OFFICE OF FAIR TRADING

Anticipated acquisition by HJ Heinz of HP Foods Group

The OFT's decision on reference under section 22 (1) given on 26 October 2005. Full text of decision published 8 November 2005.

Please note square brackets indicate information excised or replaced by a range at the request of the merging parties or third parties for reasons of commercial confidentiality

PARTIES

1. **HJ Heinz Company (Heinz)** is a US-based company with global operations in the branded foods sector; its shares are quoted on the New York Stock Exchange. Heinz's UK activities include the manufacture and marketing of sauces and condiments, frozen foods, soups, beans and pasta, infant foods and seafood.

2. **HP Foods Limited, HP Foods Holdings Limited and HP Foods International Limited (HP)** are companies which, prior to the transaction, were ultimately owned by Groupe Danone SA (Danone), a company incorporated in France. HP's principal UK activities include the manufacture and marketing of sauces and condiments, herbs, spices and seasonings, food oils and dry side dishes. HP's UK turnover for the year ended 31 December 2004 was around [ ].

TRANSACTION

3. On 16 August 2005, Heinz acquired the entire issued share capital of HP from Danone. The administrative deadline in this case expires on 26 October 2005.

JURISDICTION

4. As a result of this transaction Heinz and HP have ceased to be distinct. The UK turnover of HP 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 the case that a relevant merger situation has been created.

RELEVANT MARKET

5. The activities of the parties overlap in the UK supply of the following table sauces: (i) tomato ketchup; (ii) brown sauce (to food service customers only); and (iii) barbecue sauce (together referred to as the overlap sauces).

6. Danone/HP currently licences the HP brand to Premier Foods plc (Premier) and Premier manufactures and markets tinned baked bean and pasta products under the HP brand name. The 10-year licence agreement was part of the sale of HP's baked bean business to Premier; the current licence is due to expire in [ ] 2006.

7. Both parties also supply some pickle and chutney products in the UK. Since the activities of the parties in this segment are relatively insignificant[1], the competitive effect of the transaction in this segment has not been considered in any detail.

Product market

8. Two general issues posed by this case are (i) segmentation of the market by customer category (i.e. retail customers and food service customers) and (ii) whether branded and own label (e.g. supermarket-branded) goods are sufficiently close substitutes for the purpose of product market definition, and/or whether own label suppliers/products provide an effective constraint on the merged entity.

Food service sector and retail sector

9. In Unilever/Bestfoods, the European Commission distinguished between the supply of sauces to two categories of customer: the retail sector and the food service (catering) sector. The parties submit that, based on the differences in distribution channels, pack sizes, service levels and health and safety factors, this distinction is correct, in respect of supply of sauces as well as tinned baked beans and pasta products. Previous OFT decisions on food sector mergers have reached a similar conclusion.[2]

10. In this case, on the supply side, a supplier to the food service sector could begin to supply the retail sector, with some investment in packaging – although there may be quality differences to overcome. On the demand side, however, there is little evidence that many customers would be able to switch their custom

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[1] In a market comprising pickles, relishes and chutneys, the parties have estimated that their combined share of supply by value (year end July 2005) is around [0-10] per cent (increment [0-5] per cent).

[2] See for example OFT merger decision on the anticipated acquisition by Bakkavor Group Hf of Geest plc, 28 April 2005.

between retail and food services suppliers. The supply to retail and food service customers will therefore be considered separately. Issues mainly arise in, and the competitive analysis focuses on, supply of overlap products to the retail sector.

Branded and own label products

11. This transaction involves the merger of two, previously independent, suppliers of various branded products. The parties submit that the branded products at issue form part of the same product market as the equivalent own label products.

12. Competition in the supply of products under consideration is a linked, two-stage process. Suppliers of branded goods compete with each other for supermarket shelf space; they may also compete for shelf space with the supermarkets' own label products. Secondly, having obtained a position on the shelves, products compete for a share of supply to consumers. Competition at both stages is likely to be influenced by consumer preferences, which in turn will be influenced by the brand strength of the products in question (including the strength of the own label brand). Supermarkets' margins on own label products are often higher than their margins on branded products; achieving optimal margin mix will therefore also influence a retailer's negotiations. Product differentiation, both of branded and own label ranges, will also play a role.

