OFFICE OF FAIR TRADING

Anticipated acquisition by AB Agri Limited of certain of the business and assets of JE Porter Limited from the Porters Group

ME/4057/09

The OFT's decision on reference under section 33(1) given on 17 April 2009. Full text of the decision published on 24 April 2009.

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

PARTIES

1. **AB Agri Limited** (AB Agri) is a wholly owned subsidiary of Associated British Foods plc (ABF). AB Agri manufactures and distributes agricultural products, animal feed and related products.

2. **The Porters Group** (Porters) comprises the JE Porter Limited Private Pension Scheme, JE Porter Limited (JE Porter) and GE Porter and Sons Limited. The Porters Group owns two mills, in Flixborough and Navenby, both of which produce compound monogastric animal feed (see the product market section below for an explanation of the various types of animal feed products).

3. This acquisition relates to the Flixborough Mill and its associated assets in Scunthorpe (Flixborough Business). The UK turnover of the Flixborough Business is approximately £[ ] million.

TRANSACTION

4. Porters has agreed to sell the Flixborough Business to AB Agri (the Acquisition). AB Agri has submitted that the Flixborough Business comprises:

   - the freehold interest in Flixborough Mill
   - the assets and rights owned by Porters and used in connection with the operation of Flixborough Mill
   - the plant, machinery and equipment at Flixborough Mill.

5. AB Agri notified the transaction to the OFT on 23 February 2009. The Office of Fair Trading's (OFT) administrative deadline is 22 April 2009.

JURISDICTION

6. The OFT considers that the Flixborough Business constitutes an enterprise within the meaning of section 129 of the Enterprise Act 2002 (the Act).[1] As a result of this transaction AB Agri and the Flixborough Business will cease to be distinct. AB Agri and the Flixborough Business overlap in the supply of compound monogastric feed and together, AB Agri estimates that they account for approximately [25–40] per cent of the supply of UK retail compound poultry feed in the UK.[2] Consequently, the share of supply test in section 23 of the Act is met. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

MARKET DEFINITION

Background

7. AB Agri and the Flixborough Business are active in the production and supply of animal feed. Livestock may be fed a number of different products, including compound feed, straight feeds (often referred to as 'straights'), home mixed feeds and home grown feeds.

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[1] OFT guidance says "An enterprise may comprise any number of components, most commonly including the assets and records needed to carry on the business ... The transfer of customer records is likely to be important in assessing whether an enterprise has been transferred". Mergers: Substantive Assessment Guidance, OFT516, May 2003, paragraph 2.8.

8. Compound feeds are combinations of various ingredients (including cereal grains, oilseed products, pulses, vitamins and minerals) which are blended together in different proportions according to the feed's intended purpose. Compound feed can be sold in meal or pellet form, and can be complete or complementary.[3] Straights are raw materials such as wheat, soya and barley which are mixed with supplements and/or home grown products to create home mixed feeds (home mixing).[4] AB Agri estimates that straights and home mixing account for around 51 per cent of the total UK animal feed market, with compound feeds accounting for the remaining 49 per cent.

9. Compound feed manufacturers can specialise in producing feed for ruminants (including cattle and sheep) and/or monogastric animals (including poultry and pigs).

10. Livestock producers may purchase animal feed from the following channels:

- compound feed manufacturers (sometimes through a merchant), who manufacture animal feed solely for sale to other manufacturers, retailers and end users
- Integrated Processing Units (IPUs) who manufacture feed predominantly for their own livestock, but additionally sell to end-users
- agricultural merchants, who supply UK or globally produced straights to end-users for direct consumption or home mixing, and
- Premix/supplement/additive suppliers, whose products are supplied to end-users for direct consumption or home mixing.

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[2] AB Agri submits that it accounts for [20–30] per cent of the supply of retail compound poultry feed in the UK, while the Flixborough Business accounts for [5–10] per cent.
[3] Complete compound feed is a compound mixture of feed materials supplying the total daily dietary needs of an animal. Complementary compound feed is a compound mixture of feed materials with a high concentration of certain nutrients which is sufficient to provide the total daily dietary needs of an animal when fed in combination with other feedstuffs.
[4] Home mixing involves livestock producers either mixing the straights and supplements on-site using their own equipment, or through the services of a mobile mill and mixer.

