Office of Fair Trading

Anticipated merger between the Grainfarmers Group and Centaur Grain Group

ME/3850/08

The OFT's decision on reference under section 33(1) given on 23 September 2008. Full text of decision published 30 October 2008.

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

PARTIES

1. **Grainfarmers Group** (Grainfarmers) is an arable input and grain marketing farmers' co-operative. Grainfarmers purchases agricultural outputs from farmers which it markets mainly to the food industry, animal feed manufacturers and exporters. It is also active in the supply of agricultural seeds and fertilizer to farmers.

2. **Centaur Grain Group** (Centaur) is a grain marketing farmers' co-operative. It markets arable products as an agent, primarily to the food industry. Its turnover for the financial year 2006/7 was £28 million.

TRANSACTION

3. The parties announced on 11 September 2008 that they are to merge the whole of their businesses through a scheme of arrangement. The resulting new company will be branded 'Openfield'.

4. The parties notified the transaction to the OFT by way of a Merger Notice on 11 September 2008. The OFT's extended statutory deadline to announce its decision is 23 October 2008.

JURISDICTION

5. As a result of this transaction Grainfarmers and Centaur will cease to be distinct.

6. The parties overlap in the purchase and marketing of arable crops. The parties submitted that the merged entity's combined share of grain acquisition exceeds 25 per cent in certain UK regions. On a segmented product basis, the test may also be met in relation to the UK supply of feed wheat. Therefore, 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.

MARKET DEFINITION

Product scope

7. The parties overlap in the purchase and marketing of arable crops, namely wheat, barley, oats, pulses, rye/maize and oilseeds. As part of these activities, the parties also operate grain storage facilities.

8. There is also a small overlap between the parties in the supply of seeds to farmers. However, on the basis that the increment is less than one per cent on a national basis and that no concerns were received from third parties, this aspect is not considered further.

9. The parties submitted that the relevant product market is the merchandising of all types of grain. They argued that, amongst other things, all traders compete in relation to a wide range of grain types, farmer co-operatives compete on the same basis as other merchants, and farmers easily switch who they use to market their grain (including selling directly to customers).

10. The parties also submitted that farmers have a wide range of marketing options available to them. These include a committed model (where farmers commit to supply the co-operative or merchant with an estimated tonnage of a certain crop on an annual basis) and a non-committed model (where grain is purchased and marketed on a daily, weekly or monthly

'spot' basis, or on an individual contract basis). Farmers may also supply grain for pools or long-term supply agreements entered into between co-operatives or merchants and certain customers. They can also choose between marketing their grain on an agency or principal basis. The Department for Environment, Food and Rural Affairs (DEFRA) agreed that a wide range of marketing options are available to farmers. The parties also raised the fact that farmers have the option of supplying their products direct to end-customers.

11. In terms of the business models adopted by the parties, Centaur operates mainly on the committed grain model, Grainfarmers mainly uses the non-committed model. The parties stated intention is that Openfield will offer both options, but will aim to increase the proportion of its combined activity which uses the committed model.

12. In a previous case (ABF/Cargill), the OFT assessed the purchasing of grains and pulses separately from purchasing of oilseed rape, but did not preclude a wider market definition.

13. Comments received by the OFT indicated that on the demand side there is only limited substitutability between different grain types, and then only for some types of end user (such as animal feed manufacturers). On the supply side, since the parties and other merchants are intermediaries between farmers and end customers, they have a degree of supply-side flexibility over the range of arable products which they market. The parties submitted that the necessary storage facilities (barns, stores, warehouses, silos) and transportation (lorries and grain trailers) can be used for any grain type, and associated costs are comparable.

14. The parties submitted that farmers vary which crops they grow depending on seasonal variation, climate, market conditions and farmers' preferences. Merchants and co-operatives are flexible over which farmers and customers they transact with to match customer requirements. No third parties made the case for segmentation by grain type. Both parties, and their major competitors, appear to offer marketing services across a broad range of grain types.

