

Completed acquisition by Dairy Crest Group plc of the doorstep and depot based middle ground milk businesses of Arla Foods UK plc

The OFT's decision on reference under section 22 given on 26 October 2006.  
Full text of decision published 8 January 2007.

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**Please note that square brackets indicate figures or text which have been deleted, amended or replaced with a range for reasons of commercial confidentiality.**

## **PARTIES**

1. **Dairy Crest Group plc (Dairy Crest)** is active in the production and supply of milk and other dairy products in the UK. Its turnover in the year ended 31 March 2006 was approximately £1,424 million.
2. **Arla Foods UK plc (Arla)** is also active in the production and supply of milk and other dairy products in the UK. Arla was established in October 2003 as a result of the merger between Arla Foods plc and Express Dairies plc. Arla is 51 per cent owned by Arla Foods amba, a Danish/Swedish cooperative. Its turnover in the year ended 30 September 2005 was around £1.32 billion.

## **TRANSACTION**

3. On 19 August 2006 Dairy Crest acquired various assets pertaining to Arla's doorstep and depot-based middle ground milk business.<sup>1</sup> The assets include dairies at Liverpool and Nottingham, 77 depots and all collection sites located in England and Wales, delivery vehicles, stocks, personnel,

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<sup>1</sup> Prior to the transaction, this business was conducted by Arla's subsidiary, Express Limited.

brands, contracts and goodwill (the acquired business).<sup>2</sup> The UK turnover of the acquired business was approximately £[ ] million for the year ended September 2005.

4. Arla has retained a number of larger middle ground milk customers as well as the milk supply contracts it currently has with national multiples (the retained business). These customers will be serviced from Arla's dairies, whereas the customers transferred to Dairy Crest were, prior to the transaction, predominantly serviced from Arla's depots.
5. The transaction was notified to the OFT on 30 August 2006. The administrative deadline in this case expires on 27 October 2006 and the four month statutory deadline expires on 18 December 2006.

## **JURISDICTION**

6. As a result of this transaction Dairy Crest and the acquired business have ceased to be distinct. The UK turnover of the acquired business exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.
7. Pursuant to section 27 of the Act, the OFT may, for the purposes of a reference, treat successive transactions between the same parties within a two year period as having occurred simultaneously on the date on which the latest of them occurred.
8. On 29 October 2005, Dairy Crest acquired the Express Foodservice Business in London from Arla (the Foodservice acquisition). Dairy Crest submitted details of the transaction to the OFT on 2 November 2005, and on 28 November 2005 the OFT announced that this transaction did not qualify for investigation under the mergers provisions of the Act because neither the UK turnover test nor the share of supply test was met.
9. The Express Foodservice Business supplied milk, cream and other products to foodservice businesses (coffee bars, hotels, caterers), wholesale traders

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<sup>2</sup> Dairy Crest has also acquired certain non-liquid milk products that will be sold through the depot infrastructure.

and bottled milk buyers in the South of England. Dairy Crest acquired these customers, as well as one depot and various vehicles.

10. The OFT has exercised its discretion under Section 27(5) of the Act to aggregate the acquisitions of 29 October 2005 and 19 August 2006 and treat them as having occurred simultaneously on 19 August 2006.

## **RELEVANT MARKET**

11. The activities of Dairy Crest and the acquired business overlap in the procurement of raw milk and the processing and supply to customers in England and Wales of fresh processed milk and cream.
12. The parties also overlap in the supply of certain other non-dairy products (such as fruit juice, bakery goods, eggs). However, the merged entity will not enjoy a share of supply in excess of three per cent for any of these products and there are a number of other suppliers present in this sector (for example, supermarkets). On this basis, competition concerns are not considered to arise in respect of these non-dairy overlaps and are not discussed further.

## **CREAM**

### **Product market**

13. Cream is milk with a substantial fat content. It is a by-product of the production of semi-skimmed and skimmed milk. Cream is supplied in bulk for export and for use by food manufacturers. Non-bulk cream is supplied in pots (potted cream) for retail sale or in larger containers (e.g. polybottles, palecons, etc.) for the food service sector. There appear to be significant barriers to switching quickly and easily from bulk to non-bulk cream due to the need to invest in packaging capacity and associated infrastructure.<sup>3</sup> On the demand side, several types of cream and cream substitutes can be identified. However, fresh cream can be distinguished by taste, use and shelf-life from UHT cream, sterilised cream, frozen cream and non-dairy (synthetic) cream.