11. AB Agri and the Flixborough Business are both compound feed manufacturers which overlap in the supply of compound monogastric animal feed to end-users.

Product scope

12. The animal feed industry generally has been considered previously by both the European Commission (the Commission) and the OFT.

13. In Cargill/Agribands,[5] the Commission considered that integrated self-supply by farmers of products such as corn, hay, grain and turnips should be included within the product market as they constrained commercial feeds, but did not ultimately conclude on a precise market definition.

14. In Duffield/Bury Nutrition,[6] the OFT considered that animal feed could be segmented into feed for ruminants and feed for monogastric animals, given that demand-side substitution was unlikely and the extent of supply-side substitution was unclear. The OFT considered that compound feed for monogastric animals would be constrained by the supply of straights. In ABF/Primary Diets,[7] the OFT found no demand-side substitution between animal feed for ruminants and for monogastric animals, and further found that supply-side substitution was constrained by UK legislation. The OFT did not find it necessary to conclude on whether there should be a further delineation according to type of animal, nor on whether compounds and straights formed part of the same product market.

15. More recently, in Thomson/AB Agri,[8] the OFT also considered that ruminant and monogastric feeds should be considered separate product markets. In considering whether monogastric feeds should be further delineated between pig and poultry feed, the OFT considered there to be no demand-side substitution and no barriers to supply-side substitution, but took a cautious approach and considered pig and poultry feed separately. The OFT also took a cautious approach and considered compounds,

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[5] Case COMP/M.2271 *Cargill/Agribands* (2001), ('*Cargill/Agribands*')

[6] Case ME/1518-02: Acquisition by W L Duffield & Sons Limited of the ruminant feed business of Bury Nutrition, part of ABNA Limited (December 2002) ('*Duffield*').

[7] Case ME/2522-06: Completed Acquisition by ABF Holdings Limited of Primary Diets Limited (September 2006) ('*ABF/Primary Diets*').

[8] Case ME/3637-08: Anticipated Acquisition by John Thompson Limited of the Northern Ireland Compound Feed Business and Assets of AB Agri Limited (July 2008) ('*John Thompson*').

straights and blends separately, given the mixed evidence received from third parties.

16. In this case, AB Agri has submitted that the relevant product market should include all types of animal feed (including compounds and straights) for monogastric and ruminant animals. In considering the product scope in this case, the OFT has considered the extent to which animal feeds form a single product market, or whether they should be segmented by type of animal and type of feed.

Segmentation by type of animal

17. Different animals require different feeds. For example, a ruminant animal feed cannot be fed to monogastric animals and, within monogastric feeds, poultry feed cannot be eaten by pigs (and vice versa).

18. This is supported by the submissions of AB Agri, third parties and by analysis in previous cases. Therefore, the OFT considers that there is unlikely to be demand-side substitution between animal feed for different animals.

19. In relation to supply-side substitution, AB Agri has submitted that feed manufacturers can, and do move relatively easily between the manufacture of feeds for different species (between both ruminant and monogastric animals and between different types of monogastric animals), within short periods of time and at low cost (provided they have access to suitable technical advice).[9] Such supply-side substitution may broaden the relevant market from the supply of monogastric feed using monogastric production capacity (where the parties overlap) to the supply of monogastric feed using monogastric production capacity plus that proportion of ruminant production capacity which may be profitably used to supply monogastric feed. The OFT notes that such supply-side substitution would not broaden the relevant market to the supply of monogastric and ruminant feed, however. That is, under supply-side substitution, the relevant product market would still be the supply of monogastric feed but participants in that market may include suppliers of ruminant feed not currently supplying

[9] The products that should be included in the relevant market are generally determined by reference to demand-side substitution alone. However, an exception to this generality is when firms producing one product also produce closely similar products which are not demand-side substitutes, as is the case here.

monogastric feed but who could profitably do so in response to a small, but significant, increase in the price (which is not short-lived) of monogastric feed. This is considered further below.