13. In relation to the UK retail condiments and sauces sector, Key Note market research entitled Supermarket Own Labels notes that own label products are competing against some of the most established and heavily supported brands in a number of segments, including Heinz in tomato ketchup. The Key Note research also notes generally that the strength of certain brands is an important factor curtailing own-label growth. [3]

14. Consumer brand loyalty is a general theme throughout the internal documents submitted by the parties. If a brand is out of stock, many consumers will visit another shop or postpone their purchase, but would rarely purchase another brand.[4] Internal research carried out by the parties suggests that consumers of branded product have negative feelings about own label sauces, although the document notes that the sample may be biased.[5]

15. The parties commissioned an econometric study from LECG; this is discussed in more detail below. The results of the study indicated that consumers have a strong preference for branded products.[6] LECG submits that this only holds if the

[3] Supermarket Own Labels, Market Assessment Report 2003, Key Note (p.12, p.36).
[4] PDH Shopper behaviour in the sauce category.
[5] Project Guy Fawkes – Research debrief, 5 July 2005.
[6] The study found a strong negative coefficient on the own label dummy variable.

products are sold at the same price but in practice the (often significant) price differential between branded and own label compensates for this preference.

16. On the supply side, it appears that the cost of entering the supply of branded sauces may be prohibitive for an own label supplier. This is due to the fact that considerable advertising expenditure would be required to establish a brand (see further below).

17. In this case, customers of the merging parties expressed mixed views on the issue. Two of the national multiples do not believe that own label sauces constrain branded sauces. One noted that some constraint is exerted, although some branded sauces have increased in price, while the price of own label sauce has fallen. Another suggested that own label acts as a constraint and follows a similar price pattern to branded sauces. Competitors of the merging parties (many of which produce own label) have stated that own label products do act as a constraint to some extent.

18. To conclude, there is mixed evidence as to the extent of the constraint on branded products that is provided by own label. Customers suggest that own label may not be a strong constraint, although competitors generally believe that it is. Internal documents suggest that many consumers have a preference for a particular brand. It appears that the constraint exerted by own label products is likely to vary across products and sectors, depending on the strength of the incumbent brands and other factors influencing negotiations between suppliers of branded products and own label suppliers.

Characteristics of the overlap sauces

19. In terms of their general characteristics and usage patterns, the overlap sauces can be described as thick, cold, table sauces. By this we mean that the consistency of the sauces is thick rather than thin (such as Tabasco or Worcestershire sauce); they are consumed cold rather than heated (such as pasta sauce) and they are generally used to add flavour to food after the meal has been served (as opposed to being added to food as an ingredient while the meal is being prepared). The sauces are also suitable for adding flavour to a range of different host foods, as opposed to being traditionally associated with one particular type of food (examples of dish-specific sauces are mint sauce, apple sauce and horseradish sauce).

20. This merger principally involves the combination of various branded sauces supplied to retail customers, as summarized below (leading brands in bold):

Sauce type	Heinz brands	Acquired brands
Tomato ketchup	**Heinz**	Daddies
Brown sauce	-	**HP** Daddies
Barbecue sauce	**Heinz**	**HP**

21. There are a number of frames of reference that could, conceivably, provide a suitable focus for the competitive analysis of this case, ranging from a single type of branded sauce to a wide range of branded and own label sauces. The parties have argued that appropriate frames of reference are (i) tomato ketchup, (ii) brown sauce and (iii) a wider product category comprising barbecue sauce and all other cold sauces (but excluding tomato ketchup and brown sauce). This segmentation is based on the approach adopted by the European Commission in Unilever/Bestfoods[7] and the econometric study commissioned from LECG for the purpose of this investigation, which is considered below.

Parties' econometric evidence

22. Using IRI data from the sales of cold sauces over the past three years (on a four-weekly basis), LECG considered whether any of the sauces produced by the parties constituted a distinct product category from 'other cold sauces'.

23. The LECG analysis[8] found that tomato ketchup, brown sauce and thick chilli sauce each form separate markets from the other cold sauces. However, some of the assumptions made in analysis, together with evidence from internal documents provided by the parties, lead to the conclusion that the analysis does not provide a definitive answer to the issue of market definition.[9] In particular, the OFT believes that the reliability of analysis could have been affected by a number of issues. These are discussed below.

