the parties argued that most customers can meet their demand for a range of chicken products from a wide variety of sources.
[11] For example the parties noted that all poultry suppliers will supply all chicken products.

example, from switching from primary to processed[12] chicken) producers would seek to exploit those opportunities quickly.

27. The parties also contended that chicken by-products should be broadly categorised into two areas:[13]

- animal by-products that can be further processed for human consumption, and

- animal by-products only fit for other uses.

Product Scope: Chicken

28. The OFT has previously considered, but not concluded, on the precise market definition in relation to the supply of chicken.[14] In both cases, BHL submitted that there is a distinction between primary and processed[15] chicken. In *BHL/Storteboom*,[16] third parties generally also agreed that primary chicken products represent a distinct market.

Demand-side considerations

29. In the present case, in relation to substitution between different types of protein (that is, red meat, chicken, turkey, etc), customers generally noted that they would not switch from chicken to other poultry or meat to any material degree in the event of an increase in the price of chicken by five per cent. More generally, customers noted that prices would not significantly affect the product mix of their poultry purchases.[17]

30. In relation to substitution between different types of chicken, some retailers noted that, in the event of a five per cent SSNIP in UK reared primary fresh chicken, they would not switch their buying patterns. The retailers explained that their observations of consumer behaviour, which drive retailer buying patterns, indicated that a five per cent price rise would not lead to consumer substitution away from primary fresh chicken to

[12] Whether cooked or uncooked.
[13] See Case COMP/M.3968, Sovion/Südfleisch, Commission decision of 21 December 2005.
[14] BHL/Storteboom and BH Acquisitions/Northern Foods
[15] Cooked and uncooked
[16] BHL/Storteboom
[17] Including switching between different types of chicken, such a primary and processed (cooked and uncooked) chicken.

frozen or processed chicken. As such the OFT has taken a cautious approach and segmented its analysis by these types of chicken when examining the affects of the merger on retailers.

31. Other customers, such as processors and caterers, also noted that in the event of a five per cent SSNIP in UK reared primary fresh chicken they would not switch from primary fresh chicken to primary frozen chicken.

Supply-side considerations

32. From a supply-side perspective, most chicken suppliers noted that they could switch their supply to some extent between different types of chicken product, including fresh primary, frozen primary, and processed (both cooked and uncooked), but that switching would be likely to take some time and require material investment.[18] There were also a number of chicken suppliers who do not supply fresh primary chicken.

Product scope: Chicken by-products

33. In *ABP Food/RWM Food*,[19] the OFT did not look at a wide market for animal by-products, but distinguished between cattle hides and sheep skins because third-party comments indicated a lack of demand and supply side substitution between the two.

34. In this case, comments from renderers indicated a distinction between chicken by-product and other animal by-products, and by risk category of chicken by-product. Specifically renderers noted that they typically paid for Category 3 (low-risk) chicken by-product, whereas they charged to collect Category 1 and 2 (higher-risk) chicken by-product. They noted that Category 3 chicken by-product was used in pet foods and other products and was typically more expensive than other animal proteins in part because of the more palatable taste of chicken by-product. More generally, they pointed to little scope for demand and supply side substitutability between this and other animal by-product. The OFT therefore considers Category 3 chicken by-products to be a distinct product frame. As the parties typically receive services for the collection of Category 1 and 2

[18] For example, in changing to the packaging requirements for fresh, frozen and processed chicken.
[19] ABP Food/RWM Food

chicken by-products and that there were no customer concerns relating directly to these areas, the OFT considers this overlap no further.

35. Third-party renderers noted that two chicken producers have their own downstream renderers (of chicken by-products).[20] Third-parties noted that both these producers were active in the merchant market (that is, that they didn't just self-supply). It was also noted that these producers supply external renderers when the market value of the by-products was higher than their internal transfer values.