Ruminant and monogastric feeds

20. AB Agri submitted that as a result of the growth in the use of ruminant blends demand for ruminant compounds has decreased and as such many suppliers would consider switching to manufacturing poultry or pig feed. To support this, AB Agri provided two examples of where it was able to switch (in a short timescale and at no cost) from producing ruminant and monogastric feed at a given mill to producing monogastric feed only following the loss of a ruminant feed contract.

21. However, third party comments have suggested that UK legislation makes it difficult to switch between ruminant and monogastric feed production, specifically that following the BSE epidemic, legislative restrictions were put in place which meant that fishmeal, which is more widely used in monogastric feeds, cannot be used in mills which produce ruminant feeds without extensive cleaning. In addition, one supplier told us that while mills can produce both ruminant and monogastric feed, this is not only limited by legislation, but also by other factors such as:

- differing raw material requirements, which can act as a limitation where mills have limited raw material storage availability

- operational inefficiencies, i.e. short runs are less efficient

- additional equipment requirements, given that some pig and poultry feeds require heat treatment not required in ruminant feeds, and

- some feeds require the addition of medication which may be undesirable to have traces of in feed produced for other animals.

22. Furthermore, this supplier informed the OFT that while they would consider switching production between ruminant and monogastric production, in order to do so there would need to be a sufficient increase in the relative margins they could obtain from ruminant rather than monogastric

production. In this regard, they considered that a 5 to 10 per cent price increase would not be sufficient to consider switching production.

23. Another supplier informed the OFT that while switching from ruminant to monogastric production is relatively straightforward, it would require some investment in equipment. The same supplier considered switching from monogastric to ruminant production to be more difficult and more costly.

24. A further relevant consideration in relation to supply-side substitution appears to be the type of livestock surrounding a given mill. This may affect that mill's incentive to switch production, given the importance of local demand.

25. Given the mixed evidence the OFT has received, it has taken a cautious approach in this case and considered ruminant feed to be in a separate market to monogastric feed.

Pig and poultry feeds

26. The OFT has also considered whether it was necessary to segment monogastric feed further into pig and poultry feed. AB Agri considers that switching production between producing pig and poultry feed can be done easily, in a short time period and at limited cost. AB Agri submitted that it switches between pig and poultry feed production on a daily, if not hourly, basis; all of its mills manufacture both types of feed[10] and the cost of switching production is so limited it is not even recorded.

27. This was broadly supported by one of AB Agri's competitors, who informed the OFT that within reason, it is straightforward to switch production between pig and poultry feed, with the main issue being access to the necessary storage facilities were a mill to begin producing both.

28. As noted in paragraph 19 above, the products that should be included in the relevant market are generally determined by reference to demand-side substitution alone. However, an exception to this generality is when firms

[10] AB Agri submitted that its mills generally have one or two mixers through which all products are mixed. Cross-contamination is controlled through scheduling or the use of a 'flush' batch. Flush batches are mainly used to ensure that batches are not contaminated with traces of medication.

producing one product also produce closely similar products which are not demand-side substitutes, as is the case here.

29. Another supplier confirmed that supply-side substitution was relatively straightforward between different monogastric feeds. It commented that pig and poultry feed have similar raw material and production process requirements. They considered that the majority of monogastric mills would be set up to manufacture both forms of feed and that suppliers could easily switch production between them.

30. On the basis of the information available to it in this case, the OFT does not consider it necessary to further segment monogastric feed by type of animal due to the ease of supply-side substitution.

Segmentation by type of feed

31. AB Agri submitted that compounds and straights[11] form part of the same product market on the basis of demand-side substitution. It considers that livestock producers can either purchase compound feed (from retail manufacturers and/or IPUs) or they can purchase straights, vitamins, minerals and other supplements, which they can then use for home mixing.

32. AB Agri provided information from the Advisory Committee on Animal Feedingstuffs (ACAF) to the OFT illustrating that home mixing is widely practised.[12] This is supported by DEFRA statistics[13] which report that in 2007 49 per cent (by volume) and 58 per cent (by value) of purchased feedstuffs in the UK were purchased as compounds, with the remainder being straights.

33. AB Agri has submitted that although home mixing is less widespread in poultry farming, it has been common place in the past and would be expected to be more widespread were compound prices to increase.