24. The model is limited in the range of substitution patterns it allows. For example, the model imposes the assumption that substitutability between own label products and branded goods is proportional to their respective volume share of

[7] Decision of the European Commission of 28 September 2000, Unilever/Bestfood (COMP/M.1990).

[8] LECG estimated the degree of substitution between different cold sauces using a nested logit demand estimation model. This model extends the standard logit model of consumer demand by grouping products into nests. Products within a nest are assumed to compete more closely with each other than with products outside the nest.

[9] Ignoring any reservations, the model appears to indicate that tomato ketchup is a constraint on barbecue sauce.

sales, but this assumption is not tested. In addition, the introduction of new products during the time period, the selection of instruments[10] and the choice of serving size in the model may also lead to inaccurate results.[11]

25. The study did not cross-check whether the prices, elasticities and assumed marginal costs were consistent with pre-merger profit maximisation. The results appear to imply that substantial pre-merger price increases (and decreases) would be profitable for certain products, which raises some questions as to the accuracy of the estimates, since it would be profit-maximising to increase prices when it is possible to do so.

26. The model places the parties' sauces in separate 'nests'; this initial grouping of products into nests is a critical part of the analysis, but no alternative nests were tested and no alternative models were used. The parties said they had considered other models but viewed the one they used to be the most appropriate. Finally, the marginal cost data used in carrying out the hypothetical monopolist test involved a number of assumptions that may have affected accuracy.

27. The reliability of the study was also considered in light of commercial realities as portrayed in the internal documents submitted by the parties. In our view, the contemporaneous business documents available to the OFT in this case are likely to provide a more accurate reflection of the way in which those within the parties' businesses that are responsible for sales and marketing situate the overlap sauce products, both in terms of customer and consumer demand and as against competitor products. There was considerable evidence in the internal documents that the way the merging parties view the product categories in question does not wholly correspond to the assumptions on which the LECG study is based; moreover, the conclusions drawn from the analysis are not supported by evidence in the business documents. This also raises concerns about the reliability of the econometric analysis.

28. Evidence from internal documents submitted by the parties informs the OFT's further consideration of product market definition, which is described in relation to each sauce segment below.

[10] LECG undertook the analysis using instrumental variables; it is not clear that the choice of instruments was optimal and this could lead to bias in the results.
[11] LECG assumed that consumers base their purchase decision on price per serving rather than per 100g. The serving size estimates used vary greatly between sauces and different sources give different estimates for serving sizes.

Geographic market

29. Geographic market definition is not a contested issue in this case. The appropriate geographic frame of reference in this case is the UK since the major customers of the parties operate on a national basis. This is in line with previous OFT decisions on consumer food products and no evidence in this case suggests a different conclusion.

SUBSTANTIVE ASSESSMENT

30. We consider below the impact of the merger in terms of the pairing of a Heinz-branded sauce with the acquired brand(s). The issue of which other products are included in the relevant frame of reference, to the extent not already covered, is addressed as a preliminary matter.

Heinz and Daddies (HP) tomato ketchup

31. In Unilever/Bestfoods, the Commission stated that the market test in that case had confirmed that ketchup constitutes a separate market from the other categories of cold sauces. Heinz internal documents indicate that it considers ketchup separately from other sauces, and also underscore the tremendous 'pull' of the Heinz tomato ketchup brand, as reflected in retailers' low margins, the volume of sales, and advertising spend. For the purpose of this discussion, the supply of all tomato ketchup is adopted as a relevant frame of reference.

32. Heinz and HP, via the Daddies brand, are practically the only two suppliers of branded tomato ketchup in the UK; shares of supply for branded and own label tomato ketchup are set out in Table 1.

Table 1: Shares of supply of tomato ketchup in 2005 (by value)

Company	**% Share**
Heinz	[70-80]
HP (Daddies brand)	[0-10]
Combined	*[ ]*
Own label	[10-20]
Others	[0-5]

Source: IRI sales date provided by the parties

33. The shares indicate that Heinz is by far the largest supplier of tomato ketchup in the UK, but the increment resulting from the transaction is small. In order to assess whether competition concerns are likely to arise from the horizontal overlap we have assessed whether: (i) Daddies imposes important price or innovation pressure on Heinz in tomato ketchup, and vice versa, and (ii) whether own label products constrain the price of branded products.