15. The OFT therefore considers that the most appropriate frame of reference for the merger is likely to be the procurement and supply of grain, pulses and oilseeds (subsequently referred to jointly as 'grain'). However, the OFT

has not identified any competition concerns on even the narrowest reasonable basis (namely segmentation by grain type) and, therefore, has not felt it necessary to come to a conclusion on the precise product market definition.

Geographic scope

16. The parties submitted that the marketing of grain is at least national in scope, which accords with the views of a number of customers and competitors. The parties argued that grain is marketed to customers on a national basis, and merchants move large amounts of grain from one UK region to another to meet customer demands, and provided evidence to support these claims.

17. According to the parties, imports accounted for approximately five per cent of total UK consumption of grain. The parties submitted that prices are set on the basis of world supply and demand, based in part on broker data and futures prices on commodity exchanges. Several third parties, including DEFRA, concurred that UK prices are ultimately influenced by world supply and demand. However, it does not necessarily follow that the market is broader than national. Transport costs may mean that UK prices are broadly pegged to world prices, but not necessarily constrained to fully competitive levels.

18. In *ABF/Cargill*, consideration was also given to regional shares of the parties for some of the products relevant to that case. The parties' shares of farm grain output (that is, procurement) do vary across regions. The parties submitted that this is simply reflective of strong historical links with certain regions, for example relating to their original areas of establishment or local co-operatives which have been absorbed into the parties' groups.

19. The OFT considers that the appropriate geographic frame of reference on the supply side of the market is national. On the procurement side, consideration of regional markets provides a fuller understanding of the competitive constraints faced by the parties and the OFT has therefore taken a cautious approach by addressing these below.

HORIZONTAL ISSUES

20. The parties overlap in the procurement and supply of grain[1]. The proposed merger combines the only two national grain marketing farmer co-operatives. Broadly speaking, the different types of grain are commodity products.

Supply of grain

21. The parties submitted that their combined share of supply of UK grain volumes is [15-25] per cent, and that the increment is [0-10] per cent. The parties also submitted that there are a number of strong competitors active in the marketing of grain in the UK, such as Frontier Agriculture ([15-25] per cent), Gleadell ([0-10] per cent), Glencore ([0-10] per cent) and Nidera ([0-10] per cent), who will continue to provide a competitive constraint on the parties following the merger. Additionally, a number of smaller competitors based in specific regions of the UK (such as Fengrain and Grain Co) will also remain after the merger. DEFRA indicated that the share data provided by the parties accorded with its understanding.

22. Given the variation in grain supply business models discussed above, there is scope for differentiation in the services provided by grain marketing intermediaries to their suppliers and customers. Grainfarmers and Centaur have, broadly speaking, operated different models. In this respect the merging parties might not be considered particularly close competitors, although third party views on this question were somewhat mixed.

23. In terms of the impact of the merger on customers, third party responses indicated that most customers currently tend to split their grain purchasing requirements between a range of suppliers (co-operatives and/or national or regional merchants). Given this multi-sourcing, customers indicated that in response to any worsening of terms offered by the merged entity they could (and would) switch to other suppliers.

24. As set out above, the parties and third parties (including DEFRA) submitted that prices are set on the basis of global supply and demand, based in part on broker data and futures prices on commodity exchanges. The parties

[1] As mentioned above, there is also a small overlap between the parties in the supply of seeds to farmers.

argue that grain commodity trading is an open process and prices are transparent. Prices in supply contracts to customers are generally determined on the basis of tracking market movement (in accordance with standard form contracts).

Procurement of grain

25. On a regional level, the data provided by the parties on regional volumes of farm output (that is, grain procured) indicated that the parties' combined share is highest for Yorkshire/Humberside ([35-45] per cent), West Midlands ([35-45] per cent), and South East ([30-40] per cent). In the two regions with the highest farm output of grain (Eastern and East Midlands) their combined share is only [10-20] per cent and [0-10] per cent respectively. The parties submitted that there are a number of strong national players active in all of these regions, plus a number of regional competitors who have a strong presence in particular areas. In each region of the UK, the parties maintain that there are between five and nine other competitors.