Customer markets

36. The OFT also considered whether the supply of primary or processed chicken could be segmented by customer group as regards supply to retailers, caterers, and food processors. In previous cases, the OFT has left the segmentation by customer group open.[21]

37. In *BHL/Storteboom*, third parties indicated that it is not difficult to switch production of primary chicken between chicken for industrial processing, and supply to the retail and catering trades and that the time needed to switch production would not be prohibitive. However, the OFT noted that each type of customer is likely to demand different qualities of primary chicken meat and different specific cuts.

38. The parties submitted that segmentation of the chicken market by customer channel is not appropriate, as chicken producers supply to all channels and there is no significant differentiation between the chicken meat supplied to each of the channels.[22]

39. However, the parties' competitors – other chicken suppliers – pointed towards customer channels being distinct. For example, although suppliers serve all types of customer, shifting supply between them could take a significant amount of time and could require a major review of business model requiring capital outlay (for example, to equip specific factories to be

[20] In considering whether self supply should be included in the product reference, the OFT will generally follow the principle that captive production by the firms will be included in the relevant market only if it can be demonstrated that it would be profitable for the supplier to forgo its use and sell into the merchant market in response to a SSNIP.
[21] 2 Sisters/Storteboom and BHL/Northern Foods.
[22] Producers supply chicken to retailers, caterers and food processors.

dedicated to serving food processors).

40. Nevertheless, the OFT's market testing found that different customers do have different requirements.

Conclusion on the product and customer frame of reference

41. The OFT has not considered it necessary to conclude on the precise market definition appropriate for an assessment of the supply of chicken. For the purposes of its competitive assessment, on a cautious basis, the OFT has assessed this transaction by reference to the following market segmentations:

- Firstly, by supply of all chicken by customer channel. Namely retailers, caterers, food processors and renderers.

- Then, in each customer channel, by the supply of different types of chicken, where relevant. In particular, the OFT examined:

    - in the retail channel, the supply of primary fresh chicken, primary frozen chicken, processed cooked chicken, processed uncooked chicken

    - in the food processor channel, the supply of primary fresh chicken and

    - in the renderer customer channel, the supply of Category 3 by-products.[23]

Geographic scope

42. The parties submitted that the supply of chicken is at least EEA-wide in scope. The OFT's investigation did not support this contention. Specifically:

- Demand for UK-reared chicken has grown in recent years, particularly following the recent health scares involving red meat.

[23] Including self supply.

- Retailers were unlikely to respond to a five per cent SSNIP in UK-reared primary chicken by seeking to source non-UK reared chicken and/or changing their policies of supplying, in the main, UK-reared fresh chickens.

- Consumers demanded fresh chicken to be UK-reared (albeit food processors and caterers did not face this level of demand).

- Overall, the evidence available suggested, consistent with previous decisions[24] that the appropriate geographic market is no wider than the UK for retailers. The OFT has not seen any evidence which would support a narrower geographic market than the UK given logistics capabilities.

43. The OFT considers it appropriate to leave the precise geographic market definition open in this case but has assessed the transaction on the basis of a UK wide geographic market for supply of chicken to retailers. For processors and caterers, the OFT accepts that there may be a wider range of options and the geographic market may be wider but it has not been necessary to conclude.

SUBSTANTIVE ASSESSMENT

44. The OFT has assessed the following theories of harm in respect of each of the segmentations set out in paragraph 41 above:

- Unilateral effects in the supply of chicken in the UK.

- Unilateral effects in the supply of chicken by-products in the UK.

Unilateral effects analysis: the supply of chicken

Shares of supply

45. For each of the relevant segmentations (by product and by customer) the OFT has, based on evidence from the parties and third parties, estimated shares of supply (see Table 1).

[24] BHL/Storteboom and BH Acquisitions/Northern Foods

Table 1 – UK estimated shares of supply of chicken (by customer channel)

Company	Share of Supply (Per Cent)		
	Retailers	Caterers	Food Processors
2SFG	[30 – 40]	[0 – 10]	[0 – 10]
Vion	[10 – 20]	[0 – 10]	[20 – 30]
Total	**[40 – 50]**[25]	**[0 – 10]**	**[20 – 30]**[26]

Source: OFT's best estimates of the parties' and third party data.

