Anticipated acquisition by Muller UK & Ireland Group LLP of the dairies operations of Dairy Crest Group plc

ME/6524/15

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 12 June 2015. Full text of the decision published on 17 July 2015.

Please note that [✄] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. Muller UK & Ireland Group LLP (**Müller**) has agreed to acquire the liquid milk, packaged cream, flavoured milk and bulk commodity ingredient business (**Target Business**) of Dairy Crest Group plc (**Dairy Crest**) (the **Merger**). Müller and Dairy Crest are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) considers that the Parties will cease to be distinct as a result of the Merger, that the turnover test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

3. The Parties currently overlap in the procurement of raw milk in the United Kingdom (**UK**), as well as in the supply of fresh processed liquid milk (referred to in this decision as '**fresh milk**'), cream (including bulk and packaged cream), flavoured fresh liquid milk (**flavoured milk**), bulk butter, skimmed milk powder and buttermilk in the UK.

4. The Merger was assessed against a counterfactual in which the Target Business would downsize to a single dairy, namely **Dairy Crest Severnside**, absent the Merger. The CMA did not consider the continuation of the prevailing conditions of competition to be realistic in the absence of the Merger. The CMA believes that the assets of the Target Business other than the Severnside dairy would inevitably exit for strategic reasons, and is confident that there would be no substantially less anti-competitive purchaser

for these assets. The CMA does not believe that the exit of these assets would be a more competitive outcome than the Merger.

5. The Parties submitted that the downsized Target Business would exit the supply of major grocery retailers with national scope (**national multiples**) [✄]. However, the CMA found that the implications of the downsizing of the Target Business for Dairy Crest's supply of fresh milk to national multiples are too uncertain for it to reach the conclusion that it is inevitable that Dairy Crest, absent the Merger, would cease supplying fresh milk to national multiples [✄]. As such, it has examined this question as part of its competitive assessment.

6. The CMA has assessed the impact of the Merger in the following product frames of reference:[1]

   (a) The procurement of raw milk.

   (b) The supply of fresh milk to national multiple customers.

   (c) The supply of fresh milk to middle ground customers.

   (d) The supply of packaged cream to middle ground customers.

   (e) The supply of flavoured milk drinks.

   (f) The supply of concentrated buttermilk.

   (g) The supply of buttermilk powder.

   (h) The supply of concentrated buttermilk and buttermilk powder.

   (i) The supply of skimmed milk powder.

7. In relation to the geographic frame of reference:

   (a) for the supply of fresh milk to national multiples, fresh milk to middle ground customers and packaged cream to middle ground customers, the Merger has been examined on a Great Britain-wide basis and, to the extent that this was relevant to the overall competitive assessment, on a regional basis;

[1] The downsized Target Business would not supply packaged cream to national multiples, bulk cream or bulk butter under the counterfactual. As such, under the counterfactual, there would be no overlap in these product areas.

(b) for the supply of flavoured milk drinks, and concentrated buttermilk and buttermilk powder, the CMA did not need to conclude since no competition concerns arose on any plausible basis; and

(c) for the supply of skimmed milk powder, the Merger was examined on an EEA-wide basis.

8. The CMA found that there is a realistic prospect that the Merger would give rise to a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects in the supply of fresh milk to national multiples in the Severnside catchment area. This area includes parts of the South West, Wales, the Midlands and the South of England. The CMA considered that:

(a) under the counterfactual, the downsized Target Business may continue to be an effective competitor in the Severnside catchment area, given that it may have the ability and incentive to supply fresh milk to national multiples in those regions; and

(b) the loss of rivalry between the downsized Target Business and Müller would result in a realistic prospect of a SLC in that area, taking into account the closeness of competition between the two businesses and other competitive constraints.

9. The CMA found that the Merger would not give rise to a realistic prospect of an SLC in the other product frames of reference considered.

10. The Parties submitted that the Merger would result in efficiencies that would prevent a SLC in the supply of fresh milk to national multiples from arising. While the CMA could not rule out the possibility that the Merger would give rise to efficiencies of the type suggested by the Parties, there was insufficiently compelling evidence to support the Parties' submission. Therefore, the CMA could not find that efficiencies or relevant customer benefits arising from the Merger would prevent the realistic prospect of an SLC.

11. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (**the Act**). The Parties have until 19 June 2015 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to sections 33(1) and 34ZA(2) of the Act.

ASSESSMENT

Parties

12. **Müller** is the primary UK trading company for the Müller Group. The majority of Müller Group's turnover is achieved through its activities in the dairy sector. Müller processes around 2.2 billion litres of British milk per annum into liquid milk, butter, cream, yoghurt and desserts.

13. **Dairy Crest** is a British dairy products company listed on the London Stock Exchange. Dairy Crest's dairies operation processes and delivers around 1.3 billion litres of British milk per annum and also manufactures and sells Dairy Crest's flavoured milk (including its branded product Frijj along with other private label products), packaged cream, bulk cream, bulk butter, milk powders and buttermilk.

Transaction

14. On 5 November 2014, Müller entered into an asset purchase agreement to acquire the Target Business.[2] The Target Business includes the following key assets:

    (a) The Dairy Crest dairies at Severnside, Chadwell Heath, Foston and Hanworth.

    (b) Assets and equipment at Dairy Crest's Chard facility, as chosen by Müller.

    (c) 72 Dairy Crest depots, of which 65 are operational.

    (d) Goodwill, stock, plant and machinery.

    (e) The benefit and burden of the contracts.

    (f) The Target Business's intellectual property.

15. Müller and Dairy Crest also agreed to enter into a number of transitional supply arrangements to enable the separation of the Target Business from the rest of Dairy Crest and to ensure continuity of butter supply for the operations being retained by Dairy Crest.

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[2] The business being retained by Dairy Crest comprises its cheese and spreads operations, which include household brands such as Cathedral City, Clover and Country Life. Dairy Crest will also continue to develop whey-based products, such as demineralised whey powder and galacto-oligosaccharide, for the global infant formula market. Dairy Crest will continue to procure the milk required for its cheese operations and will retain certain milk processing.

16. The Parties submitted that the Merger will enable the combined entity to become a more effective competitor, primarily by improving margins through a number of cost savings.

Jurisdiction

17. As a result of the Merger, the enterprises of Müller and the Target Business will cease to be distinct.

18. The UK turnover of the Target Business exceeds £70 million.[3] Therefore, the turnover test in section 23(1)(b) of the Act is satisfied.

19. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

20. The Merger meets the thresholds under Council Regulation (EC) 139/2004 (the **EC Merger Regulation**) for review by the European Commission. The Parties submitted a reasoned submission to the European Commission on 13 February 2015 requesting pre-notification referral to the CMA under Article 4(4) of the EC Merger Regulation. The CMA informed the Commission that it agreed with the referral request and considered the Merger capable of being reviewed in the United Kingdom under the Act. On 20 March 2015 the European Commission announced its decision to refer the Merger to the CMA for review.

21. The preliminary assessment period for consideration of the Merger under section 34A(2) of the Act started on 21 March 2015 and the statutory 45 working day deadline for a decision is therefore 12 June 2015 (including an extension to the preliminary assessment period under section 34A(5) of the Act).

Background

Background of the UK dairy sector

22. The UK currently produces around 14 billion litres of raw milk per annum. Dairy processors procure raw milk from farmers and process it into different dairy products. About half of the raw milk produced on farms in the UK is processed and packaged into fresh milk. The other half is sold for processing into products such as cheese, milk powder, cream and butter.

[3] The Target Business' revenue in 2013/14 was £944.8 million.

23. Upstream in the supply chain, there has been a decrease in the number of dairy farms in the UK in the last ten years. The total domestic raw milk production has nevertheless been fairly static between 2008 and 2013, as the yield per cow has increased.

24. There has been considerable consolidation among processors over the past ten years such that the market is now dominated by three large processors (Arla, Dairy Crest and Müller), which supply the majority of the retail market.[4]

25. Market conditions in the milk market appear to be very competitive and public announcements from processors suggest that competition over the last few years during the re-tendering process for the large retail contracts has seen milk buyers continue to compromise margins to secure the sales volumes needed to keep factories running at efficient levels.[5]

26. Competition at the retail level is also intense with many retailers pricing four pints of fresh milk at £1 or lower. Retailers consider milk to be a strategic product and price it very competitively as it generates footfall. This has also made it difficult for liquid processers to negotiate higher wholesale selling prices.

Production process

27. Milk processing has three principal stages: separation, homogenisation and pasteurisation. Separation removes cream from the milk by the use of centrifuges. Homogenisation ensures that the remaining fat content is evenly distributed throughout the milk by applying high pressure. Pasteurisation involves rapidly heating the milk and cream to 74°C for 25 seconds and cooling it rapidly to 4°C.

28. Excess cream is a by-product of milk production. Therefore, cream and butter production is linked to the processing of milk. Figure 1 below shows the stylised production process of these three products.

