OFFICE OF FAIR TRADING

Anticipated acquisition by Prosper De Mulder Limited of Canterbury Mills Limited

No. ME/3445/07

The OFT's decision on reference under section 33(1) given on 18 January 2008. Full text of decision published 28 January 2008.

PARTIES

1. **Prosper De Mulder Limited** (PDM) provides a national integrated animal waste collection and processing business covering edible meat products. It handles past sell by date edible food through to high risk and condemned animal waste. PDM operates five rendering plants located at Silvertown (East London), Widnes, Exeter, Nuneaton and Nottingham. The plant at Nottingham processes only poultry waste the remaining plants all process red meat animal waste.

2. **Canterbury Mills Limited** (CML), a subsidiary of Cheale Meats Limited, operates a Category 1 animal waste rendering plant located at Canterbury, Kent. The majority of its waste is delivered to its plant by third parties for processing. CML's UK turnover is £3 million.

TRANSACTION

3. PDM proposes to acquire the whole of the issued share capital of Canterbury Mills.

4. The parties notified the OFT by way of a Merger Notice on 4 December 2007. The statutory deadline expires on 18 January 2008.[1]

JURISDICTION

5. As a result of this transaction PDM and CML will cease to be distinct. The parties overlap in the supply of animal waste rendering and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RATIONALE

6. PDM has sold its rendering plant at Silvertown (East London) for property development. Despite having a lease on these premises until 2010 it has been looking to purchase an alternative plant in the South East of England. The parties submit that Canterbury Mills is attractive as it has a 'Category 1' licence while its own plant has a 'Category 3' licence.[2] PDM plans to continue using the Canterbury Mills plant for Category 1 processing but wishes to add a Category 3 production line to the plant.

7. The parties submitted that since the discontinuance of the Over Thirty Month Scheme (OTMS),[3] Canterbury Mills has been operating at below capacity, and has been making a loss.

FRAME OF REFERENCE

Regulatory environment

8. The disposal and processing of animal waste materials – that is, what remains of the animal after meat and offal for human consumption (and other uses) has been removed - such as waste from abattoirs, animals which have died on farms 'fallen stock' and animals slaughtered under

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[1] The 20 working day statutory deadline was extended by 10 days under section 97(2) of the Enterprise Act 2002.

[2] See paragraph 9 for an explanation of the categories of animal waste.

[3] Government regulation regarding the slaughter of animals over thirty months in response to BSE crisis. This program was in place from 1996 to 2005 and has been replaced by the smaller scale Older Cattle Disposal Scheme.

government regulations such as OTMS, is strictly regulated by the government. The key piece of legislation covering the disposal of animal waste is the European Commission's Animal By-Products Regulation.

9. The regulations stipulate that different categories of animal waste (based on their likelihood of transmitting BSE) must be separated from each other at all stages, including during transportation and at the processing stage. Rendering plants are licensed by DEFRA (Department for Environment, Food and Rural Affairs) reflecting the different risk levels associated with the waste materials. The licensing system categorises the rendering plants into one of three bands.

   - **Category 1** is for processing waste materials with the highest risk of transmitting BSE. These materials must be disposed of through incineration or land fill (although category 1 tallow can be burned as a fuel source).
   - **Category 2** is for processing materials which present a risk to other animals and therefore cannot be used in animal feed. These are rendered or incinerated, or processed for use as fertiliser.
   - **Category 3** is for processing low risk materials which can be processed for use as pet food, but not animal feed.

10. The regulations allow for lower risk materials to be upgraded to a higher risk category for the purposes of processing, but higher risk materials cannot be reclassified as lower risk materials. This means that category 2 or 3 materials can be processed in a plant with a category 1 licence (and category 3 materials can be processed in a category 2 plant), but category 1 and 2 materials cannot be processed at a category 3 plant.

11. Rendering plant licences also distinguish between mammalian and poultry waste which must be processed separately.

Product market

12. The parties overlap in the rendering of animal waste.

Different categories of waste

13. As explained above, for the purposes of rendering, waste is categorised as either category 1, 2 or 3. Although there is little possible demand side substitution, as customers cannot choose what category their waste is processed as, based on the evidence before it, the OFT considers that there is some limited scope for supply side substitution.