34. The OFT received mixed evidence on this point from third parties. One competitor stated that 40 to 50 per cent of pig producers may switch

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[11] In addition to any additives and supplements required.

[12] *ACAF REVIEW OF ON-FARM FEEDING PRACTICES, Recommendations on identifying hazards and minimising risks* (September 2003). Available at: http://www.food.gov.uk/multimedia/pdfs/farm.pdf

between compounds and home mixing, depending on relative raw material and compound prices and possibly the need to incur some limited capital expenditure. However, this supplier also stated that switching to home mixing was not a serious option for poultry producers.

35. Furthermore, none of the customers that provided information to the OFT considered that switching to home mixing was a viable option in response to a small price increase in compound feeds. Among the reasons given for this were the geographical distribution of customers' farms, the quantities purchased by those customers and the necessary capital expenditure required to build or purchase the necessary capacity to undertake home mixing. One customer submitted that home mixing was possible, but it would incur relatively high costs and would take up to two years to implement. Another customer submitted that while it currently home mixes 90 per cent of its demand, its facilities are operating at full capacity and the cost of expanding capacity would be such that it would not consider switching the remaining 10 per cent of their demand to home mixing in response to a 5 to 10 per cent price increase.

36. In terms of supply-side substitution, compound producers can switch to supplying straights easily and quickly, as they already purchase them for use in the manufacture of compounds. However, one competitor submitted to the OFT that this is unlikely to be a commercially attractive option to a compounds supplier, given the high fixed costs associated with a compound feed mill.

37. Given the mixed information received from third parties, the OFT has taken a cautious approach and considered compound feeds separately to straights in this case.

38. In light of the above, the OFT considers the appropriate relevant product market in this case to be the supply of compound feed for monogastric animals.

Geographic scope

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[13] DEFRA, *Agriculture in UK 2007*. Available at: http://www.defra.gov.uk/corporate/publications/default.htm

39. In Cargill/Agribands and CVC/PAI, it was argued that the geographic scope of the market was national. While the Commission considered that the market information it had collected broadly supported this, it did not consider it necessary to conclude on the geographic scope in either case.

40. In Duffield, the OFT considered that animal feed was typically delivered within 50 to 60 miles, but could be delivered over distances of up to 200 miles. In ABF/Primary Diets, the OFT considered the geographic scope to be national due to the existence of overlapping regional catchments. Finally, in John Thompson, the OFT considered that there was sufficient evidence to conclude that the relevant geographic market was wider than Northern Ireland and included the north of Eire.

41. AB Agri has submitted that the geographic scope of the market should be Great Britain. While it notes that customers tend to be more concentrated the closer they are to mills, it is not essential for mills to be located close to the end customer.

42. AB Agri provided information showing the maximum delivery radius from each of its mills based on actual customer locations and found that the maximum delivery radius ranged from [ ] to [ ] miles, giving an average maximum delivery radius of [ ] miles. The figure for the Flixborough Mill was [ ] miles. AB Agri submitted that these figures indicate wide catchment areas and, furthermore, as there are over 400 compound feed manufacturers located throughout the UK, in reality these catchment areas strongly overlap, resulting in a national geographic market.

43. However, third party comments were mixed, and none stated that the appropriate geographic market was national. One supplier informed the OFT that they had supplied customers up to 160 miles away. Other suppliers stated that most customers were located within a range of 70 to 100 miles, although some were located further away. Customer estimates for the distance within which a customer would need to be located in order to be considered a potential supplier ranged from 50 to 200 miles.

44. Given the mixed responses on this issue from third parties, AB Agri conducted an 80 per cent catchment analysis for each of its mills in order to determine the distance within which the majority of its customers are

located.[14] This analysis showed that the 80 per cent catchment areas vary between mills, ranging from 50 to 60 miles to 120 to 130 miles. On average across the nine AB Agri monogastric feed mills, 80 per cent of customers are located between 90 and 100 miles from the relevant mill.[15] The 80 per cent catchment area for customers of Flixborough Mill was 110–120 miles.