Price competition

34. In the UK, the parties supply tomato ketchup in both glass and plastic bottles in various sizes. Heinz also offers 'top down' bottles, 'easy squirt' and organic tomato ketchup. The product is therefore differentiated. According to the parties, the price per kilo ranges from around [ ] to [ ]. Only a small range of Heinz tomato ketchup products is priced within 20 per cent of the Daddies range.

35. In view of the small share of supply attributable to Daddies tomato ketchup, and the retailer perception that Heinz tomato ketchup is a 'must stock' product, it is unlikely that Daddies constrains Heinz tomato ketchup in terms of price. Responses from customers support this conclusion.

36. Due to the asymmetric shares of supply, it is more likely that prices of HP/Daddies tomato ketchup are constrained by those of Heinz tomato ketchup than vice versa. Heinz's category audit for the financial year 2004 confirms that Daddies has lost volume to Heinz: buyers of Daddies tomato ketchup switched mainly to Heinz tomato ketchup. Therefore the merger is likely to result in a substantial lessening of competition by removing the competitive constraint exercised by Heinz tomato ketchup on HP/Daddies.

Innovation competition

37. Currently the parties do not appear to compete closely on innovation. According to the parties, HP/Daddies has not significantly innovated its tomato ketchup range in the past five years; innovation by Heinz is driven by consumer preferences in the USA and Europe.

Raising barriers to entry

38. In our view, the acquisition of the Daddies brand could have the effect of raising barriers to entry (see further below). Before the merger, it might have been a viable strategy for a new entrant into the branded ketchup segment to target Daddies ketchup. Post-merger, any new entrant into the segment would have to compete with Heinz, who would have a proportionately greater incentive to deter new entry.

Own label constraints

39. Most of the national multiples offer a differentiated range of own label ketchup products (premium, mid-range, budget). According to consumer research carried out for Heinz, some consumers are willing to accept own label as a substitute. Another report prepared for Heinz suggests that many consumers are willing to pay a high premium (on average [ ] per cent more) for the brand because it is 'perceived to be better' and because of the low frequency of purchase.

40. As noted above, Heinz's category audit for the financial year 2004 confirms that Daddies has lost volume to Heinz: approximately three quarters of buyers of Daddies tomato ketchup switched to Heinz tomato ketchup; the remaining one quarter switched to own label tomato ketchup.

Third party responses

41. Three of the national multiples have raised concerns about the loss of the only branded competitor to Heinz tomato ketchup; they believe that their negotiation position will be weakened as a result of the acquisition. However, it should be noted that there appear to have been few, if any, occasions on which national multiples have threatened to switch a proportion of their business from Heinz to Daddies. A further concern raised by third parties is that Heinz will remove the Daddies brand and, since most Daddies consumers would switch to a (more expensive) Heinz product (not to own label), additional shelf space would be dedicated to Heinz, thereby further increasing its presence.

Conclusion

42. The extent to which the HP Daddies brand constrains Heinz tomato ketchup may be limited; the constraint exercised by Heinz on Daddies is likely to be more significant. Moreover, there is insufficient evidence to support the view that own-label ketchup suppliers would constrain the merged entity.

43. The merger may therefore result in a substantial lessening of competition in supply of tomato ketchup in the UK, resulting in reduced choice and innovation and higher prices for retail customers and, ultimately, consumers.

Heinz Tomato Ketchup and HP Brown Sauce

44. HP has two brands of brown sauce: HP and Daddies, which it supplies to the retail and food service sectors; [a significant percentage] of HP's total share of the brown sauce market is attributable to HP branded brown sauce. Heinz does not supply brown sauce to the retail sector, therefore there is no overlap in this area.

The remainder of this section therefore focuses on the competitive interaction between brown sauce and tomato ketchup.

45. The issue of market definition and competitive assessment are not usefully segregated in this analysis. Neither brown sauce as such nor the interaction between Heinz tomato ketchup and HP brown sauces was specifically considered in the Unilever/Bestfoods case. From the perspective of retailers, Heinz tomato ketchup and HP Brown sauces are two must-stock items, and might best be viewed as complements. Certainly there is no evidence available to us that supermarkets played off Heinz tomato ketchup and HP brown sauce in negotiations with the parties.

46. Consumer preference and the degree to which these two branded sauces constrain one another in terms of price and other dimensions of competition is likely to be decisive in determining the competitive effect of the transaction in this segment. The parties argue that the fact that many consumers have a strong preference for either ketchup or brown sauce, and the different consumer demographics of the two products, point to them forming distinct product categories.