Supply of fresh primary UK-reared chicken to retailers

46. The OFT notes that Moy Park is the second largest supplier by sales with a share of supply of [10 – 20] per cent. Other competitors include Faccenda ([0 – 10] per cent share of supply); Sun Valley ([0 – 10] per cent) and Banham ([0 – 10] per cent). The remainder of the market ([10 – 20] per cent) is supplied by a large number of smaller suppliers.

47. The parties further estimated shares of supply of chicken to retailers by product type, showing their share of supply of the market was between [0 – 10] per cent and [40 – 50] per cent, dependent on the specific category (see Table 2). The OFT notes that the parties' shares of supply on the basis of UK-reared chicken may be higher in all categories.[27]

[25] The parties estimate that their combined national market share in the supply of all chicken in the UK to retailers is [30 – 40] per cent with an increment of [0 – 10] per cent.
[26] The parties' estimated that their combined share of supply of chicken to UK food processors is only [10 – 20] per cent but third-parties believed that that 2SFG and Vion have a larger share of around 40 to 50 per cent. Using market size estimates from Vion's Information Memorandum and data on the parties' supply volumes, suggests the parties have a combined market share of around [20 – 30] per cent in the supply of chicken to food processors (with an increment of [0 – 10] per cent)
[27] The parties figures included estimates for imported chicken.

Table 2 – UK estimated shares of supply by chicken (by product type)

Type of chicken		Share of Supply (per cent)		
		Retailers		
		2SFG	Vion	Total
All types		[20 – 30]	[0 – 10]	**[30 – 40]**
Primary fresh		[30 – 40]	[10 – 20]	**[40 – 50]**
Primary frozen		[0 – 10]	[0 – 10]	**[0 – 10]**
Processed	**Not cooked**	[20 – 30]	[0 – 10]	**[20 – 30]**
	Cooked	[10 – 20]	[10 – 20]	**[20 – 30]**

Source: Parties' estimates by value as at 1 May 2013 based on Kantar retail data, Defra statistics and the parties' internal estimates.

48. The parties' estimated combined share of supply of processed cooked ([20 – 30] per cent with increment of 10-20] per cent), processed uncooked ([20 – 30] per cent with increment of [0 – 10] per cent) and primary frozen chicken ([0 – 10] per cent with increment of [0 – 10] per cent) to retailers are unlikely to give rise to prima facie competition concerns. Moreover, the OFT notes that no third party raised concerns relating to the supply of processed or frozen chicken. As such, the OFT considers that the merger does not give rise to a realistic prospect of an SLC in the supply of processed or frozen chicken to retailers (or other customers). These areas are not considered further.

49. The OFT found that the merger will lead to the parties' combined share of supply of primary fresh chicken being in excess of [40 – 50] per cent. The OFT further received a number of concerns from third parties in relation to this area. As a consequence, the OFT considered whether the merger may give rise to unilateral effects in the supply of fresh primary UK-reared chicken to UK retailers.

50. The OFT received a number of concerns from third parties that the acquisition would reduce competition in the supply of fresh chicken. Three main concerns were levied by these third parties:

   i. Merger is a three to two of major suppliers of fresh chickens in the UK (the other being Moy Park).

ii. Other firms, Sun Valley and Faccenda, were not effective competitors to the merged parties due to their and that some use primarily GM feed.[28]

iii. The acquisition had already led to a removal of competitive quotes made by Vion in contract/tender processes.

51. Set against this, a number of third parties raised no concerns in relation to the supply of primary UK reared chicken. In summary, these third parties submitted that:

i. Post-merger, there would remain sufficient numbers of competing firms in the UK to provide effective levels of competition to the merged entity.

ii. Four additional competing suppliers to the merged entity were generally noted as effective and could compete for contracts supplied, pre-merger, by Vion: Moy Park, Faccenda, Sun Valley and Banham.