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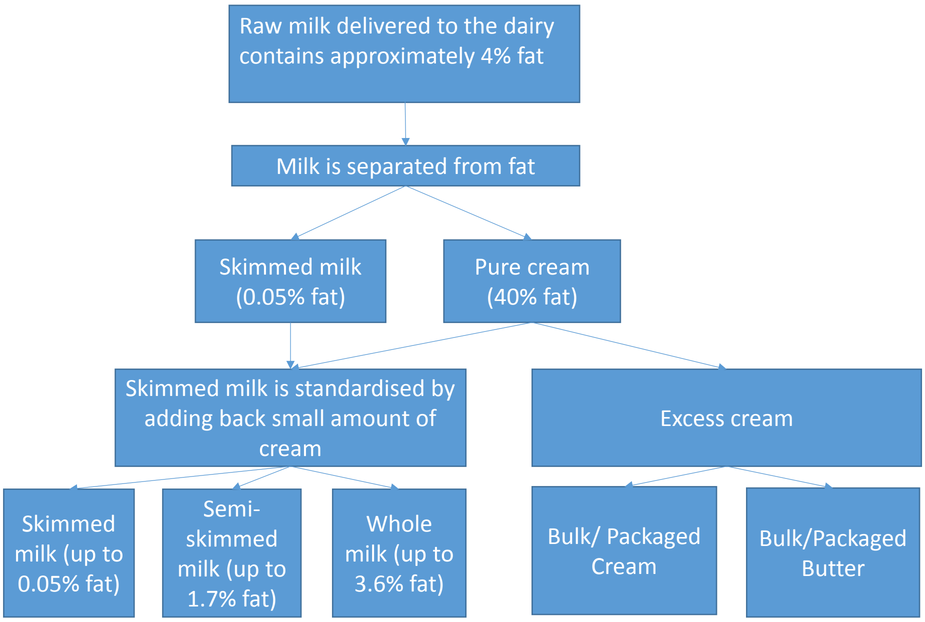
[4] The principal transactions in the Great Britain dairy sector that have been considered by the competition authorities are: the European Commission's decision of 2012 in case No COMP/M.6611 – Arla / Milk Link; the OFT's decision of 2007 regarding the Anticipated merger between First Milk Limited and Milk Link Limited; the OFT's decision of 2005 regarding the Anticipated acquisition by Robert Wiseman Dairies plc of the fresh milk business of Scottish Milk Dairies Limited (which was abandoned following a reference to the CC; the OFT's decision of 2005 regarding Completed acquisition by Dairy Crest Group plc of the dairy business of Midlands Cooperative Society Limited; the OFT's decision of 2004 regarding the Completed acquisition by Milk Link Limited, First Milk Limited and Dairy Farmers of Great Britain Limited of assets of United Milk, namely the Westbury Processing Plant; and the CC's decision of 2003 regarding Arla Foods amba and Express Dairies plc: A report on the proposed merger. Müller's acquisition of Robert Wiseman Dairies in 2012 was not reviewed by competition authorities.
[5] Dairy CO (April 2013), *Guide to Milk Buyers, A review of strategy and performance*, page 15.

Figure 1: Stylised production process of milk, cream and butter



Source: Parties.

29. Dairy processors supply milk, cream and other dairy products to a variety of customers including retailers, food manufacturers, wholesalers and foodservice customers like restaurants and caterers.

EU milk quota and global impact on UK milk price

30. After three decades of regulation, the European Union (**EU**) abolished milk quotas in April 2015. Over recent years, the EU and world market prices have converged which was mainly due to a considerable increase in the world market price.[6] Reduced market support from the EU and increased exposure to the world market is expected to bring with it greater price volatility compared to the stability created by the Common Agricultural Policy. On the other hand, global demand is expected to increase in the future.[7]

31. Although almost all fresh milk produced in the UK is consumed internally, the raw milk price is to some extent influenced by the global market due to tradable dairy products like cheese, butter and milk powders. For example, recently, the price for raw milk in the UK decreased significantly which was attributed to increased global milk production and Russia's ban on EU dairy products.[8]

[6] European Commission statistics in its 'European Milk Market Observatory'.
[7] Environment, Food and Rural Affairs Committee (20 January 2015), *Dairy prices, Fifth Report of Session 2014-15*, page 5, provided at Annex IV.14 of the Merger Notice Form.
[8] Environment, Food and Rural Affairs Committee (20 January 2015), *Dairy prices, Fifth Report of Session 2014-15*, page 5, provided at Annex IV.14 of the Merger Notice Form.

Aligned farmers

32. Since the early 2000s, certain national multiples began entering into arrangements with farmers that sit alongside the farmer-processor agreement. These agreements are referred to as ‘retailer-aligned’ contracts that set the pricing mechanics according to which a farmer is paid. When dealing with retailer-aligned milk, the role of milk processors is akin to that of a toll-manufacturer due to the retailer negotiating prices directly with their aligned farmers and simply negotiating processing costs with the processor.

Counterfactual

33. The CMA assesses the impact of a merger relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it considers that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive as between the parties to the merger than these conditions.[9]

Dairy Crest’s ‘Plan B’

34. Dairy Crest submitted that the impact of the Merger should be assessed against an alternative counterfactual which is referred to as ‘Plan B’ in some of its internal documents. More specifically, Dairy Crest submitted that its ‘Plan B’ which it would implement absent the Merger would involve:

    (a) the downsizing of the Target Business to a single dairy at Severnside (**Dairy Crest Severnside**) as well as a reduced depot network. Following the closure of the Hanworth dairy and the Chard creamery, the further downsizing envisaged under this counterfactual would involve the closure of Dairy Crest’s Foston and Chadwell Heath dairies;

    (b) the retention of sufficient fresh liquid milk processing capabilities at Dairy Crest Severnside to allow Dairy Crest to preserve [✂] [the profitable parts of Dairy Crest’s business: flavoured milk, spreads and packaged butter]. Under this counterfactual Dairy Crest would process fresh milk in significantly smaller volumes, [✂]; and

[9] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The Merger Assessment Guidelines have been adopted by the CMA (see *Mergers: Guidance on the CMA’s jurisdiction and procedure* (CMA2), January 2014, Annex D).

(c) the exit from the supply of fresh milk to any national multiples [✄].[10]

35. Dairy Crest submitted that, absent the Merger, these developments would be the only realistic prospect for the Target Business, noting in particular that:

(a) the Target Business is loss-making and cash flow negative [✄];

(b) [✄];

(c) [✄];

(d) the Target Business under the alternative counterfactual poses a lower risk than the status quo and would deliver substantial savings; and

(e) it is not realistic [✄] for it to carry on with the status quo and that it therefore adopted the strategic approach to implement Plan B absent the Merger.

Overview of relevant analytical framework

36. In forming a view on whether to adopt an alternative counterfactual in which one of the merger parties would have exited from the market (or one segment of the market), the CMA will generally consider whether the prospect of prevailing conditions of competition continuing is not realistic. In particular, the CMA will consider:[11]

(a) whether the firm would have exited – exit is most commonly considered in the context of financial failure, but can also occur for other reasons, for example because the selling firm’s corporate strategy has changed; and, if so

(b) whether there would have been a substantially less anti-competitive alternative purchaser for the firm or its assets than the acquirer under consideration; and

(c) what would have happened to the sales of the firm in the event of its exit.

37. In an exiting firm scenario, it is particularly important for the CMA to understand the rationale for the merger. Evidence of the exiting firm scenario being met is of particular interest to the CMA if it has not been prepared in contemplation of the transaction, especially in circumstances where exit is not based on reasons of financial failure, but driven by strategic considerations. In

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[10] Merger Notice Form, Appendix II.D, and Dairy Crest’s responses dated 23 April, 15 May, 21 May, 1 June and 5 June 2015.
[11] *Merger Assessment Guidelines,* paragraphs 4.3.8–4.3.18.

general, the CMA will seek to establish whether a strategic exit of a firm (or part of a firm) would occur in order to facilitate a merger or is the consequence of that merger. In both instances, exit would most likely not be the appropriate counterfactual as it would be much more difficult to establish that such an exit would inevitably have occurred absent the merger.

38. The CMA also applies the exiting firm scenario framework to situations that do not involve the exit of an entire firm but are limited to a division of a firm. In that situation, the CMA will consider whether the parent firm would have closed that division absent the merger, including the reasons for doing so if the parent firm as a whole was profitable.[12] Similarly, the same substantive considerations apply to situations where a division of a firm does not exit in its entirety in the sense that it remains active in the relevant market(s), albeit to a much more limited extent.[13]

39. Accordingly, the CMA has examined whether the prospect of prevailing conditions of competition is not realistic and, if so, what counterfactual the Merger should be assessed against. In doing so, the CMA has focused on the extent to which the Target Business would inevitably exit absent the Merger (both in terms of assets and activities), whether there would be a substantially less anti-competitive purchaser for the Target Business as a whole or those assets that would inevitably exit absent the Merger, and whether exit of these assets would be more competitive than the Merger.