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<sup>3</sup> See Case No. COMP/M.3130 Arla Foods/Express Dairies, 10 June 2003.

14. Similar to fresh processed milk, the market for non-bulk cream could be segmented according to distribution channel (e.g. national multiples, middle ground and doorstep). However, in the context of this case it has not been necessary to conclude on this point.

### **Geographic market**

15. The UK is a net exporter of cream, with most cream exported in bulk to continental Europe. There are also some imports of cream.<sup>4</sup> The geographic scope, therefore, appears to be at least national. However, in the context of this merger it has not been necessary to conclude on the geographic scope of the market since competition concerns do not arise in any event.

### **Horizontal Issues**

16. The parties submitted that, post-merger the merged entity will have a combined share of approximately [10-20] per cent (increment [less than 5] per cent) of the supply of cream to the retail sector nationally. This represents a relatively small increment to the parties' sales. Furthermore, a number of other significant competing suppliers are present in the sector. On this basis, no competition concerns arise.

## **FRESH PROCESSED MILK**

### **Product market**

17. The Competition Commission (CC) concluded in *Arla/Express*<sup>5</sup> that fresh pasteurised non-flavoured cows' milk (or 'fresh processed milk') represented a distinct product. On the demand side, there was found to be little substitution with other products, while on the supply side, evidence from processors suggested that it was not easy to switch into the production of fresh processed milk from the production of other dairy products. This is in line with evidence obtained in more recent OFT merger investigations in the sector.<sup>6</sup> Fresh processed milk is therefore considered to be a distinct product.

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<sup>4</sup> Source: DEFRA.

<sup>5</sup> Competition Commission report on the proposed merger of Arla Foods amba and Express Dairies plc of 15 October 2003 (Cm 5983).

<sup>6</sup> OFT decision of 3 December 2004 on the completed acquisition by Dairy Farmers of Britain Ltd of Associated Co-operative Creameries Ltd.

18. The Arla/Express Report also noted that the supply of fresh processed milk can be segmented into supply to the following three categories of customer on the basis that each category requires different standards, has variable levels of buyer power, varying geographic arrangements and different milk sourcing methods:
- supply to national multiples;
  - supply to middle ground customers (that is, all customers who are neither national multiples nor doorstep customers); and
  - supply to doorstep customers.

In this case, the parties overlap in the supply of fresh processed milk to the middle ground and doorstep segments.

19. It is worth noting that the term middle ground is effectively a 'catch-all' and, as such, it contains a variety of different types of customers with different purchasing behaviours and a range of requirements in terms of service type and level (for example frequency of deliveries, number of drop points and container size). Middle ground customers range from small single store newsagents and petrol stations to smaller supermarket chains, prisons, and local authority school milk contracts. The CC also found that prices in respect of middle ground customers were not transparent (as they are individually negotiated) and processors were able to price discriminate by charging different prices to different customers types depending on their needs.
20. The parties submit that the distinction between national multiples and larger middle ground customers is rather arbitrary and that they themselves have organised their respective businesses according to customers' volume requirements. It has also become apparent that the distinction between doorstep and the middle ground segment may not be completely clear cut from a supply-side perspective, with the parties indicating that some middle ground customers are served with a combination of mixed doorstep and middle ground delivery rounds, and others are served by delivery rounds designed to service the middle ground only.
21. Consistent with past cases, we have analysed this merger by reference to CC's customer segmentation outlined above, although it is recognised both that some blurring may exist between the different segments (doorstep,

middle ground, national multiples) and that within the 'middle ground' category, price discrimination can and does take place.