45. AB Agri also provided data on transport costs, which indicated that transport costs were in the region of [ ] per cent of total costs of production. One competitor agreed that transport costs were low, stating that they were below [ ] per cent for long distances (approximately 150 miles) and significantly below for local deliveries.

46. Given the information obtained relating to transport costs and 80 per cent customer catchments, the OFT considers that it is reasonable in this case to conclude that the local sales area for the Flixborough Mill is approximately a 100 mile radius.

47. However, the OFT has also considered whether these catchment areas overlapped to the extent that the relevant geographic area was wider than the 100 miles. AB Agri argued that the geographic spread of both customers and mills across Great Britain means that there is a strong chain of substitution between 100 mile catchments, resulting in a wider geographic market.

48. In relation to Flixborough Mill, the locations of the 400 mills in the UK suggests that it may be the case that a high proportion of the customers located within the 100 mile radius from Flixborough have a choice of mills that are within 100 miles of them, but which fall outside the 100 mile radius around Flixborough Mill. Consequently, these mills would not be

[14] The OFT has considered from time to time that the figure of 80 per cent used in this analysis, while not determinative, provides a good indication of the competitive dynamics between suppliers and the choices available to customers in this case. For example, Case ME/3978/08 Completed acquisition by Aggregate Industries UK Limited of Atlantic Aggregates Limited and Stone Haul Limited (March 2009); Case ME/3427/08 Completed acquisition by Home Retail plc of 27 leasehold properties from Focus (DIY) Ltd (April 2008); and Anticipated merger between Co-operative Group (CWS) Limited and United Co-operatives Limited (July 2007).

[15] The OFT notes that it may be the case that the relevant 80 per cent catchment areas for AB Agri might be narrower than for single mill operators, as it may be possible for AB Agri to supply customers located further away from an alternative AB Agri mill. This may indicate a wider geographic market, although we note that the Flixborough Mill 80 per cent catchment is only marginally wider. However, as discussed at paragraph 50, widening the geographic market beyond 100 miles does not affect the competitive assessment in this case.

considered to represent a competitive constraint on Flixborough Mill under a strict 100 mile geographic market definition. However, the OFT does not have sufficient evidence to conclude on what proportion of customers have alternative suppliers outside the identified 100 mile radius and therefore the extent to which the catchment areas overlap.

49. In any event, the OFT considers it unlikely that chains of substitution between catchment areas would remain unbroken, such as would be required in order to suggest a national geographic market. Maps of mill locations provided by AB Agri suggest that there are certain areas with fewer mills, which may indicate breaks in the chain of substitution between catchment areas. One supplier also submitted that it does not compete with Flixborough Mill due to the fact that the limited livestock numbers in South Lincolnshire creates a natural boundary to its selling area. Therefore, the OFT does not consider that there is sufficient evidence to support AB Agri's view that the relevant geographic market is national on the basis of overlapping catchments.

50. In light of the above, it appears possible that overlapping catchment areas could widen the relevant geographic market beyond the 100 mile radius; however it is not clear as to how far these chains of substitution would extend. In any event, the OFT does not find it necessary to conclude on the extent to which overlapping catchment areas might widen the geographic market as widening the market beyond the 100 mile radius does not affect the outcome of the competitive assessment in this case.

HORIZONTAL ISSUES

Unilateral effects

51. AB Agri and the Flixborough Business overlap in the supply of compound animal feed for monogastric animals. As discussed above, for the purposes of the competitive assessment the OFT considers that they overlap within the 100 mile radius around Flixborough Mill,[16] although the existence of

[16] Within 100 miles of the Flixborough Mill are four AB Agri monogastric feed mills: Gainsborough (21 miles), Fridaythorpe (46 miles), Sherburn (47 miles) and Northallerton (87 miles). Re-centring the 100 mile radius on each of the four AB Agri mills (in order to determine whether there is any loss of asymmetric constraint post Acquisition) does not significantly affect the competitive assessment in this case.

overlapping catchments may mean that they face additional constraints from outside this radius.

Shares of Supply

52. AB Agri provided estimates of the monogastric feed output[17] of its mills within the 100 mile radius (driving distance). Following the Acquisition, AB Agri would have a [35–45] per cent share of supply (an increment of [10–15] per cent)[18]. However, post Acquisition two national suppliers, each with two other mills in the area would remain and would be expected to exert a significant competitive constraint on AB Agri.