To what extent would Dairy Crest have exited absent the Merger?

40. Dairy Crest submitted that it planned downsizing its dairy operations to Dairy Crest Severnside, where it would continue to process a reduced volume of fresh liquid milk. Accordingly, the CMA has, in the first instance, assessed to what extent there is compelling evidence of such a downsizing of the Target Business absent the Merger. It has also separately assessed the prospect of whether such a downsizing would inevitably entail Dairy Crest ceasing to supply fresh liquid milk to national multiples [✂].

Downsizing of the Target Business

41. Dairy Crest submitted that there are compelling financial and strategic reasons necessitating the downsizing of the Target Business to just Dairy Crest Severnside. The CMA has, therefore, considered the financial

[12] *Merger Assessment Guidelines*, paragraph 4.3.15.
[13] Under the counterfactual proposed by Dairy Crest, it would continue to supply fresh milk from its Severnside dairy, meaning that the downsizing of the Target Business to a single dairy at Severnside would not necessarily be characterised as a 'division' of a firm exiting.

performance of the Target Business as well as Dairy Crest's strategic plans for the Target Business absent the Merger.

Poor financial performance of the Target Business but no inevitable financial failure

42. Dairy Crest submitted the following evidence in relation to the financial performance of the Target Business:

(a) The Target Business made a trading loss of £15.8 million in its 2014/15 financial year. The Target Business generated a profit of £1.8 million in this financial year only after accounting for profits derived from the disposal of a number of depots. The trading results for 2014/15 deteriorated by £16.4 million against the previous year, consistent with a general trend of declining profitability since its 2009/10 financial year.

(b) After costs of restructuring are taken into account, the Target Business recorded audited losses in the last four years of £[✂] million.

(c) Since its 2011/12 financial year, the Target Business has been cash flow negative (excluding profits from the disposal of closed depots). Dairy Crest submitted that in that period, the Target Business required over £[✂] million of funding from the wider Dairy Crest group.

(d) Dairy Crest's internal forecasts for next three years [✂].[14]

43. The evidence submitted by Dairy Crest indicates that the financial conditions facing the Target Business are very challenging. Despite efforts to restructure the Target Business and to reduce costs, including by closing depots and dairies over a sustained period of time,[15] the profitability of the business has consistently declined, has turned negative and is forecast [✂].

44. However, the financial difficulties of the Target Business are not sufficiently acute such that it would be at risk of financial failure in the near future. While the profitability of the Target Business is low [✂], the evidence, including the fact that the business made a small profit in the most recent financial year (albeit against the background of the sale of assets), does not demonstrate compellingly that its financial viability in the short term was at risk such that its exit (either partially or fully) was inevitable.

[14] Merger Notice Form, Appendix II.D, paragraphs 4–14.
[15] The dairies that Dairy Crest has closed since 2011/12 are Aintree and Fenstanton.

45. The CMA has, therefore, considered to what extent there is compelling evidence of Dairy Crest's plan to downsize the Target Business to Dairy Crest Severnside being based on strategic considerations.

Dairy Crest's failed attempts to achieve its commercial objectives with the Target Business

46. Dairy Crest submitted that it has taken significant steps to revitalise the Target Business in recent years as part of an effort to achieve a 3% margin, including efficiency savings (exceeding £[✄] million per year) and, since 2009, a reduction in the number of depots from [✄] to [✄] and, in the number of dairies, from eight to five, but these have failed to reverse the decline of the business. Dairy Crest submitted that the underlying causes of the increasing trading losses will persist, including the negative and declining margins from supply contracts to national multiples, terminal decline of the profitable doorstep business by more than 10% per year, the presence of high fixed overheads that cannot be reduced in line with volume declines, and reducing opportunities for profits from property sales. Dairy Crest also noted that its forecast for unsustainable losses applies even after taking account of benefits from lower raw milk costs. [16]

47. According to Dairy Crest, these factors mean that it was no longer able to achieve its commercial objectives, making a downsizing of the Target Business the only credible strategy it was prepared to pursue absent the Merger. Dairy Crest also submitted [✄]. Outside of the Target Business, Dairy Crest has a profitable business in branded dairy products including dairy drinks, butter and cheese with brands including 'Frijj', 'Country Life', 'Clover', 'Utterly Butterly', 'Cathedral City' and 'Davidstow'. Consistent with its wider strategic aims, Dairy Crest stated that its 'Plan B' focused on retaining these profitable and strategically important parts of its business, which it would be able to do by retaining just Dairy Crest Severnside.

Third party reports and sale price indicative of poor performance of low value of Target Business

48. Dairy Crest submitted that reports from equity analysts on Dairy Crest's stock bear out that the Target Business was performing poorly (before

[16] Merger Notice Form, Appendix II.D, and Dairy Crest's responses of 15 and 21 May 2015 to the CMA's issues statement.

announcement of the Merger)[17] and show that the dominant view among the brokers who cover it was that the Target Business had become a liability and that the proposed sale would be beneficial to shareholders. For example, one report stated about Dairy Crest that '[D]airies has been something of a poison pill and the ongoing and far smaller group will be a much more attractive concern with less exposure to commoditised operations'.[18] Another report notes 'the deal removes a liquid milk business that is commoditised and volatile, currently loss-making and situated in an industry with deep structural challenges'.[19]

49. In addition, the valuation of the Target Business agreed in the Merger suggests that both Dairy Crest and Müller expect the low profitability in the industry to continue. Müller has agreed to pay £80 million for the Target Business and the CMA understands that [✂]. The majority of this valuation could be regarded as reflecting the value of the Frijj brand ([✂]), the property portfolio ([✂]), and the potential synergies achievable by the merged entity ([✂]). [✂]. This is also consistent with an internal document of Müller discussing the transaction, [✂] ([✂])[20] and corroborates Dairy Crest's submission that the poor performance of the division is likely to endure as it reflects wider structural trends in the industry.

Internal documents showing development of strategic plan to significantly downsize dairy operations over time

50. Dairy Crest provided the CMA with a large volume of internal documents relating to its strategy for the Target Business. These documents evidence that Dairy Crest's strategic planning for the Target Business evolved over time, covering multiple options at first, from restructuring to significant downsizing, and, against the background of continuous failure to achieve commercial objectives and industry decline, moving to developing a more

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[17] See the Merger Notice Form, Appendix II.D, paragraph 33, which refers to the following examples: an Exane BNP Paribas report of 21 May 2012 stated: 'While an exit may seem desirable to some, we see this as unlikely. Management remain committed to the business due to the critical mass with retailers and supply of cream for the spreads business. To be frank, we do not see these as compelling reasons to retain a business where we estimate returns have exceeded the cost of capital […] in just one of the last seven years…Given the apparent lack of value from this business, we believe management needs either to present a more robust case to investors or make an exit'; a Numis report of 28 May 2012 stated: 'A 3% medium term margin is the aim here (vs last year's underlying 0.5%) and it is accepted that this could necessitate 10–15% less sales and a deliberate shrinkage of the business as Dairy Crest walks away from unacceptable margin work… Shrinkage of this business now looks inevitable… supply is to be ceased if acceptable margins cannot be earned, and there is an acceptance that the business may have to be shrunk in turnover terms by 10–15% as a result'; and an Investec report of 23 May 2014 stated: 'the 3% margin target does not seem to be getting much closer, the doorstep is falling away quickly and the PER you can ascribe to the replacement property profits is low.'
[18] Numis, Dairy Crest Trading Update, 5 February 2015, provided at Appendix 7 to Dairy Crest's response of 21 May 2015.
[19] Jeffries, Flash Note on Dairy Crest (DCG LN) titled 'Transformational Exit from Dairies', 6 November 2014, provided at Appendix 7 to Dairy Crest's response of 21 May 2015.
[20] Merger Notice Form, Appendix II.37, slide 16.

detailed single-site option that ultimately culminated in 'Plan B' in the event that the Merger does not go ahead. By way of summary, see the following:

(a) Between 2011 and June 2014, Dairy Crest considered various restructuring options to secure the sustainability of the Target Business. Under several of these options, the Target Business would continue to supply customers on a similar basis as it had previously, albeit from a significantly reduced dairies footprint.

(b) As early as November 2013, the possibility of a more profitable business limited to a single site focused on dairy drinks and non-returnable containers (**NRC**) was raised by members of Dairy Crest senior management considering options for restructuring.

(c) In June and July 2014, Dairy Crest developed these earlier plans to downsize the Target Business to Dairy Crest Severnside. Under this 'one dairy' option, the Target Business would considerably reduce its supply to [✂] and shift its focus toward producing milk and cream for Dairy Crest's profitable spreads, butter and flavoured milk businesses. Dairy Crest only ceased further development of Plan B when the main terms of the Merger were agreed in late July 2014.