## **Geographic market**

### Middle ground

22. As discussed earlier, the middle ground is not a homogeneous group, with customers in this category ranging from individual stores to medium sized retail chains. As such, the geographic scope will vary between customers. On the demand side, different types of customer within the middle ground sector will have different requirements, and this leads to different geographic frames of reference. Some of the largest middle-ground customers require national contracts, whereas smaller customers will require a small amount of milk to be delivered to a single site and this could potentially be fulfilled by any local supplier whose delivery area covered the customer's location.
23. Even amongst customers with centrally negotiated 'national' contracts, there is a likely distinction between those that can be serviced from a few major sites/dairies (for example, a factory or, in the case of a retail chain, its distribution centre), and those requiring localised delivery arrangements and infrastructure (for example, individual stores). Regional factors may be important for the latter type of customer in determining supply options. In addition, the parties submitted that Wiseman was the only processor capable of supplying on a national basis. For all other suppliers it was necessary to 'piggy-back' on the distribution networks of their competitors, through agency agreements or by forming a consortium.
24. On the supply side, whilst it is certainly true that milk can be transported long distances from dairy to depot (in some cases up to 160km) and then further (30-50km) from depots to customers, it is clear that different processors are stronger in different parts of the country, which may suggest that competition tends to be predominantly regional.
25. In *Arla/Express* the CC found that whilst the geographic scope of the market may be quite broad for some middle ground customers (particularly those with centralised procurement), this was not the case for all middle ground customers. The CC rejected the argument that there is a chain of substitution linking each geographic region and its neighbours, and

concluded that it was not appropriate to adopt a broad geographic market definition for middle ground customers on the basis of such a chain. The CC concluded that there were 'a series of markets that overlap geographically,' determined on the basis of the supply options available to different groups of consumers. The OFT did not identify any evidence during the course of its investigation which would suggest that it may be appropriate to deviate from this view.

26. Accordingly, in line with previous OFT merger decisions in this sector,<sup>7</sup> consideration has been given to the competitive situation in the narrower geographic areas where the parties both supply middle ground customers, as well as the effect of the transaction at a national level.

#### Doorstep

27. In previous cases, the CC and the OFT concluded that the geographic frame of reference for doorstep deliveries is limited to individual rounds, at least in the short term.<sup>8</sup> On the demand side, doorstep consumers generally have only one choice of supplier so have no opportunity to switch. On the supply side there are strong economies of density which mean that it would not be economic for houses in the same street to be served by several different milkmen.
28. The OFT did not identify any evidence during the course of its investigation which would suggest that it may be appropriate to deviate from the view taken in past merger cases.

#### **Non-coordinated effects**

#### Doorstep

29. The parties submitted that while the CC concluded in *Arla/Express* that the doorstep segment is distinct, it remains the case that customers purchase their milk from a variety of outlets (for example, supermarkets, petrol stations, local stores, newsagents), which provide competition to the

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<sup>7</sup> OFT decision of 7 April 2005 on the completed acquisition by First Milk Limited of a 15 per cent stake in Robert Wiseman Dairies plc.

<sup>8</sup> See for example: CC report on *Arla/Express*; OFT decision of 3 May 2006 on the completed acquisition by Claymore Dairies Ltd of the milk businesses of Allarburn Farm Dairy Ltd.

doorstep sector. It was further argued that that there is very little actual competition on a street-by-street basis between doorstep suppliers.

30. Following the transaction, the merged entity would be responsible for around [80-90] per cent of doorstep sales in London, [65-75] per cent in the Southern region and [85-95] per cent in the Midlands region. However, there is no overlap between the vast majority of the parties' doorstep rounds, with the parties only identifying a limited number of locations in the Midlands and London where there may be some overlap or adjacency between the parties' doorstep rounds.<sup>9</sup> The parties also submitted that individual pricing on their respective rounds do not differ between areas in which there are other doorstep providers and those where there are not.
31. In this segment, direct competition between the parties appears to be minimal. Furthermore, as recognised in *Arla/Express*, the main price constraint in the doorstep segment is provided by the potential loss of customers to alternative sources of supply, such as national multiples. Given the effective lack of material competition between the parties on the one hand, and the fact that the principal competitive constraint on either party derives from third parties (supermarkets), the transaction does not eliminate any important competitive constraint in any geographic area within the overall doorstep segment. On this basis, competition concerns are not considered to arise.

