
Completed acquisition by Dairy Farmers of Britain Limited of
Associated Co-operative Creameries Limited

The OFT's decision on reference under section 22 given on 3 December 2004.

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

PARTIES

1. **Dairy Farmers of Britain Limited (DFB)** is an Industrial & Provident Society with approximately 3,250 members. It procures raw milk from its members and either sells it to processors or processes it at one of its own processing sites.
2. **Associated Co-operative Creameries Limited (ACC)** is an Industrial & Provident Society operating primarily in the processing of raw milk into a range of dairy products. ACC's ultimate parent was the Co-operative Group (CWS) Limited (the Co-operative Group). ACC's turnover for the last financial year was approximately £460 million.

TRANSACTION

3. DFB has acquired the business of production, marketing and distribution of milk and dairy products carried on by the Co-operative Group in the name of ACC and the entire issued share capital of ACC. The transaction completed on 10 August 2004 and the statutory deadline expires on 9 December 2004.

JURISDICTION

4. As a result of the transaction DFB and ACC have ceased to be distinct. The UK turnover of ACC 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

Product market

5. The parties overlap in the procurement of raw milk and the processing of raw milk into fresh milk and dairy products (cream, butter, powdered milk, cheese and cultured products such as yogurt, fromage frais, etc.).

Procurement of raw cows' milk

6. Co-operatives collect raw milk from their members and transport it under supply contracts to processors for conversion into dairy products. Farmers can also opt to supply milk directly to processors. Co-operative members generally receive a lower milk price per litre than farmers who sell directly to processors. However, they also receive an annual payment based on the profits made by the co-operative during the year.
7. On the demand side, milk processors cannot substitute other products for raw cows' milk for the vast majority of their products. On the supply side, while some dairy farmers suggested to us that they could increase milk production, they also indicated that they would be unlikely to do so currently because of low returns and excess capacity in the market. Switching from other farm activities to dairy farming is likely to be difficult and take time since the latter requires specific plant, buildings, technical knowledge and land in an area with a suitable climate.

Processing of raw milk and supply of fresh milk and dairy products

8. Raw milk is processed into either fresh milk or dairy products. These products exhibit limited demand substitutability.
9. On the supply side, there is limited substitutability between processing raw milk into fresh liquid milk and processing into other dairy products (butter, cream, milk powders, cheese and cultured products, etc.) since the facilities needed to produce each are very different. Processors also suggested that, given the significant excess capacity in the milk sector, in the event of an increase in the price of milk relative to dairy products, dairy processors would be unlikely to switch to milk processing.
10. However, a number of processors suggested that, while some product-specific investment is required, they are able to switch between some of the other dairy products fairly easily.

11. In relation to fresh milk production, DFB and ACC overlap in the supply of fresh milk in bulk packaging (15kg trays or 1 tonne boxes). All of the fresh milk produced by DFB is supplied in this way and is used in industrial food manufacturing. Third party responses suggested that the price of bulk milk is constrained by the price of milk for the retail sector, especially given the ease with which milk suppliers can switch production to bulk milk supply. As competition concerns do not arise in this case even if a narrower segmentation is considered, it is not necessary to conclude on this point.
12. Based on the above, the most appropriate frames of reference in this case are taken to be: the procurement of raw cow's milk; the production and supply of fresh milk; the production and supply of other dairy products (butter, cream, milk powders, cheese and cultured products, etc.). Other dairy products may be segmented further, but this is not crucial to the assessment in this case.

Geographic market

13. Raw milk needs to be transported to the processor within 24 hours. A 100 mile radius is considered, on average, to be a viable delivery range for raw milk to processors and, as there are no clear geographic breaks, a chain of substitution within England, Scotland and Wales is likely to operate.
14. For fresh milk, the market is not wider than Great Britain since imports and exports of liquid milk from outside Great Britain are negligible.
15. Butter, cream, milk powders, cheese and cultured dairy products are traded on a European and even global basis. UK levels of imports and exports of such products support an EU-wide frame of reference.