Parties' submission on unilateral effects

52. The parties submitted that the merged party will continue to be constrained by the presence of a number of strong competitors including Moy Park, Sun Valley, Faccenda and Banham.

53. The parties also contended that the merged parties will also be constrained by the potential for expansion, or entry into the market. In particular the parties highlighted that retailers have the option to work with suppliers to grow their capacity to meet increased demand.

54. In addition, the parties submitted that retailers concerns about losing Vion as a competitor is not reflected by their actions as neither Sainsbury's, nor [C3] (who declined an opportunity to remedy some of the harm of losing the Sainsbury's contract, by awarding a contract for [ ] birds/week to Vion) were prepared to support Vion. These actions demonstrate that retailers consider the remainder of their supply base to be credible alternatives to the merging parties.

[28] Some third parties noted that chickens raised on GM feed would not meet the standards set by a number of the major retailers.

55. Further, the parties contended that the retail market for chicken is a bidding market. Hence a supplier's share of supply is not indicative of a supplier's future strength, nor reflective of a supplier's strength in the market.

56. Finally, the parties submitted that 2SFG was not a uniquely close competitor to Vion, 2SFG did not offer any constraint that was distinct from the constraint placed on Vion by all of Moy Park, Sun Valley, Faccenda, and Banham, to each of whom Vion lost business.

OFT's unilateral effects analysis

57. The OFT has assessed, taking all the evidence in the round, whether the merged entity will be able to increase prices or reduce quality significantly post-merger. In doing so, the OFT has paid regard to the competitive constraints which will remain in the market post-merger including internal documents and data, evidence on previous win/loss scenarios, capacity, third party information and the results of the OFT's market investigation.

58. The OFT found that Vion's internal documentation supported the existence of a range of competitive constraints. For example, Vion's Information Memorandum[29] identifies 2SFG as one of five competitors to Vion, the other competitors being Moy Park, Sun Valley, Faccenda and Banham. Of these 2SFG and Moy Park are the largest in sales in the primary retail segment. Sun Valley and Faccenda are about a third of the size of these two large players with Banham 10 times smaller.

59. 2SFG is singled out in Vion's Strategy Plan Update (2011-2013) 'Competitor Deep Dive'. It sets out that 2SFG has a [40 – 50] per cent share of small retail whole birds. Vion considers responding to 2SFG's position [ ]. Given [ ] is a key customer of 2SFG, this suggest that Vion intended to compete aggressively against 2SFG.

60. The parties submitted bidding data covering tenders for contracts where 2SFG's had submitted a bid from January 2012 – April 2013.

61. The bidding data showed that the parties face competition from a number of significant competitors in the UK. The main UK retailers have large contracts with a number of other suppliers including Moy Park, Sun Valley,

[29] Project Scorpius Information memorandum, October 2012, Rabobank, Rothschild, page 13.

Faccenda and Banham. Also Sun Valley is part of a major US food group which would give it the ability to invest to allow Sun Valley to expand.

62. The OFT found, based on this data, and comments received from third parties, that Vion has not been 2SFG's closest competitor and likely represented a reasonably weak competitive constraint on 2SFG. This is demonstrated by an analysis of the aggregate value lost to competitors by 2SFG between January 2012 and March 2013. The aggregate loss was split in the following terms: Moy Park ([40 – 50] per cent), Banham ([10 – 20] per cent), Faccenda (10 - 20 per cent), Sun Valley ([0 – 10] per cent) and Vion ([0 – 10] per cent). This is indicative of two essential factors: first, that Vion was the weaker of the five pre-merger competitors to 2SFG; second, that smaller competitors (such as Banham) can be invited to tender and win value and pose a real competitive constraint to 2SFG (and will do to the merged entity).