51. These documents evidence the evolution of the single-site strategy in the context of a [✂] declining performance of the Target Business. In particular, tenders of [✂] ([✂]) and [✂] ([✂]) resulted in significant detrimental impact on the Target Business's revenues of £[✂] million and approximately £[✂] million per annum respectively.[21]

52. The evidence relating to these phases is set out in more detail below.

- *The period between 2011 and June 2014*

53. The internal documents from the period between 2011 and June 2014 show that Dairy Crest undertook a lengthy and sustained consideration of the options available to it to secure the sustainability of the Target Business. Even during this early period where Dairy Crest was still seeking to secure the strategic viability of the entirety of its dairy operations, there was already a considerable period of time during the course of which strategic options were developed that increasingly envisaged downsizing the Target Business against the background of its consistently declining performance.

[21] Merger Notice Form, Appendix II.D, paragraphs 17–23.

54. In December 2011, the Dairy Crest Board of Directors meeting considered possible future dairies strategies and noted that '[✂]'. The management's conclusion was that '[✂]'.[22] This document corroborates Dairy Crest's submissions to the effect that, even at this relatively early stage, it had considered a significant retrenchment of or even exit from the Target Business.

55. During 2012 and 2013, internal documents still refer to efforts to reverse worsening returns in the Target Business, including closing and consolidating dairies, although also noting the risks involved in any restructuring of the business.[23] In January 2013, the Dairy Crest Board of Directors considered the '[✂]'.[24]

56. On 29 January 2013, the Dairy Crest Board of Directors meeting, based on the document '[✂]',[25] agreed with the implementation of a risk mitigation strategy based on a reduction of Dairy Crest's depot network.

57. The Dairy Crest Board of Directors reviewed [✂] in November 2013 [✂]. The Board discussion slides circulated before the meeting highlighted the risks of moving toward a strategy focusing on major retail customers and that the 3% margin target for dairies was 'very challenging'. Following this meeting, Dairy Crest established a working group called 'Project Dakota'. Dairy Crest submitted that the aim of the Project Dakota working group was to identify ways in which the Target Business could meet its target profitability (a 3% margin and a 'sustainable' dairies business). The working group conducted an in-depth review of Dairy Crest's strategy for its milk and cream operations culminating in the '[✂]' business strategy presented to Dairy Crest's Board of Directors in January 2014.[26]

58. A note of a meeting of senior Dairy Crest managers that took place in November 2013 sets out further considerations relating to an increasingly likely downsizing of the Target Business, including references to a single site operation at Severnside. In particular, the meeting note states: 'Is there a more profitable business model focused on Dairy Drinks? Potential for a one site Dairies solution, Dairy Drink and NRC in Severnside?'[27] This reference

[22] Dairy Crest Board of Director's meeting notes for 8 December 2011 meeting provided in Dairy Crest's response of 7 April to the CMA's section 109 notice of 20 March 2015, Question 1 and 2 response, document 1.
[23] For example, Appendices 3 and 6 to the Dairy Crest's response of 7 April 2015 to the CMA's section 109 notice of 20 March 2015, [✂].
[24] See Annex 9 to Dairy Crest's response 15 March 2015.
[25] See Annex 9 to Dairy Crest's response 15 March 2015 and the minute of the Dairy Crest Board of Directors meeting submitted by Dairy Crest on 1 May 2015.
[26] Annex 16 of the submission made on 25 March 2015 ('[✂]', January 2014).
[27] A note of the 'SCLT' meeting of 21 November 2013 circulated by email to the meeting attendees including [✂] on 29 November 2013 provided in Dairy Crest's response of 21 May 2015 to the CMA's issues paper, Appendix 4 [✂], pages 4–7.

shows that, already in 2013, a one-site solution in Severnside was identified as a future solution to address 'Wider Dairy Category Challenges'. This is particularly significant as the statement in this meeting note appears to have reflected discussions that formed the basis of what ultimately culminated in a more detailed articulation of 'Plan B', namely the downsizing of the dairy operations to Dairy Crest Severnside. The internal documents available to the CMA indicate that this meeting amongst senior Dairy Crest managers evidences a shift towards greater momentum and commercial urgency to develop a single-site solution in Severnside at a time when Dairy Crest and Müller were discussing [✄], but the Merger (or an outright sale of the Target Business) had not been subject of any negotiations.

59. The [✄] highlighted significant challenges for the Target Business, and emphasised that Dairy Crest had not yet identified a route to achieving its target profitability despite having modelled a number of scenarios in detail. At this time, the [✄]. Slides [✄] again include a reference to 'one site Dairies solution' with a 'more profitable business focused on Severnside'. In addition, Dairy Crest submitted that at this time the working group had [✄] which was, however, not presented to the Dairy Crest Board of Directors because it did not meet the Project Dakota brief. [28]

60. The working group then continued to consider the proposals in further detail. The Dairy Crest commercial team considered the Project Dakota presentation in a meeting on 16 April 2014. The Dairy Crest Management Board reconsidered Project Dakota on 16 June 2014, although no final decision was taken at this stage.[29] Dairy Crest submitted that this contemporaneous documentation shows that, despite considering all options, it had not identified a solution that would lead to a sustainable dairies business, resulting in the commercial imperative to significantly downsize its dairies operations.[30]

- *Period of June and July 2014*

61. As set out below, the period of June and July 2014 shows Dairy Crest devoting increasing attention to a one dairy option. By July 2014, the evidence shows that none of the options for securing a sustainable Target Business was a realistic proposition for the Dairy Crest Board of Directors, and that downsizing to one dairy at Severnside was the only strategic option Dairy Crest would consider absent the Merger.

[28] Dairy Crest's response of 21 May 2015 to the CMA's issues paper, paragraph 33. The CMA has not received any contemporaneous evidence to support this statement. However, [✄].
[29] The Minute of Dairy Crest Management Board on 16 June 2014 states: [✄].
[30] Dairy Crest's response of 21 May 2015 to the CMA's issues statement, paragraph 24.

62. Dairy Crest submitted that the full-scale development of the 'Plan B' proposal was precipitated by [✂].[31]

63. Following [✂], senior figures within Dairy Crest committed to modelling a one dairy proposal based at Severnside in more detail: '[✂]'.[32] Dairy Crest submits that the Project Dakota team attended a meeting on 3 July 2014 to discuss single site scenarios.[33] The output from this senior level meeting was a decision to model the financial plan for a single site operation. An email was circulated among a number of the attendees on the same day, which included a contract map, timeline and financial data regarding an exit from national multiple contracts.[34]

64. Dairy Crest submits that the single-site dairy proposal was presented to the Dairy Crest board on 14 July 2014 along with the current terms offered by Müller for the Merger. [✂]:

> [✂].[35]

65. The Board paper went on to conclude '[✂]'.

66. Dairy Crest submitted that this presentation was considered by its Board of Directors in its meeting on 14 July 2014 where Plan B was endorsed by the Board leading to [✂].[36] Plan B was not referred to in the minutes of the Dairy Crest Board of Directors meeting. Dairy Crest submitted it was unnecessary to state this in the Board minutes given that [✂].[37] Dairy Crest also referred generally to the great degree of sensitivity of the Plan B consideration as a reason for the relatively limited number of references to Plan B in documents for wider internal circulation.

67. Discussion of Plan B at the 14 July Board is supported by the preparation of a presentation titled 'Plan B' on 16 July 2014 with supporting financial analysis, which was then circulated to the Dairy Crest's Management Board on 21 July 2014.[38] This document sets out the core elements of the restructuring proposal, including downsizing to one dairy at Severnside. The minutes of the

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[31] The CMA notes that [✂]. See Dairy Crest's response of 21 May 2015 to the CMA's issues paper, Appendix 4 [✂].
[32] Dairy Crest's response dated 21 May 2015, at Appendix 4, [✂].
[33] The meeting was attended by [✂]. Dairy Crest refers to a handwritten note of the meeting a copy of which is provided at Appendix 4 [✂] of Dairy Crest's response of 21 May 2015 to the CMA's issues paper, page 239.
[34] Email from [✂].
[35] Response of 7 April 2015, Annex 20. This is an email dated 25 June 2014 from [✂].
[36] Dairy Crest's response of 21 May 2015 to the CMA's issues paper, paragraph 43.
[37] More specifically, Dairy Crest submitted that this [✂].
[38] The attendees of the meeting include [✂].

Management Board show that it discussed Plan B as [✄].[39] This demonstrates serious consideration of the specific details of Plan B at a Management Board level (including key senior executives such as the Chief Executive Officer and Finance Director).

68. Although more detailed proposals relating to the downsizing of dairy operations to Dairy Crest Severnside were described as a 'very early draft',[40] the CMA understands that the proposal did not need to be considered further at this stage following the Board of Directors' decision to pursue the Merger.