26. In terms of impact of the merger on farmers, the parties set out that members of the co-operative will be able to choose whether to continue to be members post-merger and that members will benefit from easier access to a range of trading options through the parties' supply chains and relationships with end customers. This view was supported by the responses received from farmers. All farmers (both members and non-members) will continue to have a range of trading options open to them, including the option of direct supply.

Barriers to entry and expansion

27. The parties submitted that barriers to entry are very low, with few sunk costs or specialised assets involved. This is broadly supported by the ABF/Cargill decision, which also noted evidence of regional merchants expanding into other regions.

28. The parties identified ADM Direct and Wellgrain Ltd (with the latter also identified by a third party) as new entrants into grain procurement and/or marketing in the UK in the last five years.

29. Third party comments as to ease of entry were somewhat mixed. However, given that no competition concerns arise, the OFT has not found it necessary to conclude on barriers to entry.

Buyer power

30. The parties submitted that customers are well-informed, sophisticated buyers who can easily switch between grain suppliers, and generally trade with at least two or three merchants. DEFRA agreed that many grain customers are sophisticated purchasers. The fact that many customers multisource (with the exception of some smaller customers) allows for easy switching of volumes in response to price or quality variations. However, given that no competition concerns arise, the OFT has not found it necessary to conclude on countervailing buyer power.

VERTICAL ISSUES

31. A Grainfarmers subsidiary (John Loader (Wessex) Limited) is supplied with animal feed grain by Grainfarmers. The merger therefore entails a new vertical overlap between Centaur and John Loader. However, post-merger shares of supply at each relevant level of the supply chain appear insufficient to raise substantive vertical concerns and the OFT received no concerns from third parties that this transaction would lead to any vertical competition issues.

THIRD PARTY VIEWS

32. The OFT received responses from a number of customers, farmers and competitors (merchants and other farmer co-operatives) and sought the views of DEFRA. Farmers were uniformly supportive of the transaction. The majority of competitors (including some which are also customers of the parties) were not concerned.

33. One competitor argued that the merged entity's move to a committed model would lead to a reduction in the total amount of grain which is traded on spot markets. However, post-merger farmers will retain the choice of which option and which co-operative or merchant to use to market their grain.

34. Most marketing competitors who responded did not expect a reduction in competition as a consequence of the merger. One competitor considered that the transaction may well enable the merged entity to compete more effectively with Frontier.

35. Customer reaction was mixed, with some concerns expressed in relation to consolidation of grain supply options arising from the merger. They perceived that a reduction in the supplier base could impact on the ability to obtain competitive quotes. However, almost all customers indicated that in response to any worsening of terms offered by the merged entity, they could (and would) switch to other suppliers.

36. DEFRA considered that the merger is not likely to lead to a substantial lessening of competition, either with respect to the impact on farmers or customers. It noted that farmer members of the co-operative would limit the degree to which the merged business can exercise any market power towards them whilst the global nature of grain pricing would act as a constraint on the merged business' pricing actions.

ASSESSMENT

37. The parties overlap in the procurement and supply of grain. The merger brings together the two national grain marketing farmer co-operatives. The parties are two of the four largest UK grain marketing businesses and post-merger the merged entity's volumes of supply will be broadly equivalent to that of the current largest player, Frontier (at around a [15-25] per cent share). In addition to Frontier, there remain a number of other merchants and co-operatives active either nationally or in specific regions of the UK.

38. As regards procurement, in all of the regions where the parties' combined share of farm output exceeds 30 per cent, there are a number of national players active, plus a number of regional competitors who have a strong presence in particular areas.

39. Remaining constraints in the market will mean that the merged entity will not be able to raise prices to customers or reduce prices to farmers, as both will have a number of other sources to which to sell or from which to purchase their grain respectively in response to any worsening of terms.

40. Some customers were concerned about the loss of a supply option, but they did not provide any compelling evidence of likely price effects, and indicated that they have access to sufficient alternative sources of supply. On the procurement side of the market, farmers were uniformly supportive of the merger.

41. 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

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