63. Further evidence relating to these two points (that is, Vion's competitive strength and credibility of smaller suppliers) can be derived from the OFT's analysis of bidding data and responses from third parties.

   i. First, after OFT questioning, customers were not able to provide compelling evidence of head-to-head competition between 2SFG and Vion leading to significant price decreases for a retailer. This accorded with the fact that Vion did not appear to be a strong bidder in tenders which have taken place since January 2012 in the bidding data.

   ii. The bidding data also shows that large retailers multi-source and split contracts. In fact, their purchasing process involves reasonably frequent contract renewals or tenders where they regularly invite one, or more, smaller companies[30] to bid for contracts. This lends further support to the fact that smaller firms will pose a credible constraint to the merged parties.

64. The OFT therefore considered the competitive constraint imposed by 2SFG on Vion. Around [70 – 80 per cent] of the value of contracts that 2SFG won during the period were in instances where Vion was the incumbent supplier. It is important to note that 2SFG as one of the two largest suppliers in the market, is likely to pose a constraint on each and every firm

[30] That is, not 2SFG, Moy Park or Vion.

within the market. Even so, it is noticeable that that around [40 – 50 per cent] of the competitive interaction between 2SFG and Vion is accounted for by one contract (that is, the Sainsbury's contract). Consistent with the fact that Vion faced a wider array of constraints than the value loss in the past year, is the fact that the data shows that Moy Park was just as strong a competitor against Vion as was 2SFG. Indeed, of these remaining tenders worth a total of £[ ] per year, Moy Park won [40 – 50] per cent of the contracts (by value) whilst 2SFG won [40 – 50] per cent.

65. In addition to the points made above, the OFT found that smaller suppliers are a credible constraint in the supply of UK-reared chicken. This is, in part, due to the fact that retailers often do not award all of their requirements to a single supplier but rather will break up their requirements into smaller packages to be awarded across a number of suppliers. As a consequence Sun Valley, Faccenda and Banham have been able to effectively compete against the parties (and Moy Park) for many contracts let by the major retailers. For example, a tender for £[ ] of fresh primary chicken for [C4] in [ ] was awarded to a combination of Sun Valley, Moy Park and 2SFG.

66. The OFT also considered carefully the extent to which capacity constraints may make unilateral effects more likely to occur as a result of the merger through an analysis of the level of capacity concentration in the market and an analysis of the impact of any capacity constraints on firms' ability to compete.

67. In relation to levels of capacity in the market, the evidence received by the OFT was mixed. 2SFG and Vion said they operate at close to full capacity based on the number of shifts being operated.[31] In addition, some third parties provided qualitative commentary indicating that capacity to produce UK-reared chicken is limited and that demand for British chicken currently exceeds supply.

68. The OFT therefore considered whether firms could win business and then build up capacity to meet a contract award. The evidence in relation to this was mixed but the OFT found that retailers had, in the past, supported suppliers in this way when awarding contracts. For example, the Sainsbury's contract won by 2SFG in March 2012 has a 12 months lead in

[31] The parties reported that some plants could put on extra shifts and/or weekend working to deal with additional capacity issues.

time with the supply being transferred between Vion and 2SFG [ ] over the year. This allowed 2SFG sufficient time to plan and action the investment in capital necessary to expand its production. Third party responses indicated that this type of customer support did occur especially in relation to contracts with longer or staggered lead-times. 2SFG submitted that there were a number of options for a business to increase its capacity including:

- **capital Investment**: as an example, 2SFG is currently upgrading its production capacity in the UK across [ ] of its sites, in which it envisages an increase of [40 – 50] per cent ([1.5 – 2.0] million chickens per week) of its processing capacity over a [ ] month period

- **increasing the number of shifts at a plant:** for example increasing working days from five to six per week ([10 – 20] per cent increase in throughput of birds), or

- **upgrading production lines:** for example, increasing processing speeds ([30 – 40] per cent increase in throughput).