53. In addition, there are a considerable number of smaller mills, the majority of which would be expected to have spare capacity. AB Agri and third parties have informed the OFT that there is spare capacity across the sector. AB Agri estimates that spare capacity is around 15 to 20 per cent, and third parties have confirmed that spare capacity in the industry is significant. In particular, two such suppliers have told us that they compete actively with AB Agri in the area.

54. Furthermore, customers have raised no concerns regarding the loss of competition post Acquisition. Several customers named both local and national mills as potential suppliers and provided examples of alternative potential suppliers. Of these potential suppliers, several were located outside the 100 mile driving distance radius, indicating that the geographic market may be wider than 100 miles as a result of overlapping catchments. Were this to be the case, AB Agri's share of supply post Acquisition would be notably lower. For example, if the driving distance radius was widened to 150 miles, AB Agri's share of supply post Acquisition would fall to [25–35] per cent.

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[17] The OFT did not have capacity estimates for all of the relevant mills in this case, but using the capacity estimates AB Agri was able to provide (for around 60 per cent of indentified mills) and production estimates for the remaining mills, AB Agri and the Flixborough Mill would have a combined share of supply that was only 2 percentage points different from the share of output figures. The OFT therefore considers that share of output figures provide a reasonable estimate of the extent of market power.

[18] The OFT notes that there is an inconsistency in the share of supply data, specifically the geographic market is defined on the basis of a 100 mile radius (as the crow flies), whereas, due to data availability, the competitors included in the share of supply analysis are located within a 100 mile road distance which covers a smaller area than a 100 mile radius since roads are not perfectly straight. Therefore, these shares of supply are conservative. For completeness the OFT also considered a 120 mile road distance (arguably more consistent with a 100 mile radius) under this analysis the combined share of supply post acquisition and the relevant increment were both lower than under a 100 mile road distance.

Switching

55. AB Agri submitted that the high levels of spare capacity in the sector make switching easier; furthermore, it considers that there is little customer loyalty in the animal feed industry, and that churn rates are high. In 2008, the rate of churn at AB Agri was [ ] per cent. This level of churn was also supported by another supplier, who estimated that churn can be as high as [ ] per cent per annum. This supplier also submitted that customers can and do switch for as little as a 50 pence change in the price of a £200 per tonne product, as there are no costs associated with switching.

56. Several customers commented that they would switch to alternative suppliers if faced with a small price increase. One customer informed the OFT that if such a price increase was not justified by cost increase, it would re-tender its supply arrangements. Another supplier submitted that it could obtain alternative supply in around three months, and had in fact done this on a previous occasion in order to monitor supplier prices. However, one customer did note that switching was becoming more difficult in light of industry consolidation.

Closeness of competition

57. Whilst the product is considered to be a homogenous good, in this case the route to market for AB Agri and the Flixborough Mill has been slightly different, in that the Flixborough Mill currently supplies 100 per cent of its output to one customer. Therefore, the OFT has therefore considered closeness of competition. Third party comments suggest that the JE Porter's Navenby Mill is considered a closer competitor to AB Agri than the Flixborough Mill. This may be due to the fact that Flixborough Mill currently supplies 100 per cent of its output to one customer, meaning that some customers may consider that Flixborough Mill is effectively acting as an IPU and not on the open retail market. In contrast, JE Porter's Navenby Mill actively competes on the retail market and was mentioned by several customers as an alternative source of supply.

58. Of particular importance in this case is the fact that there does not appear to be an identifiable group of customers who have a significantly reduced choice of suppliers as a result of the Acquisition. Flixborough Mill has only one customer who, AB Agri submits, instigated the Acquisition [ ]. Those suppliers that may have considered JE Porter as an alternative supplier

would most likely have been supplied from its Navenby Mill,[19] which will still operate as an independent supplier post Acquisition. The Navenby Mill is located well within the 100 mile catchment area of Flixborough Mill and has spare capacity.