14. For example, the parties submitted that sub-contracting out the processing of waste a renderer may not have a licence to process itself was common within the industry (within the industry this is known as 'streaming'). It is also possible to re-classify lower risk waste material into (and process it as) a higher risk category thereby allowing a renderer to process greater volumes of animal waste under a higher risk category. However, the parties submitted that re-classification of waste in this way may be undesirable as generally the higher risk category waste is, the less value it has as there is more limited scope for processing it into useful by-products of the rendering process such as pet foods or fertiliser.[4]

15. Renderers could also seek to re-licence a rendering plant through obtaining DEFRA approval. The OFT has been informed by PDM that moving a plant up the risk scale (e.g. from Category 3 to 2) would be relatively straightforward. However, given the decreasing value of waste the higher risk it is, the OFT considers that there is limited incentive for renderers to wish to do this. PDM informed the OFT that moving down the risk scale (e.g. from Category 1 to 2) would involved thoroughly cleaning a plant to avoid any risk of contamination. This would be a more costly exercise and would take a longer period of time, perhaps up to a year.

Rendering mammalian and poultry waste

16. The parties overlap in the processing of mammalian waste as Canterbury Mills does not deal in the processing of poultry products. The OFT considers that there is no need to conclude on whether the relevant product market includes both mammalian and poultry processing since the competition assessment is unaffected by this.

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[4] Category 3 waste therefore has the highest post-rendering value and often renderers such as PDM will pay customers for the right to collect this material.

Other waste disposal methods

17. The OFT does not believe, given the evidence that it has gathered in the course of this investigation and in the past[5] that other methods of processing waste such as incineration provide a strong constraint on animal waste rendering.

Conclusion on product market

18. The OFT has not found it necessary to conclude on a precise product market since this does not affect the outcome of the competition assessment. However, Canterbury Mills does not undertake processing of poultry waste and so this has been excluded and the case assessed on the basis of mammalian waste only. The OFT considers that, in principle, each waste category could form its own product market. However, the prevalence of streaming waste and the possibility of, albeit limited, supply side substitution indicate that, for the purposes of this case, it would be appropriate to consider a product market that includes all three categories. In selecting the narrowest possible market the OFT has excluded incineration. Therefore, the OFT has restricted its analysis to the rendering of mammalian waste products although it does also consider segmentation by category of animal waste.

Geographic market

19. PDM submitted that the geographic scope should be wider than regional or local but no wider than national. PDM argued that streaming meant that some waste material travels distances further than might be considered regional or local and that economies of scale meant that sometimes it was more economical to by-pass small local volumes of waste in preference to collecting larger volumes located further away.

20. However, PDM itself submitted to the OFT that the key rationale for the acquisition was to secure 'replacement processing capacity in the South East of England' following the sale of the Silvertown plant. On which basis, the OFT considers that the geographic market (or, at least, the market for

[5] OFT: Animal Waste: A review of undertakings given by Prosper de Mulder and William Forrest & Son (Paisley), October 2006 ('the OFT 2006 review').

category 3 waste) is narrower than the England and Wales area in which PDM operates.

21. Third party customers who responded to the OFT's survey indicated that they did not believe their animal waste was transported on a national basis.

22. Without prejudice to the possibility that the geographic market might be wider than regional, there is some evidence to suggest that the appropriate geographic market is regional. However, there is no need to conclude on the geographic market in this case since the outcome of the investigation does not depend on it. The OFT has examined the merger on a cautiously narrow geographic market comprising the South East of England, as well as a wider geographic market comprising England and Wales.

HORIZONTAL ISSUES

Shares of supply

23. Last year the turnover of PDM's rendering activities of mammalian waste was around £50 million. This indicates that throughout England and Wales the market is worth around £120–150 million.[6]

24. PDM estimates that after the merger it will hold 35 per cent of mammalian rendering capacity in England and Wales (increment of around 3 per cent).[7] In its 2006 review, the OFT estimated that PDM had a share of supply of 42 per cent, Pointon & Sons accounted for 21 per cent and Waddingtons had five per cent.[8] Pears, another significant renderer, has one mammalian rendering plant at Market Harborough (and one poultry plant). There is a long tail of small renderers, at the time of the OFT's 2006 review there were 27 renderers in all across Great Britain.[9]

25. Within the South East of England, the parties own the only two rendering plants (although PDM is expected to exit the Silvertown plant no later than October 2010). Therefore, post merger PDM will have a share of supply of

[6] Based on PDM's turnover, PDM's estimated share of the market in England and Wales and information from the OFT's review of undertakings. This assumes that PDM's share of capacity is broadly in line with its share of output by value.
[7] The parties did not submit any estimates based on actual rendering volumes or value.
[8] OFT (2006) table 4.1.
[9] Down from 125 plants in 1970.

100 per cent in the South East post merger (increment of 20-25 per cent).[10]

Unilateral effects

26. At the national level, given the low increment created by the merger, the OFT does not believe that the merger is capable of creating unilateral effects. The merger does give rise to a reduction of one in the number of operators of category 1 rendering plants. However, all the evidence the OFT has received, in assessing this merger and through the OFT's 2006 review, indicates that Canterbury Mills was not a substantial competitor in processing category 1 animal waste.