#### Middle ground

32. In *Arla/Express* the CC did not define each geographic market for a customer or group of customers. Instead it considered the alternative supply options available to customers in those parts of Great Britain where both parties held a significant share of sales and where their combined sales would be substantial. ACNielsen regions, whilst not representing a meaningful geographic market, were considered a useful 'first cut' of data to indicate where the merged entity would have a substantial share of sales and may therefore require further investigation. A similar methodology has been followed in this case. As a result, the parties provided a breakdown of their share of final milk sales post-merger.

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<sup>9</sup> In London, the overlap is limited to only 23 rounds out of a post-merger total of [in excess of 500] and in the Midland, only 25 out of [in excess of 500].



33. At a national level, the merged entity's share of final milk sales to the middle ground segment will be around [15-25] per cent in England and Wales, and significantly less in Scotland.
34. At the regional level, the Midlands is the only ACNielsen region where the merged entity's share of final sales exceeds 25 per cent. In London, Southern and Anglia the merged entity's shares of supply are greater than 20 per cent. However, the parties noted that there was no increment to Dairy Crest's share of supply in the Southern region and only a one per cent increase in the Anglia region. This might suggest that competition concerns are more likely to arise in London and the Midlands, which is also where the parties have the greatest overlap between their depot coverage. Nonetheless, given the diversity of customer behaviours and requirements, together with the scope for price discrimination, we examined the different supply options available post-merger to a range of customers across a range of locations to determine whether competition concerns arise.
35. The majority of customers who responded to the OFT's questions indicated that they did not have concerns about the merger. Responses from small and medium sized middle ground customers indicated that there was overcapacity amongst suppliers and that sufficient alternative suppliers would be present post-merger. For large middle ground customers who require significant volumes of milk delivered on a regular basis, such as Aldi and wholesalers, the parties have indicated that are generally supplied direct from the dairy. As part of the transaction, Arla is retaining those customers supplied direct from their dairies. Therefore, the competitive landscape in relation to these large customers will remain unchanged as they will be able to continue sourcing their milk from both parties post-merger.
36. However, concerns were expressed by a small number of customers who appeared to belong to a sub-segment of larger middle ground customers. Customers in this sub-segment are not supplied directly from the dairy but instead from the merged entity's depots, either through a combination of mixed doorstep and middle ground rounds, or via middle ground only wholesale rounds. In general, these customers fell in to two groups, (i) customers with a preference for national contracts, requiring regular deliveries to a large number of geographically diverse drop points ('national customers') and (ii) local education authorities procuring milk for schools. Both these customer groups exhibited some or all of the following features:

- i. require large volumes of milk;
  - ii. delivered via a large number of small drops on a regular (often daily) basis;
  - iii. specific types of containers (such as third of a pint containers for schools); and/or
  - iv. deliveries at certain times of year but not others (for example, schools only require deliveries for 39 weeks in the year).
37. A number of customers within this sub-segment expressed concerns about the lack of competition in the sector in general that did not appear to be merger specific. These customers considered that they had alternative supply options post-merger and were unconcerned by the transaction itself. However, a small minority raised merger-specific concerns indicating that they felt the parties were their only competitive sources of supply prior to the merger, and suggesting that smaller dairies/processors may not be viable alternative suppliers post-merger as they do not have the necessary volumes and/or distribution network to supply their needs. The position of each of these customer classes is considered below.

#### National customers

38. The OFT considered the alternatives available to those customers who indicated they preferred to contract on a national basis and therefore faced a limited choice of suppliers. As noted above, for those national customers who can be supplied direct from the dairy, Arla will still remain a credible supplier.
39. For those who are supplied from the depots, there was evidence that supply-side responses from a range of potential rivals to the merging parties would act to discipline Dairy Crest post-merger. These include national food wholesalers and consortia of smaller regional processors. Such consortia already exist and those we spoke to stated they were able to provide national coverage for customers by grouping a number of smaller suppliers.
40. This is supplemented by evidence that, on the demand-side, many national customers possess a degree of flexibility as to their requirements that permits them to stimulate competition from a wider range of suppliers than

simply the merged entity or the major milk processors. For example, certain customers may be able to reduce the required frequency of deliveries from daily to every second day, thereby increasing the number of suppliers who would be able to service the contract. An example is one customer, who told us that they had recently changed their delivery system from daily drops to individual stores, to having their milk delivered direct to two distribution centres operated by one of their other suppliers (who also made regular deliveries). This suggests that customers may be able to broaden the number of alternative sources of supply by developing flexible supply chain arrangements.