47. While some third parties contacted by the OFT in this investigation confirmed that many consumers do have a strong preference for one of the two sauces, others stated that tomato ketchup and brown sauce compete for marginal consumers. Most importantly, internal documents supplied by the parties suggest that Heinz tomato ketchup may impose a material constraint on HP sauce.

48. A two-year tracking study for HP specifically considers the relationship between Heinz tomato ketchup and HP brown, including brand awareness, purchasing patterns, brand image, usage and popularity.[12] As far as we are aware, Heinz tomato ketchup is the only sauce product which HP tracked against its brown sauce.

49. There was evidence of high levels of switching to tomato ketchup following introduction of a 285 g plastic bottle of HP brown sauce to replace a 255 g glass bottle of the same sauce. Research for HP by AC Nielsen on the impact of the withdrawal of the 255g glass bottle resulted in significant losses to various sizes of Heinz tomato ketchup in plastic bottles. In summary, the research noted that 'the most significant competitive loss is to Heinz tomato ketchup (570g top-down), and that this was a theme seen across the HP brown sauce range'. [13]

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[12] Research Craft *Sauces Tracking Study presentation*.

[13] Presentation to HP on Understanding the impact on the HP sauce consumer base after the introduction of 285g plastic variant.

50. Conversely, there is little evidence of HP brown sauces imposing an important constraint on Heinz tomato ketchup. As such, it does not appear appropriate to consider a candidate relevant market that encompasses both ketchup and brown sauces. The relevant question is whether a 'monopoly' supplier of both Heinz tomato ketchup and HP brown sauces could profitably raise price by a small but significant amount. The evidence suggests that this is true in relation to HP brown sauce. While pre-merger a price rise by HP would have led to substantial sales losses to Heinz tomato ketchup, which is likely to have made it unprofitable, evidence suggests that post-merger Heinz may recoup a substantial proportion of lost sales in the form of increased Heinz tomato ketchup sales, thereby potentially making such a price rise profitable.

51. Apart from the competitive constraint imposed on HP brown sauce by Heinz tomato ketchup, it is also relevant to note that Heinz was, prior to the merger, a credible entrant into the brown sauce segment. Heinz is particularly well placed to enter this segment because it already has a brown sauce offering in the food service sector; it also has an established reputation in tomato ketchup, and perceived expertise in the sauce sector. A Heinz retail customer confirmed this view. [ ].

52. In Heinz's view it is indeed a credible entrant, and it has in the past regularly considered the possibility of entry into the brown sauce segment. However, Heinz denies that entry was in any way imminent. It is possible that the decision not to enter is based partly on a perceived risk of significant cannibalisation by any new brown sauce product of sales of Heinz tomato ketchup. Heinz also stated that in taking a decision to enter the brown sauce segment it would take into account HP's reaction; such a reaction could – in their opinion – consist of retaliation by HP in the tomato ketchup segment.

53. The HP document referred to in paragraph 49 above indicates that there is a relatively low level of switching to/from own label brown sauce. Third parties and customers provided mixed evidence on the constraint exercised by own label on branded product. There is therefore insufficient evidence to allow us to conclude that own label products act as a constraint on the merged entity. On the basis that Heinz tomato ketchup imposes a material constraint on HP sauce, there is a realistic prospect that the merged entity will be able to profitably raise the price of brown sauce post-merger, resulting in a substantial lessening of competition.

Heinz barbecue sauce and HP barbecue sauce

54. Heinz and HP are the two leading UK suppliers of branded barbecue sauce. A number of customers raised concerns about consolidation in this segment, noting that there were some smaller suppliers of barbecue sauce, but that none could offer the range and branding available from the merging parties.

55. The parties, however, argue that barbecue sauce is part of a wider 'other cold sauces' sector. In support of this proposition they cite the Unilever/Bestfoods decision. However, this decision also noted that there was considerable variation in tastes between countries, so the precedent value of this decision in the UK context may be of limited.

56. The results of the econometric modelling carried out by LECG imply that barbecue sauce does not constitute a distinct product market, but the model does not show that barbecue sauce is constrained by *all* other cold sauces. OFT concerns relating to the reliability of the results of the LECG econometric modelling have been outlined above.