59. On the basis that there are several other suppliers that customers are willing to use (including those from outside the 100 mile catchment), the relative ease of switching suppliers (particularly given industry over capacity), the position of Flixborough Mill pre-Acquisition as effectively an IPU for one customer and the lack of customer concerns, the OFT does not consider the Acquisition gives rise to competition concerns on the basis of unilateral effects.

Coordinated effects

60. No third parties have suggested that the Acquisition may give rise to or increase the risk of coordination. Furthermore, across Great Britain there are a large number of suppliers which vary considerably in size, product mix and their degree of vertical integration; the OFT would expect these factors to make coordination difficult. The Acquisition also increases asymmetry, making coordination less likely.

61. Furthermore, there is no evidence to suggest that JE Porter were acting in such a way as to prevent coordination nor that the sale of Flixborough Mill would lessen JE Porter's incentives to compete through Navenby Mill.

62. Consequently, the OFT does not consider that the Acquisition will give rise to competition concerns on the basis of coordinated effects.

Barriers to entry and expansion

63. AB Agri submitted that barriers to entry in the production of animal feed are low, with only modest capital investment required. AB Agri also provided the OFT with a few examples of recent new entry, mainly IPUs deciding to sell to third parties in addition to providing feed for their own livestock.

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[19] While Flixborough Mill's one customer did not have exclusive use of Flixborough Mill its volumes did account for a significant proportion (60 – 70 per cent) of total capacity.

64. Third parties, however, indicated to the OFT that barriers to entry are relatively high. One supplier estimated that a new mill would cost £5-10 million and take significant time to build. Furthermore, the declining demand in this industry (due to imports and cuts in farming subsidies) and the resulting excess capacity would be expected to reduce the incentives for new entry. In previous cases, the OFT has also found barriers to entry for de novo entry to be high and the prospect of new entry low.[20]

65. In terms of barriers to expansion, AB Agri and third parties agreed that there is considerable over-capacity in the industry and therefore some expansion to capacity to could take place easily and quickly. AB Agri estimates current over-capacity at 15 to 20 per cent, third parties confirmed that there is significant over-capacity in the industry. Only one supplier submitted that it was close to capacity, but added that it would be able to increase production by 10 per cent without the need for further investment. This supplier commented that an expansion in production of 25 per cent would require costly investment in building new mills or upgrading existing facilities and take up to two years to complete.

66. Therefore, it would appear that the likelihood of new entry is very low. However, the spare capacity across the industry would suggest that it would be possible for a high proportion of mills to increase production from existing spare capacity. Furthermore, while unlikely given existing spare capacity, it may also be possible to increase overall capacity, but only within certain limits (for example, by up to around 10 per cent).

67. However, the OFT does not need to conclude on the prospects for entry in this case as it does not affect the outcome of this case.

Buyer power

68. AB Agri submitted that agricultural merchants tend to source from a number of suppliers in order to meet the needs of their customers and are able to react quickly in terms of the volumes they purchase in response to relatively small price changes.

69. In addition, AB Agri considers that the substantial consolidation of livestock flocks over the last decade has increased the influence of farmers over the

[20] See, for example, the *John Thompson* and *ABF/Primary Diets* decisions.

manufacturers of compound poultry feed, resulting in more favourable purchasing conditions for farmers. For example, in the broiler chicken industry around 80 per cent of weekly production is accounted for by the seven largest players in the market. Given the size of these processors, they tend to be able to dictate terms to both farmers and feed manufacturers, often negotiating the purchase of large volumes of feed for their contracted farmers. AB Agri also submits that these processors will take their own positions on raw material prices, thereby better controlling their costs of supply.

70. Several customers commented to the OFT that a 5 to 10 per cent price increase (that was not linked to cost increases) would be extremely unlikely to occur as they purchase raw materials themselves, with mills operating as toll manufacturers. These customers therefore considered prices to be very transparent, giving them a degree of power over mill operators and preventing significant price increases. These customers told the OFT that the Acquisition would not affect their ability to negotiate.

71. The OFT has some evidence that customers use dual sourcing in order to benchmark prices and prevent non-cost related price increases. One customer informed the OFT that it previously set up alternative supply arrangements with JE Porter in order to benchmark AB Agri's prices.