#### Local education authorities

41. In relation to local education authorities, the CC identified similar potential concerns in *Arla/Express* in relation to the procurement of milk for schools in Lancashire and Yorkshire. However, the CC ultimately dismissed these potential concerns as it considered that local authorities could re-organize supply arrangements to attract a wider set of potential suppliers, for example, by combining procurement and delivery of milk with the procurement and delivery of other fresh food products provided by existing wholesalers. The parties provided some examples of where local education authorities had done this. We also identified examples of local authorities reconfiguring their contracts into smaller parcels to provide opportunities for smaller dairies and wholesalers to bid for contracts.
42. The parties argued that given the CC's findings, customers have a wide range of choice of supply post-merger, including numerous processors, bottled milk buyers (BMBs), wholesalers, buying consortia, fruit and vegetable merchants, and cash and carry. They also pointed to two further sources of supply: Cool Milk At Schools which sources the supply of milk to schools on a dedicated basis across the country; and Woodward's/DBC which has a principal customer base consisting of schools and is capable of supply throughout the country.
43. However, some customer views regarding the suitability of alternative suppliers to the merged entity and the ease with which procurement practices could usefully be altered were at odds with the CC's findings. In considering these views, the OFT contacted a number of wholesalers and other alternative suppliers. While some food wholesalers indicated that providing milk was ancillary to their existing business, there were other

wholesalers who indicated that they would be willing to supply schools. There are also a number of milk consortia present in the sector who would be able to bid for school contracts. In particular, one milk consortium we spoke to confirmed that it was planning to begin bidding for school contracts in the next year.

44. Taken together, the weight of evidence gathered did not support a non-coordinated effects theory for these customers. The CC's finding in *Arla/Express* following in-depth review is squarely on point. In that case, the CC concluded that even local authorities facing a 'merger to monopoly' of historical suppliers would, by adjusting their procurement, be able to turn to other suppliers such as wholesalers who would continue to provide a sufficient constraint on the parties' behaviour post-merger. Although a small minority of local authority customers indicated that the parties may be important actual or potential bidders for their contracts, only two affected local authorities expressed concerns about this merger, and the OFT has received indications from some wholesalers that they are seeking to expand their local authorities business. The OFT therefore believes, in respect of these customers, that any lessening of competition on this basis would not be substantial.

## Conclusions

45. Overall, the evidence gathered does not support a non-coordinated effects theory. The OFT therefore concludes that there is no realistic prospect of a substantial lessening of competition on this basis.

## Coordinated effects

46. [The OFT has reached the view that there are reasonable grounds to suspect an infringement of Chapter I of the Competition Act 1998 in the milk sector in Wales and the North of England.] Although these allegations are, as yet, unproven and should therefore be treated with caution, the OFT has taken relevant facts into account in its analysis. In addition, some third parties who responded to our questions also expressed a view that suppliers in the milk sector did not seek to compete particularly strongly with one another.
47. Coordinated effects can take the form of tacit (or explicit) collusion in various respects, including pricing, tendering, customer allocation, and/or

geographic or product market sharing. Collusion may arise in circumstances where (i) market participants have the ability to align their behaviour in the market, (ii) the firms have the incentive to maintain that coordinated behaviour (including whether there is the ability to enforce that strategy through detection of cheating and a credible punishment mechanism) and (iii) the coordinated behaviour is sustainable in the face of other external competitive constraints.<sup>10</sup> However, an assessment of potential coordinated effects should not be limited to these structural elements: other factors relevant to the behaviour of the parties to the merger and, more generally, to that of all participants in any potential coordination must also be considered.

48. Notwithstanding [existing evidence of past collusion], the relevant question in a merger control context is whether the merger has resulted or may be expected to give rise to concerns relating to coordinated effects, for example by exacerbating or heightening existing concerns in this sector – for example, by making coordination more perfect, more durable or more complete.<sup>11</sup> The following sections assess both the current position as regards the susceptibility of the middle-ground segment to collusion, and the likely impact of the merger.