57. In contrast, however, it is clear from the internal business documents submitted by the parties, and from responses received from customers, that Heinz and HP are each other's closest competitors in barbecue sauce and that they compete strongly against each other in this segment. There is also evidence from Heinz's business documents that it views barbecue sauce as a separate category when undertaking annual category audits. Importantly, the category audit for the financial year 2005 notes that only [ ] per cent of volume gains in barbecue sales are from other thick and thin sauces; the remainder of volume gains are within the barbecue category.

58. In light of this it is appropriate for us to consider the impact of the merger on competition in barbecue sauce.

59. The table below shows that the combined share of supply of barbecue sauce is [more than 60] per cent, with an increment of [20-25] per cent.

Table 3: Shares of supply of barbecue in 2005 (by value)
Source: IRI sales data provided by the parties

Company	% Share
Danone (HP and Daddies)	[40-50]
Heinz	[20-30]
Combined	*[ ]*
Own label	[10-20]
Others	[10-20]

60. Internal documents submitted by the parties show that Heinz and HP compete closely in this market. Competition between the two leading brands would be lost following the merger. There is insufficient evidence that own label is capable of providing an effective competitive constraint post merger, in particular in view of the low penetration level of own label in this segment and the importance of innovation, which is unlikely to be led by own label. Similarly, competition from other brands of barbecue sauce is limited; this is supported by the parties' internal documents and responses from third parties.

61. We therefore conclude that the merger may lead to a substantial lessening of competition in the market for supply of barbecue sauce to retail customers resulting in reduced choice and innovation and higher prices for retail customers and, ultimately, consumers.

Tinned baked beans and pasta products

62. For the purpose of product market definition, we did not receive strong evidence as to whether it would be more appropriate to consider tinned baked beans and tinned pasta products separately or together. Since the outcome of the analysis is not substantially different whichever frame of reference is considered, there is no need to conclude on this point.

63. As mentioned above, the HP brand is currently licensed to Premier Foods. The licence entitles Premier to supply tinned baked beans and pasta products under the HP brand until [ ] 2006. Heinz indicated that it will not renew the licensing arrangement. [*third party excision*]. Heinz noted that absent the merger Danone (HP's parent company) may not have renewed the licence, but no documentary evidence was provided in support of this view. In light of this the counterfactual against which the merger is assessed is the continuation of the licensing arrangement. We note that once the sale of the HP business to Heinz was announced, incentives for Premier Foods to continue to market HP beans were reduced.

64. Shares of supply in the tinned baked beans segment are set out below. Shares of supply in tinned pasta products are similar.

Table 4: Shares of supply of baked beans in 2005 (by value)

Company	% Share
Heinz	[more than 50]
Premier Foods HP branded only	[0-10]
Combined Heinz and HP branded	*[ ]*
Premier Foods non-HP branded - Crosse & Blackwell - Branston	[0-10]
Own label (90 per cent produced by Premier)	[20-30]
Waistline	[0-2]

Source: IRI data provided by Premier Foods

65. Following the merger, the combined entity will have a strong incentive to either bring production of HP branded products in-house, or to withdraw the brand from the market altogether. Heinz's internal business documents note that HP branded beans are the number two beans brand [ ]. Responses from some customers indicate that they do use HP branded beans as a bargaining tool. Post-merger Heinz documents discuss the possibility of a price increase following the transaction. [ ].

66. The parties have argued that Premier has other strong brands that compete with them in the tinned baked beans and pasta products segments. In particular Premier has branded some of their products with the Crosse & Blackwell brand. [ ].

67. Heinz has also examined the possible impact of the launch of Branston beans by Premier.[14] The launch of Branston beans appears to be a reaction by Premier to the anticipated loss of the HP brand following the merger. There is currently insufficient evidence for the OFT to conclude that Branston branded beans will be able to successfully compete with Heinz in the baked beans market following the merger.

68. In tinned baked beans and pasta products own label appears to act as a competitive constraint, although it is not clear to what extent. Internal documents submitted by the parties show that switching away from Heinz was mainly to own label and that loyalty to own label was increasing.

69. A number of third parties have raised concerns about the effect of the merger in this segment.

[14] It is understood that Premier owns the Branston brand.