27. At the regional level, PDM submitted that it and Canterbury Mills have not been close competitors since PDM's plant at Silvertown has a category 3 licence while Canterbury Mill's plant has a category 1 licence.[11] On this basis, they were not competing for the same customers. PDM submitted that there is no occasion in which the merging parties have bid against each other to win customers.

28. PDM told the OFT that prior to 2006 Canterbury Mills only processed OTMS work. Since then it has mostly been used by other renderers (including PDM) as a toll processor (in other words, third party renderers who have Category 1 materials sub-contract Canterbury Mills to render those materials on their behalf), as well as doing some in-house processing for its parent company, CML (which accounted for less than 10 per cent of its rendering activities). Canterbury Mills has not solicited upstream customers such as abattoirs, food processors or supermarkets.

29. It could also be argued that although Canterbury Mills did not compete with other renderers for the supply of waste materials, it was however the most likely entrant in the South East of England to do so. However, the fact that Canterbury Mills and PDM hold different categories of licences in the South East, means that the possibility of Canterbury Mills competing with PDM for primary customers was remote and therefore did not constrain PDM's pricing.

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[10] PDM's Silvertown plant has a weekly capacity of around 3,000 tonnes and Canterbury Mill's weekly capacity is around 2,000 tonnes but operates at less than 1,000 tonnes.

[11] PDM's other red meat plants are Widnes (category 1) Exeter (category 1) and Nuneaton (category 2).

30. Further, given the counterfactual: PDM's exiting its Silvertown plant, the OFT believes that the merger does not make any difference to the ability of the owner of Canterbury Mills to behave unilaterally at a regional level, since Canterbury Mills will be the only rendering plant in the South East of England.

31. The OFT considered the possibility of the merger enabling PDM to foreclose competition in relation to sub-contracting work (particularly of category 1 waste). On a regional basis, since Canterbury Mills is the only renderer in the South East capable of processing category 1 waste, the merger will make no difference to the parties ability to foreclose competition (to the extent possible) within this area. On a wider than regional basis, post-merger PDM may have an incentive to attempt to foreclose competitors by refusing to process their category 1 waste at Canterbury Mills. However, PDM's nearest category 1 plants are located at Exeter and Widnes and a number of competitors have category 1 plants that are closer to Canterbury (and so are more likely to be alternatives to using Canterbury Mills) than are PDM's plants. Moreover, PDM on its own would not be able to provide sufficient volumes of category 1 waste to make Canterbury Mills viable. In the OFT's view, therefore, PDM will continue to rely on seeking third party category 1 waste processing business at Canterbury Mills. The OFT does not therefore believe that the merger will significantly increase PDM's ability or incentive to foreclose rivals.

Coordinated effects

32. The OFT has no evidence to suggest that the merger would facilitate coordination. The merger results in only a small increment in share on a national basis, and therefore only a small change to market structure. In addition, there will remain numerous suppliers on a national level post-merger, making coordination around price or market sharing difficult[12].

[12] There is already some transparency on pricing as the undertakings PDM is subject to require it to publish its average prices in the Meat Trades Journal. It can be argued that this could facilitate coordination. However, average pricing information would not enable competitors to consider the factors which determine the prices set by PDM. In any case, the merger itself in this case would not significantly change any of the factors which would create or strengthen coordinated behaviour.

THIRD PARTY VIEWS

33. The third parties who responded to the OFT were largely unconcerned. There was mixed evidence from third party customers regarding the ease of switching. A competitor told the OFT that it was not difficult to gain customers. Overall, the OFT did not receive any substantive concerns from either customers or competitors.

ASSESSMENT

34. The parties overlap in the supply of animal waste rendering. On a wide geographic basis of England and Wales the parties have a post-merger share of supply of around 35 per cent with an increment of around 3 per cent. On a regional basis comprising the South East of England, the parties have a share of supply of 100 per cent post merger in the South East with an increment of about 25 per cent.

35. On a regional basis the parties operate the only two rendering plants in the South East. However, the parties' plants are licensed to handle different categories of materials and therefore they do not compete for the same customers. Canterbury Mills only undertakes work on a sub-contract basis for other renderers and therefore does not solicit upstream customers in the same way as does PDM. Finally, PDM has sold its Silvertown plant and will vacate the plant in 2010. Therefore, one rendering plant will remain in the South East regardless of what happens in this merger. At the national level, such a small increment is not expected to give rise to a substantial lessening of competition. Even if the market was limited to processors of category 1 waste alone, there are a number of other competitors that have category 1 plants closer to Canterbury Mills (and, therefore, are closer alternatives) than does PDM.

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

DECISION

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