#### Ability to align behaviour

49. There are a number of features of the milk sector which could facilitate coordination: the product is homogeneous; the market is mature and relatively stable; and there is a degree of transparency in supplier-customer relationships. As demand for fresh milk would appear to be relatively inelastic, any increases in price are unlikely to significantly reduce demand for fresh milk. In addition, the mature nature of the market and lack of growth mean that deviation from any coordination will be less likely than if the market was growing rapidly.

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<sup>10</sup> This approach is consistent with that taken by the Court of First Instance (CFI) in its judgement in *Airtours vs. Commission* of 6<sup>th</sup> June 2002 (Case T-342/99 *Airtours v Commission* [2002] ECR II-2585, and also with the OFT substantive assessment guidelines for mergers.

<sup>11</sup> The critical question in merger analysis is that of merger effects, rather than features of the market. In the terms of section 22 of the Act, the question is whether the merger 'has *resulted*, or may be expected *to result*, in a substantial lessening of competition' (emphasis added).

50. Given the middle ground segment consists of a highly differentiated customer base with individually negotiated contracts, the market does not appear to be characterised by a strong level of price transparency as to precise wholesale prices paid by individual customers. This might well call into question market participants' ability to align their behaviour in the market. However, there may be transparency as to input and retail prices that may limit the degree of uncertainty regarding wholesale prices to within a narrow band, which may make tacit coordination on terms of price more plausible.
51. Moreover, there would appear to be reasonable transparency among suppliers as to who supplies which customer. This transparency may enable other forms of coordination, such as market sharing where customers are split on the basis of customer type and/or regions. Furthermore, dairies are often customers of one another through agency agreements. This facilitates direct communication and may therefore offer opportunities for the communication of price information.
52. For school contracts, coordination may be easier due to the predictability of demand for school milk from year to year. The areas themselves are also easily defined according to local authority boundaries which permit allocations by assignment of territories and, in many cases, the set of firms potentially submitting realistic bids is likely to be small and quite stable. Public tendering of contracts may also increase transparency.
53. A further issue relevant in terms of ability and incentive to coordinate is symmetry among market participants. Symmetry is important because if firms have a similar market share, capacity utilisation, cost structure and sell very similar products then every firm will benefit similarly from the establishment of coordination, and each will have a similar incentive to maintain coordination rather than deviate from it and suffer similarly from retaliatory action. Although symmetry between market participants may currently be limited given the diverse nature of suppliers to the middle ground (larger processors, wholesalers, cooperatives, etc), the evidence of actual coordination suggests that, at least in the North of England, any existing asymmetries may not currently be sufficient to defeat coordination from arising or having arisen.
54. Overall, therefore, it seems that from a structural perspective there are indicative factors that may facilitate the ability and incentive of middle

ground market participants to coordinate, and as noted, [the OFT has found that there are reasonable grounds to suspect past coordination in respect of the North of England and Wales.] However, as set out below, the evidence does not suggest that the transaction will materially facilitate coordination in this regard. Indeed it is arguable that it will increase the asymmetries between market participants thereby reducing their ability and incentive to coordinate.

#### Incentive to maintain coordination

55. Given the transparency of customer switching and that for each individual region/areas the number of bidders present is relatively small and stable, it would appear relatively straightforward for market participants to detect whether cheating has occurred.
56. In this case, the punishment mechanism could be simply the threat of retaliation in other markets as a result of multi-market contacts between firms across different areas and also through repeat interaction over time. This could act as sufficient disincentive to deviate from any tacit or express coordination, because the short-term and localised gains from cheating in one market would be outweighed by the losses incurred from retaliation in other markets and over time. Market participants may also have the ability to increase production and win additional customers from each other due to excess capacity.
57. Overall, therefore, it seems that there may currently be sufficient incentives present to maintain coordination. This is, in part, supported by the existing evidence of collusion in the North of England and Wales. However, as set out below, the evidence does not suggest that the transaction will make the existing position materially worse in relation to the incentives to maintain coordination.