69. In response to the OFT raising issues in relation to capacity in the market, 2SFG also commissioned an independent property consultant to provide their opinion on the time and costs involved in expanding capacity at the farming level. The main conclusions of this report are that expansion at both the farming and processing levels are relatively straightforward.

70. The OFT tested this evidence in its market investigation. On the one hand, some suppliers suggested that expansion costs were higher than those estimated by the parties with one party estimating that it would cost approximately £130m - £150m to expand to achieve a further 1m birds per week (approximately five per cent of the UK market). Some customers also noted that some suppliers had cited capacity reasons for being unable to supply chicken or bid for contracts and considered planning permission may pose a barrier to entry or expansion. However, a number of suppliers confirmed that production capacity could be increased by increasing the number of shifts or increasing the level of overtime worked with one noting that this could increase their supply by around 20 per cent. Likewise, the bidding data indicates that such capacity constraints have not prevented

several suppliers from bidding across a range of contracts in the recent past.

71. The majority of competing suppliers also indicated that they were not concerned with the merger, however, a number of retailers raised concerns. However, these retailers did not demonstrate that smaller competitors would be unable to meet their specific requirements in the future. The OFT was not provided with strong evidence that in specific negotiations Vion was a significant competitive constraint on 2SFG.[32]

72. Overall, the OFT considers that capacity restrictions are faced by most operators in the market, particularly so in relation to larger contracts. However, there are sufficient mitigating measures, such as, changing shift patterns, retailer support measures and capital investment to ensure that each supplier will be able to continue to put in credible bids in competition with the merged entity for both larger and smaller contracts.

Conclusion on supply of fresh primary UK-reared chicken to retailers

73. On the basis of the evidence discussed above, the OFT does not consider that the merger gives rise to a substantial lessening of competition in the supply of fresh primary chickens to retailers.

Supply of fresh primary UK reared chicken to food processors

74. The OFT estimated that the parties have a combined market share of around [20 – 30] per cent in the supply of chicken to food processors (with an increment of [0 – 10] per cent). One food processers raised significant concerns in this area, particularly in relation to allegations of interruptions in supply and price rises imposed by Vion immediately following the transaction.

75. The OFT also considered whether the merger may give rise to unilateral effects in the supply of fresh primary UK-reared chicken to UK food processors.

76. The OFT refers to the parties' submissions in relation to the retailer channel (discussed at paragraphs 46 to 73) which the parties consider also apply to

[32] For instance, the OFT was not made aware of any negotiations where a retailer secured a significant price drop from 2SFG as a result of a competing offer from Vion.

this channel. Specifically, as regards supply to food processors, the parties also submitted that their estimated shares of supply to food processors were low and questioned the accuracy of third party estimates in this area.

77. The parties also pointed out that Northern Food, 2SFG's related business in the food processor area, operates [ ] business and sources chicken from a wide range of suppliers, not just 2SFG. The parties also noted that retailers[33] approved a large number of chicken suppliers and that food processors are free to choose between these suppliers.[34]

78. A number of food processors raised concerns that the acquisition may affect their purchasing strength. Some processers source supplies from the parties and other suppliers. They noted, however, that some of these alternative suppliers are dependent on the parties for their supply of chicken.

79. Some third party processors were concerned that prices may rise as a result of the acquisition, with reports that Vion's prices had risen following the acquisition and that shortly after the acquisition it stopped supplying a customer for a period of time. It was noted that Vion's higher price had to be accepted as other suppliers could not supply the volume of processed chicken that the parties can.

80. In response to this point, the parties noted that Vion's carcass balance prior to the purchase was not efficient. Suppliers will try to balance the contracts they have for different cuts, or portions, of a chicken to ensure income from all of the chicken is maximised as any surplus is sold on the trading desk at a lower rate of return. This is known as the 'carcass balance' [ ]. However, the parties argued that these effects were the result of efficiency improvements, and not related to the transaction.