HORIZONTAL ISSUES

Market shares

Raw milk procurement

16. In 2003, ACC procured approximately [...] million litres per annum (mlpa) of raw milk from farmers. DFB has estimated that around [...] per cent of ACC's members will join DFB. DFB's share of raw milk procurement in Great Britain would therefore increase from around [15-20] per cent (based on procurement of [...] mlpa) to [15-20] per cent. If all of ACC's members

were to join DFB, its market share would be around [15-20] per cent. This compares to around 20 per cent and 11 per cent for the two other main co-operatives, First Milk and Milk Link respectively.¹ In addition, about 45 per cent of all raw milk is procured directly by processors from individual farmers. On this basis, horizontal issues do not arise in relation to raw milk procurement.

Raw milk processing

17. DFB's share of total raw milk processing in Great Britain will increase from below [0-5] per cent to about [5-10] per cent.²

Production and supply of fresh milk

18. The overlap between the parties in the processing of raw milk into fresh milk is minimal. In the year ending 31 March 2004, DFB produced [...] mlpa of fresh milk. This accounts for less than [0-5] per cent of fresh milk produced in Great Britain. Following the merger, DFB's share of milk supply in Great Britain will be [5-10] per cent. This compares to estimated shares of 18.5 per cent for each of Dairy Crest and Robert Wiseman, and 23 per cent for Arla/Express.³

Production and supply of dairy products

19. DFB and ACC overlap in the supply of butter, milk powders, cream, cheese and cultured products. As noted above, the markets for these products are at least EU wide. Table 1 shows the parties' combined shares of supply. No horizontal issues arise.

Table 1: Post-merger shares of supply of dairy products in the EU

	Butter	Milk Powders	Cream	Cheese	Cultured products
DFB/ACC	[0-5]%	[0-5]%	[0-5]%	[0-5]% ⁴	Less than [0-5]

¹ Source: DFB estimates based on figures from MDC Datum, and DEFRA estimate.

² Source: DFB figures and DEFRA estimates.

³ Source: Estimates based on data in the Competition Commission report on the proposed merger of Arla Foods amba and Express Dairies plc of 15 October 2003 (Cm 5983) and figures provided by DFB.

⁴ Source: DFB estimates.

Barriers to entry and expansion

20. Third parties suggested that dairy farmers could increase raw milk production, but are unlikely to do so because of current low rates of return. New entry is unlikely as entry costs are high relative to the returns that can be achieved.⁵
21. The parties stated that they consider £50 million a reasonable estimate for building a processing plant for production of dairy products. They also estimated that it would take around three years for the plant to come on stream. This suggests relatively high barriers to entry in processing.
22. However, processors indicated that there is significant spare capacity in the processing of raw milk, into both fresh milk and other dairy products. Barriers to expansion are therefore relatively low.

Buyer power

23. Raw milk must be sold and processed within 24 hours. This places the onus on co-operatives to find markets for their raw milk since they are committed to buying the milk produced by their members. Processors are therefore at an advantage when negotiating supply contracts and can exert at least a degree of buyer power.
24. In the market for dairy products, large buyers (such as supermarkets) are able to exert considerable market power, but smaller buyers are less able to do so.

VERTICAL ISSUES

25. Potentially, this transaction could provide the merged entity with the incentive to foreclose access to ACC/DFB processing facilities by independent farmers who are not members of DFB. However, the maps provided by DFB suggest that within a 100 mile radius of each of the DFB and ACC processing plants, there are a number of other processors and/or co-operatives to which the farmers could switch. The ACC members we contacted stated that alternative raw milk purchasers would be available to them. Input from DEFRA supports this view.

⁵ OFT decision of 26 February 2004 on the Completed acquisition by Milk Link Limited, First Milk Limited and Dairy Farmers Of Britain Limited of assets of United Milk Limited, namely The Westbury Milk Processing Plant.

THIRD PARTY VIEWS

26. On the whole, third parties who responded did not have concerns about the merger and many noted that it was a positive development. Third parties also expressed the view that creation of a vertically integrated co-operative would help to redress the imbalance of power within the dairy supply chain.

ASSESSMENT

27. In all of the areas where the activities of the parties overlap, combined shares of supply are relatively low and do not give rise to competition concerns. The vertical integration aspects of the transaction also do not raise competition concerns. With regard to possible foreclosure effects, responses from farmers confirmed that there remains a choice of potential purchasers of raw milk. Third parties were generally unconcerned by the merger.
28. 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

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