#### Sustainability

58. Successful, sustainable coordination also presupposes that it will not be disrupted by new entry or expansion by market players who are not involved in the coordination, and/or substantial buyer power among customers. In the case of the middle ground segment at issue here, barriers to entry would not appear particularly high if entry is on a small scale. However, barriers are likely to be higher in relation to the supply of larger

middle ground customers, as the scale of entry needs to be larger. Moreover, given the profile of the relevant customers, it would be inappropriate to rely on buyer power as sufficient to disrupt attempts at supplier coordination.

59. Overall, the evidence on entry barriers is somewhat mixed. However, at least in the North of England and Wales, the [existing evidence of past] coordination may suggest that coordination is sustainable. Nonetheless, as set out below, the evidence does not suggest that the transaction will make coordination in the middle ground more sustainable.

#### Behavioural factors

60. Contemporary coordinated effects analysis relies not only on a basic structural assessment that a reduction of players in a highly concentrated market is a factor facilitating collusion, but also on the impact of the merger taking proper account of the particular incentives and behaviour of the respective merging parties post-merger compared to absent the merger. A particular focus is the likelihood that a merger will create or eliminate a 'maverick' supplier: eliminating a maverick that otherwise has disrupted or could disrupt coordination would be anti-competitive; conversely, a merger that created a maverick would be pro-competitive because it would destabilise coordination.
61. In this instance, there is no evidence to suggest that the merger will eliminate a maverick. In the overlap areas, the party (partially) exiting the middle ground as a result of merger is Arla. The relevant target assets cannot reasonably be described as having been operated by a maverick. Arla is alleged to [have been implicated, through one or more subsidiaries it acquired, in the past in cartel allegations] in respect of middle ground customers [ ]. In contrast, the OFT is aware of no allegation, nor there has been no suggestion from market participants contacted in this merger, that Dairy Crest is a participant in coordination among suppliers to middle-ground customers. Finally, it is speculative, based on the available evidence, to suggest that Dairy Crest is currently a maverick and that by acquiring the target assets it will become less of a disruptive force.
62. [Furthermore, as noted above, the evidence currently available to the OFT suggests that there may have been coordination in the middle ground in the North of England.] This coordination appears to be regional rather than



national and, in England, there is no evidence of wide-spread coordination in the middle ground outside the North of England.

#### Impact of the transaction

63. Together the factors outlined above would tend to suggest that the middle ground is currently susceptible to coordination [ ]. Notwithstanding the general susceptibility of the milk sector to coordination in respect of the middle ground customers, the critical question in this context is whether the situation will be made worse as a result of the transaction.
64. After careful scrutiny, the OFT has concluded that, for the reasons set out below, any posited coordination enhancing effects as a result of the merger are, in this case, speculative:
- In this case, the merged entity's overlaps in supplying middle ground customers are confined principally to the Midlands and the London areas. The OFT considers it unduly speculative to suggest that merger effects may arise in non-overlap areas, such as the North of England, in particular because there is no evidence to suggest that Dairy Crest was an important potential entrant that threatened to destabilise any coordination that might prevail absent the merger.
  - In respect of overlap areas, the OFT currently has no evidence of wide-spread collusion. As set out above, such evidence is limited to the North of England and Wales.
  - Moreover, for the reasons described in relation to non-coordinated effects above, in overlap areas the merger would not materially reduce the number of credible suppliers available to the vast majority of middle ground customers. This is the case for small and medium customers as well as the majority of larger customers including national customers.
  - For the small number of local education authority customers for whom the reduction in the number of supply options -- and therefore the increase in coordination risk -- might be material, it is arguable that the merger will have the effect of increasing asymmetries between market participants, which as noted above are already significant. Arla will exit the direct supply of milk to some local authority customers in overlap areas. It will, however, remain a potential indirect source of milk

supplies to such customers. Arguably, this will increase the asymmetries between market participants and thereby reduce their ability and incentive to coordinate.

- Further, as indicated above, there is no evidence to suggest that the merger will eliminate a maverick. [Indeed, it may be arguable that the transaction reduces the risk of coordination to the extent that it replaces a market participant against whom there is evidence of collusion in the middle ground in the past (Arla, through one or more subsidiaries it acquired) with one against whom there is currently no such evidence (Dairy Crest).] In this regard, the effect of the transaction in relation to the risk of coordination will, at worst, be neutral.