Downsizing to Dairy Crest Severnside not formulated to facilitate the Merger or a consequence thereof

69. In considering any exiting firm (or division) counterfactual, the CMA will generally place particular weight on evidence that has not been prepared in contemplation of the merger.[41]

70. The CMA notes that there is a degree of overlap in terms of the time periods during which Dairy Crest considered its strategic options for the Target Business and Dairy Crest's negotiations with Müller [✄].[42]

71. Given that strategic options involving the downsizing of the Target Business in the absence of any transaction were considered in parallel with its negotiations with Müller for a considerable period of time the CMA has approached the internal evidence provided by Dairy Crest with an appropriate degree of scepticism and caution, and has considered in detail to what extent the evidence can be regarded as a reliable indicator of Dairy Crest's strategic intentions absent the Merger.

72. A paper tabled at the Dairy Crest Board of Directors meeting of 14 July 2014[43] makes it clear that when Dairy Crest's management started to formulate and evaluate Plan B in more detail it was aware of the possible implications this may have for the purposes of a competition authority's merger control assessment. In particular, in summarising the benefits and risks of Plan B, this paper notes that:

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[39] Dairy Crest's response of 27 May 2015 attaching the Management Board Minutes of 21 July 2014, which state '[✄]'.
[40] An email dated 21 July 2014 from [✄] provided in Dairy Crest's response of 21 May 2015 to the CMA's issues paper, Appendix 4 [✄].
[41] MAGs, paragraph 4.3.9. By way of example, Dairy Crest submitted that its Board of [✄] in March 2015 (see Dairy Crest's response of 23 April 2014 to the CMA's questions of 15 April 2015). The CMA cannot place as much weight on statements made to that effect at that stage given that the Parties had already agreed on the Merger and were subject to a merger control process.
[42] [✄]
[43] See Annex 20 to Dairy Crest's response of 25 March 2015.

'[✂].'

73. [✂]

74. [✂], having examined relevant internal documents covering several years prior to the Merger and the evidence more generally, the CMA does not consider [✂] that Dairy Crest formulated 'Plan B' with a view to strengthening its competition case and thereby facilitating the Merger. The CMA has also discussed, in person, the period leading up to the Merger with senior executives of Dairy Crest[44] and requested internal documents from those executives involved in developing 'Plan B'.

75. Overall, having carefully considered the evidence available to it, the CMA is satisfied that the consideration by Dairy Crest of its strategic options (ultimately leading to the plan to downsize the Target Business to a single dairy at Severnside, namely Dairy Crest Severnside), was not formulated to facilitate the Merger nor was it the consequence of the Merger.[45]

Conclusion regarding Dairy Crest's strategy for the Target Business

76. The evidence available to the CMA shows that, absent the Merger, it is not realistic to assume that Dairy Crest would compete with Müller on the basis of prevailing conditions of competition. Instead, the evidence based on internal documents and submissions from the Dairy Crest management as well as the surrounding market conditions strongly support that the strategic decision to downsize the Target Business to Dairy Crest Severnside was inevitable, in particular given that:

    (a) the financial challenges faced by the Target Business had prompted Dairy Crest to take a strategic decision to act to avoid increasing losses. [✂];

    (b) internal documents show that Dairy Crest considered downsizing to one dairy at Severnside to be the only strategically viable option for the Target Business in the absence of the Merger. Once this option, which had been raised at least from 2013, was developed further, no other option was subsequently considered by the Board and Dairy Crest submitted that the Board accepted the implementation of the plan envisaging downsizing to

[44] The CMA met with [✂] on 27 March 2014 and 15 May 2015 and spoke to them on a teleconference on 5 June 2015.

[45] The OFT and CC previously examined whether counterfactual plans submitted by parties were influenced by, a direct consequence of or formulated to facilitate a merger. See for example, the OFT's decision regarding the 'Anticipated acquisition by Ratcliff Palfinger Limited of the commercial vehicle tail lifts spare parts business of Ross & Bonnyman Limited' (18 February 2011), paragraph 34 and the CC's 'A report on the anticipated acquisition by Ratcliff Palfinger of the commercial vehicles tail lifts spare parts business of Ross & Bonnyman' (10 June 2011), paragraph 4.36.

the Dairy Crest Severnside in June 2014. Dairy Crest reached a general agreement with Müller for the sale of the Target Business on 31 July 2014 and Heads of Terms were signed on 29 August 2014; and

(c) as set out above, the valuation of the Target Business suggests that both Parties consider that the poor performance of the business will continue absent the Merger and market analysts also consider that the Target Businesses prospects were poor.

Is it inevitable that Dairy Crest Severnside would exit from the supply of fresh milk to national multiples [✂]?

77. Dairy Crest submitted that, absent the Merger, it would exit the supply of national multiples [✂]. Dairy Crest stated that it would have neither the ability nor the incentive to supply national multiple [✂] customers with fresh milk. Dairy Crest's internal documents relating to Plan B support these submissions to some extent.

78. However, current (pre-Merger) commercial intentions as to the precise scope of Dairy Crest Severnside's activities are not outcome-determinative of the CMA's counterfactual assessment. Although it may well be the case that Dairy Crest's current senior management does not intend under its Plan B at this stage that it would engage in competitive tenders for national multiple contracts (in the form of regional lots), the CMA examines whether it is inevitable that Dairy Crest Severnside would not have the ability or incentive to compete for such contracts going forward.

79. While the CMA has concluded that a downsizing to Dairy Crest Severnside is inevitable absent the Merger, the implications of this for Dairy Crest Severnside's supply to national multiples [✂] are not sufficiently certain for the CMA to conclude that it would be inevitable that Dairy Crest Severnside would cease supplying national multiples [✂]. For example, Plan B envisages supplying Lidl, which is a national multiple. Furthermore, there is uncertainty relating to key elements of Plan B, including:

(a) [✂] the resulting spare capacity;

(b) to what extent the distribution network (around the Severnside plant) would be reduced; and

(c) the timing and sequencing of any exit from Dairy Crest's existing national multiple customers.

80. In addition, although the CMA does not need to rely on it for the purposes of its counterfactual assessment, the evidence available to the CMA indicates

that Dairy Crest Severnside may have the ability and incentive to supply national multiples in the Severnside catchment area. This is discussed further in the competitive assessment.

81. In summary, it is not sufficiently certain that Dairy Crest Severnside would cease supplying fresh milk to national multiples such that its exit would be inevitable.

Is there no substantially less anti-competitive purchaser for the assets of the Target Business?

82. Dairy Crest submitted there would be no substantially less anticompetitive purchaser for the assets of the Target Business. It argued that:

(a) synergies are the key driver for the Merger and there is no other potential buyer other than Müller which could capture those synergies;

(b) [✂]; and

(c) [✂].

83. The CMA has considered whether there would be a substantially less anti-competitive alternative purchaser of the relevant assets of the Target Business as a whole.

84. While the Target Business or its individual assets were not marketed or subject to a formal sales process, the CMA considers that the evidence shows that there would be no substantially less anti-competitive buyer:

(a) In relation to the Target Business as a whole, the CMA considers that, given the specific characteristics of the industry, the only realistic buyers would be those who could capture material synergies from the Merger. Müller and Arla are the only buyers that may potentially capture such synergies and the CMA does not consider that Arla would be a substantially less anticompetitive buyer of the Target business.

(b) In relation to the individual assets of the Target Business, the evidence shows that Dairy Crest has failed to sell any of the five dairies it has sold since 2009 as a going concern. [✂], indicating that there are realistically no alternative buyers for the Target Business's individual assets that would exit under the counterfactual. In addition, Dairy Crest submitted data showing that [✂].[46]

[46] Dairy Crest's response of 21 May 2015 to the CMA's issues statement, paragraph 62 and Appendix 5.

85. The CMA also asked certain third parties whether they would be interested in purchasing the Target Business or any of its individual assets.

86. No retailer mentioned the possibility of acquiring a dairy [✂].

87. One third party respondent noted that, although it could be interested in considering an acquisition of the Foston site (and also mentioned Severnside), there were significant risks inherent in such an investment given the low margins in the UK dairy sector. This third party also noted that [✂].

88. The CMA therefore considers that it would not have been realistic for a substantially less anti-competitive purchaser to acquire either the Target Business as a whole or the relevant assets of the Target Business that would exit under the counterfactual.

What would happen to the Target Business's sales absent the Merger?

89. The CMA considers that, absent the Merger, the Target Business' sales to national multiples, [✂] would switch either to Müller or Arla in the event of an exit. The CMA does not consider that the transfer of these volumes would be a more competitive outcome given Arla's strong market position.[47]

90. In any event, the sales of the Target Business (including those of the dairies exiting under the counterfactual) would be retendered by the national multiples [✂] in the near future (either as a result of change of control provisions or under the contractual terms of the existing agreements). Therefore, the volumes would be contestable in the near future.