72. Suppliers also agreed that large buyers have some buyer power. One supplier explained that the monogastric sector is dominated by large, sophisticated buyers requiring thousands of tonnes of feed per year. These buyers are able to negotiate very competitive prices as a result of their scale. Furthermore, this supplier informed the OFT that there is an increasing trend among customers to develop supply chain links in order to demonstrate to supermarkets that there is suitable biosecurity in the supply chain; these relationships often work on an open book basis.

73. Specifically in this case, it is notable that according to AB Agri, a significant customer apparently instigated the Acquisition [ ].

74. In this case it appears that larger buyers may possess a degree of buyer power that will not be diminished by the Acquisition. This is partly due to the volumes they produce and partly due to toll manufacturing agreements whereby customers purchase raw materials, ensuring price transparency.

However, the OFT does not need to conclude on the extent of buyer power present as it does not affect the outcome of this case.

VERTICAL ISSUES

75. AB Agri, through its ABN division, purchases a significant proportion of the grain it needs to manufacture animal feed from an agricultural merchant, Frontier Agriculture Limited (Frontier), of which ABF has a 50 per cent share. ABN has a five year supply agreement with Frontier, on which all but a small amount of its grain requirements are purchased on an exclusive basis. [See Endnote 1] Post Acquisition, this represents a potential theory of harm in that Frontier could exclusively supply AB Agri (including the Flixborough Mill), foreclosing supply to competitors of AB Agri.

76. However, Frontier has an estimated share of supply of grain within the UK of 16 per cent and there are a large number of alternative grain suppliers. Therefore, it is unlikely that downstream competitors of AB Agri would be unable to source grain requirements from elsewhere. In addition, no third parties have raised vertical concerns and therefore the OFT does not consider the vertical effects of the Acquisition further.

THIRD PARTY VIEWS

77. During the course of its investigation the OFT solicited views from competing suppliers and also customers of AB Agri and the Flixborough Mill. None of the third parties that responded to the OFT indicated that the Acquisition raised competition concerns. Specific comments of third parties relevant to the OFT's assessment in this case are summarised above as appropriate.

ASSESSMENT

78. AB Agri and the Flixborough Business are both compound feed manufacturers which overlap in the supply of compound monogastric animal feed to end-users.

79. The OFT has examined the Acquisition on the basis of the supply of compound feed for monogastric animals. The OFT has not found it necessary to conclude on the geographic scope of the market as no

competition concerns arise on the narrowest geographic market definition of a 100 mile radius.

80. Within 100 miles of Flixborough Mill, there are four AB Agri monogastric feed mills. AB Agri's post Acquisition share of supply of compound feed for monogastric animals would be [35–45] per cent (an increment of [10–15] per cent). AB Agri is the strongest player in the 100 mile catchment, however there are two national competitors each with two mills in the 100 mile catchment as well as a number of smaller suppliers, two of which have confirmed that they have spare capacity and actively compete with AB Agri. Customers raised no concerns, naming a range of alternative suppliers, including several outside the Flixborough Mill 100 miles catchment area. This may support a wider market definition, which would lower the combined share of supply.

81. Switching costs appear to be low and churn rates are in the region of [ ] per cent per annum. Flixborough Mill appears to be a less close competitor to AB Agri than the JE Porter Navenby Mill, as Flixborough Mill only has one customer who accounts for 60 to 70 per cent of its output. JE Porter's Navenby Mill will continue to operate as an independent competitive constraint to AB Agri post Acquisition.

82. It appears that large buyers may possess a degree of buyer power that will not diminish as a result of the Acquisition, due to the volumes they purchase and price transparency through the existence of toll manufacturing agreements. However, the OFT does not need to conclude on the extent of buyer power present as it does not affect the outcome of this case.

83. On the basis of the range of alternative suppliers, the existence of spare capacity, the possibility of constraints from outside the 100 mile catchment and the lack of third party concerns, the OFT considers it unlikely that the Acquisition will give rise to competition concerns.

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

DECISION

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

ENDNOTES

1. Since coming to its decision the OFT has learnt that ABN no longer has a five year supply agreement with Frontier.