65. Overall, therefore, the OFT does not believe that the transfer of the target assets to Dairy Crest has or may be expected to facilitate or strengthen more perfect, durable or complete coordination. As such, the OFT does not believe there is a realistic prospect that the merger will substantially lessen competition in this regard.

## **VERTICAL AND MONOPSONY ISSUES**

66. No third parties raised any vertical concerns. The OFT considered whether the merged entity could raise the fresh milk supply price to downstream rivals (such as BMBs and wholesalers) to render them uncompetitive with its own downstream activities. The parties rejected such a proposition as being at variance with their incentives to maximise processing capacity utilisation rates. They indicate that due to the high volume requirements of BMBs and wholesalers they have a range of supply options (including the other major processors) across a broad geographic scope, and that downstream rivals would respond to any attempted worsening of supply terms by switching to alternative suppliers. In this case, Arla will also remain as a significant supplier of fresh processed milk to wholesalers, food service operators and symbol groups.

67. As noted earlier the parties also overlap in the procurement of raw milk. Previous OFT decisions<sup>12</sup> and the CC report in *Arla/Express* have concluded that the appropriate frame of reference is the supply of raw cows' milk in

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<sup>12</sup> See for example OFT decision of 7 April 2005 on the completed acquisition by First Milk Limited of a 15 per cent stake in Robert Wiseman Dairies plc.

Great Britain. Post-merger, the merged entity will account for [20-30] per cent (increment [less than 5] per cent) of all raw cows' milk purchases in Great Britain. The parties also submitted that the merger would not reduce the number of competing purchasers of raw milk, as Arla will continue to purchase raw cows' milk to supply its remaining customers. Given the relatively small increment, the merger does not significantly increase the merged entity's purchasing power.

68. On this basis, the merger is not considered to give rise to any vertical concerns.

### **THIRD PARTY VIEWS**

69. In addition to issuing a public invitation to comment, the OFT also contacted a large number of different customers and competitors during the course of its investigation. Of those contacted, approximately a quarter responded, with the majority indicating that they were unconcerned by the transaction. However, a small number did raise concerns regarding the number of supply options available post-merger. These concerns have been evaluated above. A number of respondents also raise general concerns regarding competition in the sector which were not specific to the merger.
70. DEFRA considered that the merger would not give rise to concerns in the doorstep segment due to the lack of competition between the parties and the availability of alternative sources of supply, such as supermarkets. In respect of the middle ground DEFRA felt that despite the merged entity's somewhat high share of final sales in the Midlands, the market will still remain competitive as result of the buyer power held by larger middle ground customers; the number of alternative suppliers for smaller customers; the increasing growth of Wiseman in the segment; low barriers to entry; and Arla's ability to continue supplying wholesalers and retail chains.

### **ASSESSMENT**

71. There is minimal overlap between the parties' doorstep activities and this segment will continue to face competition from other market segments such as the national multiples. No competition concerns are therefore considered to arise in the doorstep segment.

72. With respect to middle ground customers, small middle ground customers will still enjoy the benefit of a range of different suppliers, including wholesalers, buying groups and smaller dairies. Large middle ground customers who are supplied direct from the dairy (as opposed to depots) will still be able to source their fresh milk from both the parties as Arla will continue to be present in this sub-segment.
73. A small number of customers expressed concerns that the merger would reduce the number of suppliers able to bid for their contracts post-merger. These customers tended to require large volumes, delivered from depots in small drops on a daily basis. However, consistent with the CC's findings in *Arla/Express*, the OFT believes that wholesalers provide and will continue to provide a sufficient constraint on the merged entity's behaviour post-merger. For those customers with a preference for a national contract, the weight of evidence available suggest that there are credible alternative supply options available in the form of the other large processors and milk consortia.
74. We also considered the possibility that the merger would strengthen or facilitate more perfect, durable or complete coordination. While the milk sector does appear to be susceptible to coordination, it is in the OFT's judgment unduly speculative, on the evidence available, to conclude that the merger itself has or may be expected to significantly strengthen or increase the degree, durability or scale of coordination.
75. 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**

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