Conclusion regarding the counterfactual

91. In light of the evidence set out above, the CMA considers that the prospect of prevailing conditions of competition is not realistic. The CMA believes that other assets of the Target Business would inevitably exit, and is confident that there would be no substantially less anti-competitive purchaser for these assets. The CMA does not believe that the exit of these assets would be a more competitive outcome than the Merger. The CMA therefore concludes that the relevant counterfactual against which to assess the impact of the Merger consists of a downsized Target Business operating on the basis of a single dairy only, namely Dairy Crest Severnside.

92. However, the CMA does not believe that it is inevitable that Dairy Crest, absent the Merger and operating on the basis of its dairy operations

[47] Based on the Parties' estimates, Arla's share of supply of fresh milk to national multiples, at national level, is [40–50]%.

downsized to Dairy Crest Severnside, would cease supplying fresh milk to national multiples altogether.

Frame of reference

Introduction

93. The CMA considers that market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of a merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[48]

94. Müller and the Target Business currently overlap in the procurement of raw milk, as well as in the supply of fresh processed liquid milk (referred to in this decision as '**fresh milk**'), cream (including bulk and packaged cream), flavoured fresh liquid milk (**flavoured milk**), bulk butter, skimmed milk powder and buttermilk.

95. Dairy Crest Severnside would retain its ability to produce fresh milk to allow it to produce its profitable lines of flavoured milk, cream/butter (as an input for its branded butter and spreads business) and, as by-products of production and milk balancing respectively, buttermilk and skimmed milk powder.

96. However, the CMA considers that Dairy Crest Severnside would no longer be able to supply customers of fresh milk and packaged cream on a national basis or in regions outside of its catchment area, [✂]. Accordingly, these product markets [packaged cream to national multiples, bulk cream or bulk butter] are not considered further in this decision, because no competition concerns arise on any plausible scenario, except to the extent necessary to consider related markets.

Raw milk procurement

Product scope

97. The Parties submitted that a single market for the procurement of raw cow's milk should be identified. The CMA considered whether the market could be further segmented to distinguish between the procurement of:

[48] See Mergers Assessment Guidelines, paragraph 5.2.2.

(a) organic and conventional milk; and

(b) milk that is intended for different end uses (according to the Parties, processors can seek to incentivise farmers to produce milk for particular end-uses as farmers can influence fat and protein levels in milk).

98. In relation to the procurement of organic and conventional milk, the European Commission has previously found that, for milk processors, organic milk and conventional milk are not substitutable. With regard to supply-side substitutability, the European Commission found that organic dairy farmers have no incentive to switch to conventional raw milk production, given the price premium they obtain and the investments they have made to produce organic raw milk.[49]

99. In relation to the procurement of milk which is intended for different end uses, the European Commission and UK competition authorities have previously not distinguished between the intended end uses of different types of raw milk.

100. The CMA has not found it necessary to reach a conclusion on whether the market for the procurement of raw cow's milk should be segmented, as the Merger does not raise competition concerns under any plausible frame of reference.

Geographic scope

101. The Parties submitted that raw milk procurement is national or regional in scope, and that while the delivery supply radius tends to be sub-national, the degree of differentiation in raw milk procurement among regions is limited.

102. The European Commission and UK competition authorities have in previous decisions considered that the market for the procurement of raw milk is not wider than national, and may be narrower than the UK.[50]

103. The CMA assessed the Merger at both a national and regional level but did not consider it necessary to conclude on the exact geographic delineation of the market since the Merger does not raise competition concerns under any plausible frame of reference.

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[49] See, for example, the Commission decision of 17 December 2008 on the case COMP/M.5046 – Friesland Foods/Campina (Friesland/Campina), paragraph 50. See also Commission decision of 27 September 2012 on the case COMP/M.6611 – Arla/Milk Link (Arla Milk/Milk Link). In earlier decisions, the OFT has not considered a distinction between organic and conventional milk (see for instance the OFT decisions on the anticipated acquisition by Robert Wiseman Dairies plcof the fresh milk business of Scottish Milk Dairies Limited, 19 October 2005 and on the anticipated merger between First Milk Limited and Milk Link Limited, 17 December 2007 (First Milk/Milk Link).

[50] See, for instance, Friesland/Campina and Arla Foods/ Milk Link. See also the decisions of the OFT on First Milk/Milk Link, paragraph 10.

Fresh milk

Product scope

104. The Parties submitted that the market for the supply of fresh milk should be segmented by customer type, with no further segmentation necessary.

105. The CMA considered segmenting the market for the supply of fresh milk by:

(a) customer type;

(b) branded or private label products; and

(c) organic or conventional products.

Customer segmentation

106. The CMA may sometimes define relevant markets for separate customer groups if the effects of the merger on competition to supply a targeted group of customers may differ from its effects on other groups of customers, and require a separate analysis. This may happen when, for example, suppliers can target higher prices at customers willing to pay more, or when competition for customers differs significantly between different customer groups.[51]

107. The CMA has considered the following aspects in its assessment:

(a) whether demand characteristics (eg volume requirements) are significantly different between groups of customers; and

(b) whether any differences in requirements and procurement practices affect the range of suppliers that can compete for the business of different categories of customers.

108. The Office of Fair Trading (OFT) and Competition Commission (CC) previously identified the following separate categories of customer:

(a) National multiples (which included Sainsbury's, Tesco, Waitrose, Asda, M&S, Morrisons and Co-operative Food). The OFT noted that the national multiple category may need to be expanded to include additional customers.[52]

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[51] *Merger Assessment Guidelines,* paragraph 5.2.28.
[52] See the OFT decision on the Anticipated acquisition by Dale Farm Limited of the fresh liquid milk business of Fane Valley Cooperative Society Limited, 21 December 2011, paragraph 14.

(b) Doorstep customers: direct sales of milk to households, delivered to the customer's doorstep by a milkman on a delivery round.

(c) Middle ground customers: a customer group which captures all customers between that of national multiples and doorstep. The OFT has previously noted that the middle ground 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). The OFT recognised that some blurring might exist between the different segments and that within the middle ground category, price discrimination can and does take place.[53]

109. The CMA notes that the Parties do not overlap in the supply of fresh milk to doorstep customers. Therefore, the doorstep customer segment is not further considered.

110. The Parties generally agreed that segmenting the market to distinguish between national multiples and middle ground customers is appropriate. The Parties submitted that there are two further groups of national customers that have, in the past, been considered to be part of middle ground but whose scale, operations and contract characteristics distinguish them from other middle ground customers. The two groups are:

(a) national retailers such as Aldi, Lidl, Iceland and Farmfoods and members of symbol groups (eg Spar, Nisa, Londis, Costcutter and Musgraves); and

(b) some large food outlet chains (such as Starbucks, Pret-a-Manger, Costa Coffee) whose volume and national purchasing are arguably more similar to the requirements of national retailers.

111. The CMA understands from information provided by the Parties and third parties that the following key customer requirements condition the range of suppliers that can credibly supply a given customer:

(a) **Volume of fresh milk** – national multiple retailers require large volumes of fresh milk.

(b) **Aligned farmers** – some national multiples have aligned farmers (ie a dedicated milk pool) and most national multiples require segregation of this milk from the milk of other farmers;

[53] See the OFT decision on the Completed acquisition by Dairy Crest Group plc of certain assets of Arla Foods UK plc, 26 October 2006, paragraph 21 (Dairy Crest/Arla).

(c) **Site audits** – some customers audit the facilities of dairy processors to check whether they comply with their requirements.

(d) **Direct to store (DTS) delivery** – some customers require delivery to store (often within narrow time slots and on a daily basis).

112. The CMA has reviewed the purchasing requirements of various types of customers and the extent to which this correlates with the range of suppliers used. This review has confirmed that large retailers with national networks of stores tend to have more demanding requirements along the four dimensions highlighted above (volume, segregation, audits, distribution), and that those retailers tend to source their milk from a narrower range of large suppliers (primarily Müller, Dairy Crest, Arla, and, for stores located in Scotland, Graham's).[54]

113. Third party responses also suggest that the requirements identified above at paragraph 111 pose significant obstacles to smaller dairies (ie all dairies except for Müller, Dairy Crest and Arla) supplying national multiples.

114. The CMA therefore considers that the market for the supply of fresh milk should be segmented to distinguish between supply to national multiples and to middle ground customers.

115. Given the developments in recent years in the retail sector, the CMA has adjusted the group of retailers that are considered as national multiples. The group of national multiples for the purposes of the present case comprises Tesco, Asda, Sainsbury's, Morrisons, Coop, Aldi, Lidl, Iceland, Waitrose and M&S.[55]

Branded/private label

116. The Parties submit that there is no basis to distinguish between private label and branded fresh milk supply, because both private label and branded milk compete closely from the perspective of the end customer.