70. In conclusion, we do not have sufficient evidence to conclude with the required degree of certainty that absent the merger HP branded beans would have been discontinued by Danone. Heinz and HP are the two leading tinned baked bean and pasta brands and bringing the two brands under common ownership is likely to lessen competition significantly. While Premier manufactures and supplies two other brands of baked beans (Crosse & Blackwell and Branston), evidence suggests that these brand names may not compete as strongly with Heinz as HP does.

Supply to the food service sector

71. The parties supply a range of food service customers, such as pub and restaurant chains, fast food outlets, cash and carry operators and wholesale distributors. Overlaps are the same as in the retail sector, but there is an additional overlap in the supply of brown sauce to the food service sector.

72. The food service sector is described by the parties as a 'bidding market', where negotiations are driven by price. Customers in this sector have not raised any concerns about the merger. Customer responses indicate that own label acts as a stronger constraint in the food service sector than in the retail sector. One large pub chain noted that McCormick, Welcome Food Ingredients, Griffiths Laboratories and Alembic products compete with Heinz and HP. This customer's branded restaurants currently use branded sauces/condiments for front of house use. This would be reviewed, however, if prices increased. Unbranded sauces/condiments are already purchased for back-of-house use in some of its establishments.

73. Of the competitors that responded, only one was concerned about the effect of the merger.

74. Our analysis of the merger has concentrated on retail customers, since this is where shares of supply are highest and the competitive constraint exercised by own-label is likely to be less significant. Responses from both customers and competitors suggest that the merger will not lead to a significant lessening of competition in supply of sauce and tinned baked bean and pasta products to the food service sector.

Barriers to entry and expansion

Sauces

75. Competitors of the parties who responded to our inquiries stated that the technical cost of entry would be in the region of £100,000. Food service suppliers

could enter at a similar cost in two to three months, after investment in appropriately sized packaging.[15] This assumes that a firm has existing manufacturing and packaging capacity. Entry into own label sauces would not incur significant additional costs (although suppliers would have to be able to compete on cost and gain a commitment from a national multiple). However, entry into branded sauces would be very much more costly, due to the existing strength of the Heinz and HP brands.

76. Any new entrant to a branded product segment who does not enjoy the strength of an existing major brand would have to compete with the strength and resources of the combined entity. As noted by the EC Commission in Kimberley Clark/Scott[16], advertising spend and market share are self reinforcing. There is a virtuous circle where high market share allows high profitability to engage in sustained advertising to support the brand. On the other hand there is a vicious circle where low market share means low profits and inadequate resources to implement the necessary advertising campaign to boost sales.

77. The parties have pointed out that Unilever launched four Hellmann's sauces in September 2003. Own label brown sauces were launched by Kwiksave in 2003 and Morrisons in 2004. The parties have not been able to indicate how new entry has affected prices, but submit that they would normally respond through innovation.

78. Customers and competitors of the parties have both stated that new entry into retail supply of branded sauces is unlikely; we therefore conclude that new entry is unlikely to act as a competitive constraint on the merged entity. Entry into the food services sector seems more likely to act as a competitive constraint because brand image may be less important for certain food service customers in respect of certain uses.

Beans and pasta products

79. Barriers to entry into the supply of tinned baked beans and pasta products are similar to those in sauces. We do not have information on the set-up costs, but have seen evidence that entry into branded beans is difficult.

[15] Competitors were unaware of specific examples of this happening, although one competitor said they would consider such entry, but noted that lack of suitable facilities may be an issue.
[16] Decision of the European Commission under Article 8(2) in Kimberley-Clark/Scott, 16 January 1996, Case IV/M.623.

Buyer power

80. In the retail sector, [more than 80] per cent of Heinz's sales are made to the 'big four' national multiple supermarket chains. The parties submit that negotiations are price-driven, and that their retail customers are able to exercise significant countervailing buyer power. Previous OFT merger decisions that considered the supply of consumer foods to national multiples have noted that the national multiples possess buyer power. However, when sourcing goods with strong branding, this buyer power may be weaker.

81. The parties submit that there is a real threat of de-listing, pointing to the fact that a major supermarket recently de-listed [a Heinz product line]. It is also suggested that national multiples could place Heinz products in a less visible position on the shelves. However, customer responses suggest that Heinz and HP sauces are both 'must-stock' products and that de-listing is therefore not an option. Furthermore, no retail customer has suggested that they would seek to punish Heinz in other sectors in response to a price increase in sauce or beans.