81. Additional comments were received from other processors who were less concerned about the effects of the transaction, these noted that there were a large number of potential suppliers who are used in parallel with the parties. Furthermore, as food processors generally require smaller volumes

[33] Retailers are the customers of food processors.
[34] For example, the parties reported that [ ] approved many chicken suppliers that food processors could use including Banham, CP Foods, Heijs Groep Poultry (Holland), Moy Park, Rose Poultry (Denmark), Noble Foods, and HCF Poultry.

than retailers, this allowed processers the freedom to purchase lower priced chicken.

Conclusion on supply of fresh primary UK-reared chicken to food processors

82. On the basis of the evidence discussed above the OFT does not consider that the merger gives rise to a realistic prospect of a substantial lessening of competition in the supply of fresh primary UK-reared chicken to food processors.

Supply of chicken to caterers

83. The parties estimated that their combined share of supply of all chicken to caterers is [0 – 10] per cent with a [0 – 10] per cent increment and that this share of supply was unlikely to change significantly under any reasonable product definition which was broadly confirmed by third parties. Third parties customers were concerned that the merger would lead to a reduction in choice, but were not unduly concerned as there are a large number of alternative suppliers.

84. Given the parties' share of supply to caterers and the lack of significant third-party concern in this customer channel, the OFT considered that there is no realistic prospect of a SLC in relation to the supply of chicken to caterers on any plausible segmentation. This area is therefore not considered further.

Supply of Category 3 chicken by-products to renderers

85. The parties' estimated that their combined share of supply of chicken by-products in the UK is [30 – 40] per cent ([20 – 30] per cent for 2SFG and [10 – 20] per cent for Vion). This was broadly corroborated by one customer.[35]

86. While third-party renderers did raise concerns relating to concentration of supply in this area, the OFT considered that the parties' share of supply of chicken by-product is relatively low, and likely to be no more than the parties' estimate of [30 – 40] per cent. Moreover, there are many other

[35] Another renderer believed the parties had a much higher share of supply, but were unable to substantiate these claims. The OFT, therefore, places little weight on this figure.

active suppliers of chicken by-products in the UK including Faccenda, Gafoor, Crown Chicken, Sun Valley and Moy Park. The parties also noted that there will be no reduction in the volumes of chicken by-products they supply as a result of the transaction, on the basis that there will be no reduction in their chicken supply.[36] Given that the OFT has found no SLC in other areas, it is likely that the parties will not have the opportunity to alter the supply of chicken products as a result of the transaction, hence they will not be able to alter their supply of by-products and attempt to influence price in the market.[37]

87. The parties further argued that a chicken producer will incur the costs of disposal of any Category 3 chicken by-products it fails to sell. The parties contend that to avoid this scenario, producers would need to charge a competitive price.

88. Given the parties' relatively low share of supply and the presence of other competitors in the UK, the OFT considers that the merger does not give rise to a realistic prospect of a SLC in the supply of chicken by-product.

Entry and expansion

89. The parties' submitted that entry and expansion in the poultry market is easy, and that customers will often build in sufficient lead-in time to a contract to allow sufficient time for businesses to increase capacity. These submissions are considered above at paragraphs 66 to 70, so are not addressed further here. For new entry, the parties estimated it could require a capital outlay of around £[25 – 35] million and take 12 to 18 months to complete including three to six months to secure planning permission.

90. Customers noted no experience of procuring chicken from a new entrant in the last five years or had considered doing so. Chicken suppliers suggested entry would not be sufficiently likely. As discussed at paragraph 69 suppliers believed that new entry or significant expansion would require significant levels of capital investment and could be very lengthy.

[36] The volume of chicken by-products is proportional to the volume of chicken processed for the fresh, frozen and processed markets. The transaction will not lead to a change in the levels of production in these areas, so the volume of chicken by-products produced will be unchanged.
[37] The parties also noted that it is uneconomic to withhold supplied of category 3 by-products to reduce supply as businesses would incur costs of disposing these product.