117. In *Friesland/Campina*, the European Commission found significant evidence suggesting that private label and branded products compete in the downstream market and exert a competitive constraint on each other, and

[54] The CMA notes, however, that the quality requirements of the national multiples do not represent a clear-cut dividing line between these large retailers and smaller customers as, for example, there are also some national multiples that do not require milk segregation and there are also some smaller customers that perform audits.
[55] Müller's internal documents refers [✂] as 'multiples' or 'national accounts' (which the CMA understands is equivalent to the concept of national multiples): see for example Annex IV 2 [✂]. The CMA also notes that one competitor submitted that all retailers with a national estate of stores should be included in the definition of national multiples, as their procurement and retail pricing of fresh milk and cream closely resemble that of the seven national multiples as defined in previous cases, and are materially different from that of restaurants, caterers, hotels, schools, hospitals, small retailers and wholesalers.

concluded that private label and branded products belong to the same product market.[56] In *Dairy Crest/Arla* and *Robert Wiseman/Scottish Milk Dairies,* the UK competition authorities did not distinguish between branded and private label milk in their frames of reference.[57]

118. The responses of retailers to the CMA's market enquiries indicated that, with the exception of Arla's Cravendale product, there is no meaningful distinction between branded and private label products either from their or their customers' perspective.

119. The CMA considers that it is not necessary to segment the market to distinguish between branded and private label milk.

Organic/conventional

120. The Parties submitted that there is no need for the CMA to reach a conclusion on whether segmentation between conventional and organic milk is necessary given the market share data that they provided.

121. The market share data submitted by the Parties indicates that organic fresh milk constitutes approximately [0–5]% of overall fresh milk sales. Additionally, the shares of supply of the Parties are lower for organic fresh milk than for conventional fresh milk at the national level and for the majority of regions in the supply of both national multiple and middle ground customers.

122. In *Friesland/Campina,* the European Commission noted that there is limited substitutability between conventional and organic products (citing the higher price for organic milk, specific preferences of those consuming organic milk, and differing production conditions).[58] On the other hand, in several other UK and European Commission cases no distinction was made between conventional and organic milk products.[59]

123. The responses of retailers to the CMA's market enquiries consistently stated that customers have a preference for either organic or conventional milk and would only substitute organic milk for conventional milk (and vice versa) if the other product is not available.

124. The responses of competitors indicated that processors typically have dedicated production lines for each of organic and conventional milk, but that there are no significant barriers to switching production lines between

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[56] Campina/Friesland, paragraph182. On the other hand, in its decision *COMP/M.6119* - Arla/ Hansa, 1 April 2011, paragraph 21, the European Commission did not conclude on this matter (Arla/Hansa).
[57] See Dairy Crest/Arla and the OFT decision on the Anticipated acquisition by Robert Wiseman Dairies plc of the fresh milk business of Scottish Milk Dairies Limited, 19 October, 2005 (Robert Wiseman/Scottish Milk Dairies).
[58] EC, Campina/Friesland, paragraph 140.
[59] See, for example OFT, Robert Wiseman/Scottish Milk Dairies; OFT, Dairy Crest/Arla; EC, Arla/Hansa.

conventional and organic (and vice versa). Third party responses regarding processors' access to organic raw milk were mixed, with one third party suggesting that it could be challenging, whereas another indicated that it would be relatively straightforward to access additional organic raw milk.

125. The CMA considers that, while it may be possible to combine the organic and conventional milk segments based on the evidence relating to supply-side substitution, it has not been necessary to conclude as any differences between the products are taken into account in the competitive assessment.

Geographic scope

National multiple segment

126. The Parties submitted that the geographic scope of the supply of fresh milk to national multiples has both national and regional elements. According to the Parties, many national multiples have nationwide contracts, although certain national multiples have incorporated regional buying practices into their supply arrangements.

127. The CC has previously assessed the fresh milk market at national and regional levels for national multiples.[60] More recently, in *Arla/Milk Link*, the European Commission left open whether the geographic scope of the market for the supply of fresh milk is Great Britain-wide or narrower.

128. The CMA notes that the tenders of the national multiples are often broken down into regional lots.[61] At the same time, several national multiples have indicated that they prefer to procure from few, large suppliers which helps them to keep the number of suppliers and the complexity of their procurement arrangements low. These considerations suggest that competition has national and regional elements. However, at a regional level it is difficult to define the exact boundaries of the regional markets.

129. The CMA therefore considers that the relevant product market is characterised by both national and regional parameters of competition. As such, the Merger has been examined on a Great Britain-wide basis and, to the extent that this was relevant to the overall competitive assessment, on a regional basis.

130. The regional aspect of competition is influenced by the distance over which milk can be efficiently delivered from a dairy. The Parties provided catchment areas for each of their dairies which cover 80% of the customers that each

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[60] OFT, Arla/Express.
[61] [✂].

dairy serves. These catchment areas range from 70km to 190km, with the catchment area for Dairy Crest's Severnside plant being [✄]km. [✄] submitted that milk can be efficiently supplied over a range of:

(a) [✄] from a dairy or depot to small stores;

(b) [✄] from a dairy to medium stores; and

(c) [✄] from a dairy to large stores.

131. Responses from the Parties and third parties were mixed regarding whether the use of depots may extend the distance over which milk can be efficiently delivered.

Middle ground customer segment

132. The Parties stated that the supply of fresh milk to the middle ground has both national as well as regional elements, but submitted that the relevant geographic scope to assess the effects of the Merger is regional.

133. The Parties submitted that the regions should be East England, Lancashire, London, the Midlands, the North East of England, Scotland, the South of England, South West England, Wales and the West of England, and Yorkshire following the regions defined by Kantar for the purposes of its data reporting services.

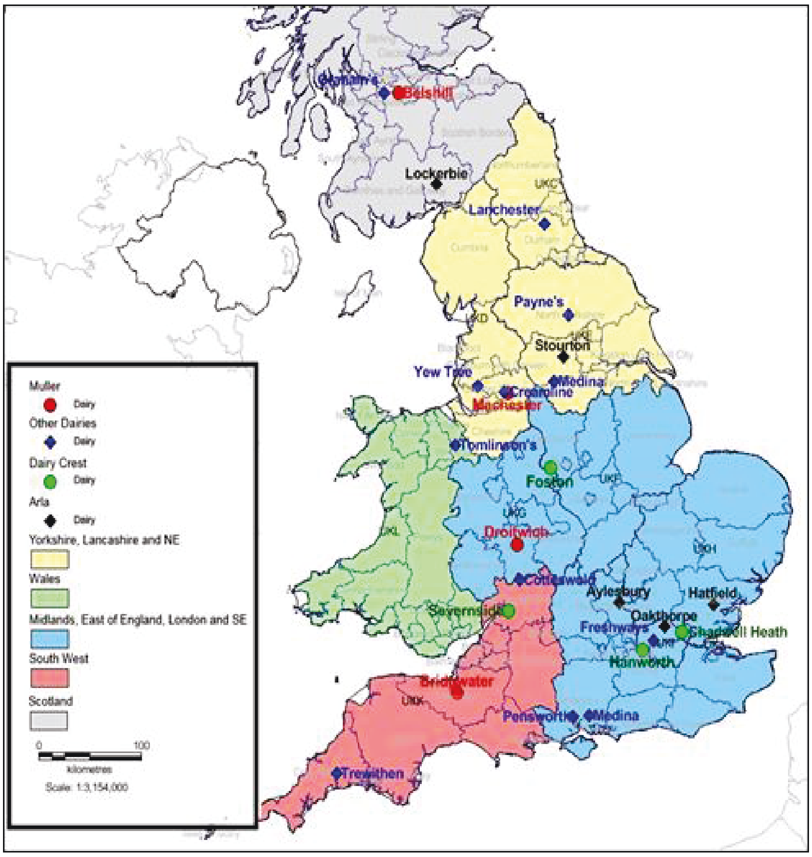
134. In *Dairy Crest/Arla*, the OFT noted that the geographic scope for middle ground customers may vary and accordingly considered the competitive situation in the narrower geographic areas where the parties both supplied to middle ground customers, as well as the effect of the transaction at a national level.[62] In *Arla/Express*, the CC assessed the middle ground segment on a regional basis, finding that while 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 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.[63] This approach was used by the OFT in subsequent decisions.[64]

135. The CMA considers that competition has a stronger regional element (compared to competition in the national multiple segment) since the strength

[62] Dairy Crest/Arla, paragraph 26.
[63] CC, Arla/Express.
[64] See, for instance, the OFT decision on the Completed acquisition by Dairy Crest Group plc of the dairy business of Midlands Cooperative Society Limited, 8 September 2005.

and number of suppliers to middle ground customers varies by region. However, the CMA notes that the suppliers are distributed across Great Britain and have varying delivery ranges depending on the type of customer that is being supplied. See Figure 2 showing the distribution of dairies across Great Britain. Therefore, the CMA has not been able to delineate precise regional boundaries.