82. Three of the national multiples that responded believe that their negotiation position would be weakened following the transaction. This is due to the increased shelf space that Heinz will command once HP has been acquired. A competitor also raised this concern, on the basis that smaller suppliers will be even less able to compete with the larger group. No customers have suggested that the merged entity may attempt to tie or bundle its products/brands.

83. Given the strength of the brands under consideration, countervailing buyer power may not act as a sufficiently strong constraint on the parties post-merger.

VERTICAL ISSUES

84. The merger does not give rise to vertical competition issues.

THIRD PARTY VIEWS

85. Third party views have been referenced in the relevant sections of the economic assessment.

ASSESSMENT

86. Heinz and HP both supply branded tomato ketchup, branded barbecue sauce and branded tinned baked beans and pasta products to retail customers in the UK; there is no overlap in the supply to retail customers of branded brown sauce,

since Heinz only supplies brown sauce to food service customers.

87. Supermarkets are active in the supply of own label products in respect of each of the product overlaps. However, there is mixed evidence whether, and if so how and to what extent, supermarket own-label products constrain suppliers of branded products, in particular where the brands in question are well-known and supported by significant television advertising campaigns.

88. The merger reduces the number of suppliers of branded ketchup to retail customers from two to one. However, the constraint exercised by HP/Daddies ketchup on Heinz tomato ketchup is likely to be limited, both in terms of price and innovation; conversely, evidence suggests that Heinz does constrain HP/Daddies. It does not appear that own label tomato ketchup would provide a sufficient constraint on the price of Daddies tomato ketchup post merger. This merger may therefore result in a substantial lessening of competition in supply of tomato ketchup to retail customers.

89. In light of the evidence available to us, we are of the view that Heinz tomato ketchup imposes a material constraint on HP brown sauce. There is little evidence that the reverse is also the case. Moreover, it is relevant to note that prior to the acquisition, Heinz was a credible entrant into the brown sauce segment. In our view the merger eliminates the competitive constraint imposed by Heinz on HP in the brown sauce segment; this may result in a substantial lessening of competition.

90. The parties are the leading suppliers of branded barbecue sauce to retail customers; the merger gives rise to a combined share of supply of [more than 60] per cent in this segment (increment [20-30] per cent). There is insufficient evidence that own label is capable of providing an effective competitive constraint post merger; the merger may therefore lead to a substantial lessening of competition in this segment.

91. Heinz and HP are the two leading tinned baked bean and pasta products brands, with a combined share of supply of around [more than 60] per cent; bringing the two brands under common ownership may lead to a substantial lessening of competition, although own label may provide some competitive constraint on the merged entity.

UNDERTAKINGS IN LIEU

92. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from the parties concerned such undertakings as it considers

appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition (SLC) concerned or any adverse effect which has or may result from it.

93. The OFT's guidance on undertakings in lieu of reference state that undertakings in lieu of reference are appropriate only where the competition concerns raised by the merger and the remedies proposed to address them are clear cut.[17]

94. The parties offered a comprehensive package of undertakings at the issues meeting on a 'without prejudice' basis. [details of the package of undertakings, consisting *inter alia* of divestment(s) and licensing arrangement(s), excised for reasons for reasons of commercial confidentiality].

95. Considering separately each of the areas in which a potential SLC was identified, we reached the following conclusions. [ ] would in principle remedy the SLC identified in respect of tomato ketchup. The undertaking to [ ] would in principle be an appropriate remedy for the SLCs [in respect of barbecue sauce, tinned beans and pasta products].

96. However, the undertaking to [ ]for brown sauce would be insufficient to remedy the competitive harm that would result from the combination of the Heinz tomato ketchup and HP brown sauce brands. This is because the potential SLC results from the price constraint Heinz's strong tomato ketchup brand strength imposes on HP brown sauce. As noted above, Daddies branded brown sauce constitutes a relatively small part of HP's total share of brown sauce sales. Therefore, the remedy [involving Daddies] does not replicate the constraint that Heinz tomato ketchup imposed on HP brown sauce pre-merger. Therefore the proposal fails to address all of the competition concerns identified above. The competition concerns that remain may be sufficient to give rise to a substantial lessening of competition in the brown sauce segment.

97. Consequently, the OFT believes 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

98. This merger will therefore be referred to the Competition Commission under section 22(1) of the Act.

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[17] Mergers – substantive assessment guidance, paragraph 8.3.