91. Vion's Information Memorandum[38] notes that its 'network of farms, feed mills and broiler units secures access to British birds, which is of high strategic value as demand for British chicken exceeds supply.' It also refers to 'limited space for growing capacity in the UK and limitations on new permits in combination with increased demand for British chicken... ... expected to increase this imbalance.'

92. However, given the outcome of its competition assessment the OFT has not found it necessary to conclude on whether barriers to entry and expansion are low in this case.

THIRD PARTY VIEWS

93. Third party views have been noted in the above sections on market definition and substantive assessment. However, the OFT noted that the majority of customers were either unconcerned, or, believed that sufficient choice would remained post merger to ensure that competition remained healthy.

ASSESSMENT

94. On 8 March 2013 BHL and [a related party to BHL] acquired Vion N.V. and therefore the enterprises 2SFG and Vion ceased to be distinct. The turnover test of the Act is met in this case.

95. The parties argued that Vion would have exited the market irrespective of the merger and therefore the merger itself does not give rise to competition concerns. The OFT carefully assessed the evidence on this in line with its published guidance and concluded that the evidence did not demonstrate to a compelling standard that Vion’s exit was inevitable. Nor did the OFT find that Vion would be expected to be weakened going forward had the merger not occurred. As such the OFT has assessed the merger against the pre-merger conditions of competition.

96. The parties overlap in the supply of chicken in the UK, on a cautious basis, the OFT has assessed this transaction by reference to the following market segmentations*:*

[38] Project Scorpius Information memorandum, October 2012, Rabobank, Rothschild, page 17

- Firstly, by supply of all chicken by customer channel. Namely retailers, caterers, food processors and renderers.

- Then, in each customer channel, by the supply of different types of chicken, where relevant. In particular, the OFT examined:

  - o in the retail channel, the supply of primary fresh chicken, primary frozen chicken, processed cooked chicken, processed uncooked chicken

  - o in the food processor channel, the supply of primary fresh chicken, and

  - o in the renderer customer channel, the supply of Category 3 by-products.[39]

97. Two areas were identified as raising potential competition concerns and were examined in detail, these were:

- the supply of fresh primary UK-reared chicken to UK retailers, and

- the supply of fresh primary UK-reared chicken to UK food processors.

Retailers

98. The parties account for at least [40 – 50] per cent of the supply of UK reared chickens to UK retailers. Some third parties raised concerns with the OFT that the merger would reduce their choice of large scale effective competitors from three to two. As a result, prices may increase.

99. However, the evidence available to the OFT did not support these concerns. Bidding data submitted showed that the main UK retailers have large contracts with a number of competitors including Moy Park, Sun Valley, Faccenda and Banham. In the pre-merger period since January 2012 Vion was a weak competitor to 2SFG. Although 2SFG was clearly a strong competitor to Vion, the evidence showed that Moy Park was equally as strong.

[39] Including self supply.

100. In addition, the OFT's market testing found that large retailers often break up their total requirements into a number of smaller contracts which maintains competition for them. Therefore, after the merger the parties will continue to face competition from Sun Valley, Faccenda and, to a lesser extent, Banham as well as from Moy Park.

101. The ability of competitors to expand may help constrain the prices of the parties, however this constraint is likely to be larger for some types of contracts than others. For large long-term supply contracts, where competitors face larger capacity constraints, retailers can allow sufficient lead-in time for suppliers to invest in new capacity, helping to mitigate any capacity constraint.

Food processors

102. Some food processor customers raised issues regarding supply problems and price rises for chicken supplied to them by Vion.

103. The parties together supply [20 – 30] per cent of fresh primary chicken to food processors. The OFT found a considerable number of alternate suppliers from whom the merged entity will face competitive constraints. Further, the OFT's market testing found that food processors did not require their suppliers to be capable of high volumes.

104. In terms of the complaints about supply, the OFT established that this was due to the changes in Vion's carcass balance being passed through its trading desk. The OFT did not consider this to be merger-specific.

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

DECISION

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