Figure 2: Map showing dairies in Great Britain



Source: Parties' submission

136. As such, the Merger has been examined on a Great Britain-wide basis and, to the extent that this was relevant to the overall competitive assessment, on a regional basis.

Cream

The Parties submitted that there are separate markets for the supply of fresh packaged cream (**packaged cream**) (further segmented to distinguish between supply to national multiples and middle ground customers) and for the supply of fresh bulk cream (**bulk cream**).

137. The Parties submitted that bulk cream is a commodity product, and that buyers of bulk cream are typically wholesalers and 'industry' purchasers such as food manufacturers and traders on commodities spot markets. Food manufacturers include large global companies, such as Nestlé or Mondelez,

who require bulk deliveries and use cream as an ingredient within the food processing industry. Bulk cream is also sold to butter producers such as Meadow Foods and Dairygold.

138. In *Dairy Crest/Arla*, the OFT segmented the market to distinguish between the supply of bulk cream to industrial customers and the supply of packaged cream. The OFT also segmented the market for packaged cream to distinguish between supply to national multiples and middle ground customers.

139. The CMA notes that national multiples and middle ground customers often run procurement processes for fresh milk and packaged cream together or simultaneously (with 60% of national multiples and 81% of middle ground customers procuring these products together within the customers that responded to the CMA's market testing) and that the differences between national multiples and middle ground customers for packaged cream in terms of their requirements (volume, quality, service) are similar to those for fresh milk.

140. The CMA therefore considers that there are separate product frames of reference for the supply of:

   (a) packaged cream. The CMA has segmented this market to distinguish between supply to national multiples and middle ground customers; and

   (b) bulk cream to industrial customers.

141. Within the packaged cream market, the CMA has also considered whether to segment the market to distinguish between different types of cream (eg. between high and low fat packaged cream) and between branded and private label cream.

142. In relation to types of cream, the Parties do not overlap in long-life cream, clotted cream, cultured creams and other specialty creams. Therefore, these types of cream have not been considered further by the CMA. The Parties submitted that the remaining types of cream (standard variations based on fat content, including half, single, double and whipping) are highly substitutable in terms of the production process. In *Friesland/Campina*, the European Commission found that there is complete supply-side substitutability for standard creams, as most liquid cream producers already manufacture both low-fat and high-fat cream, and those that do not are able to swiftly switch production in the event of a price increase.[65] Further, in *Dairy Crest/Arla Foods*, the OFT did not segment the market to distinguish between creams

[65] Friesland/Campina, paragraph 1358.

based on fat content.[66] The CMA has therefore not further segmented the packaged cream market according to type of cream.

143. The Parties submitted that the supply of branded and private label packaged cream are part of the same product frame of reference.

144. In *Friesland/Campina*, the European Commission found that there was some competitive interaction between branded and private label products. However, the European Commission left open whether private label and branded products belong to the same relevant market. The responses of national multiples to the CMA's market test indicate that their customers consider private label and branded cream to be substitutable.

145. The CMA has not found it necessary to further segment the packaged cream market to distinguish between branded and private label cream, as any differences between the products are taken into account in the competitive assessment.

Geographic scope

Packaged cream

146. The Parties submitted that the relevant geographic frame of reference is Great Britain for both national multiples and middle ground customers. The Parties also suggest that there may be regional aspects to competition principally because of the links between milk and cream contracts.

147. Given that the CMA considers that the Target Business would not supply packaged cream to national multiples under the counterfactual, only the geographic scope of supply to middle ground customers is considered.

148. In *Dairy Crest/Midlands Cooperative Society*, the OFT found that the market was national or may even be regional.

149. The CMA notes that where national multiples undertake separate, national tenders for packaged cream (ie not linked to fresh milk) these tenders are generally not split into regional lots but awarded to only one supplier for the whole of Great Britain. Nonetheless, the CMA considers that there is a regional element to competition, particularly due to the fact that fresh milk and packaged cream are often procured together. This is particularly true for the middle ground segment where cream is very frequently purchased with milk, rather than separately.

[66] OFT, Dairy Crest/Arla Foods, paragraph 13.

150. The CMA therefore considers that the market for the supply of packaged cream middle ground customers is characterised by both national and regional parameters of competition. As such, the Merger has been examined on a Great Britain-wide basis and, to the extent that this was relevant to the overall competitive assessment, on a regional basis.

Bulk Cream

151. Given that the CMA considers that the Target Business would not supply bulk cream under the counterfactual scenario, the geographic scope of supply is not considered.

Flavoured milk drinks[67]

Product scope

152. The Parties submitted that the relevant market should be for all flavoured milk drinks with no further segmentations.

153. In previous cases,[68] the European Commission has considered a number of segmentations within the supply of flavoured milk, distinguishing dairy drinks based on flavour and customer type. The European Commission also distinguished between:

(a) branded and private label dairy drinks;

(b) long-life and fresh dairy drinks; and

(c) health and standard dairy drinks.[69]

154. The CMA has not found it necessary to reach a conclusion on the further segmentation of the supply of flavoured drinks as the Merger does not raise any concerns under any plausible frame of reference for flavoured milk drinks.

Geographic scope

155. The Parties submitted that the effect of the Merger on the supply of dairy drinks should be assessed on an EEA-wide basis, notwithstanding some national brand preferences.

[67] Flavoured milk may also be referred as dairy drinks.
[68] See Friesland/Campina, paragraphs 1028–1130, and Arla/Milk Link.
[69] The Parties submitted that they do not overlap in supply of health dairy drinks.

156. The CMA has not found it necessary to reach a conclusion on the scope of the geographic frame of reference given that no competition concerns arise even on a narrower national frame of reference.

Buttermilk

Product scope

157. Raw buttermilk is a by-product of the butter production process, and is the basis for three different types of buttermilk: cultured (or liquid) buttermilk, concentrated buttermilk and buttermilk powder. According to the Parties, buttermilk is predominantly dried to produce buttermilk powder which is then used in the food industry.

158. The Parties overlap in the supply of concentrated buttermilk and buttermilk powder (although currently Müller supplies buttermilk powder only in Germany).The Parties submitted that buttermilk should be considered as a standalone product market.

159. In Friesland/Campina, the European Commission distinguished cultured buttermilk from other types of buttermilk. Third party responses to the CMA’s market testing indicated that there is some level of supply-side substitutability between concentrated buttermilk and buttermilk powder.

160. The CMA has not found it necessary to conclude on the exact product frame of reference since, as set out below, no competition concern arise on any plausible basis. The CMA has, on a cautious basis, assessed the effects of the Merger under both a separate frame of reference for concentrated buttermilk and buttermilk powder as well as a product frame of reference comprising both products.

Geographic scope

161. The Parties submitted that the relevant geographic scope for the supply of concentrated buttermilk is national. This is because the product must be fresh and the transport costs are similar to that of fresh liquid milk. The Parties submitted that the geographic scope for the supply of buttermilk powder should be EEA-wide or global, as the product can be transported easily.

162. The majority of the submissions made by third parties indicate that the supply of buttermilk powder is broader than the UK.

163. The CMA has not found it necessary to conclude on the geographic scope of the supply of the different types of buttermilk since, as set out below, no competition concerns arise on any plausible basis.

Skimmed milk powder

Product scope

164. Skimmed milk powder is manufactured by evaporating most of the moisture from skimmed milk, giving it a longer shelf like than liquid milk without the need for refrigeration.

165. The Parties submitted that skimmed milk powder is part of a wider ingredients market.

166. The European Commission has previously left open whether milk powders could form part of a wider ingredients market.[70]

167. The CMA has adopted a cautious approach and assessed the effects of the Merger under a product frame of reference for the supply of skimmed milk powder.

Geographic scope

168. The Parties submitted that the relevant geographic market is EEA-wide, if not global. According to the Parties, skimmed milk powder is easily transported due to its low bulk and non-perishable nature.

169. The only third party which made submissions in this regard considered that supply of skimmed milk powder is EEA-wide.

170. The European Commission[71] and the UK competition authorities[72] have in previous decisions concluded that the relevant geographic scope of dairy powders is at least EEA wide, if not global.

171. The CMA has, on a cautious basis, assessed the Merger with geographic frame of reference being EEA-wide.

Conclusion on frame of reference

172. The CMA has assessed the impact of the Merger against the following product frames of reference:

    (a) The supply of fresh milk to national multiple customers.

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[70] See the decision of the European Commission on COMP/M.6348 – Arla Foods/Allgauland, paragraph 69, 7 November 2011 (Arla Foods/Allgauland).
[71] See Arla Foods/Allgaulland, paragraphs 71–77.
[72] See the OFT decision on Dairy Farmers/Associated Co-operative Creameries and the OFT decision First Milk/Milk Link Limited.

(b) The supply of fresh milk to middle ground customers.

(c) The supply of packaged cream to middle ground customers.

(d) The supply of flavoured milk drinks.

(e) The supply of concentrated buttermilk.

(f) The supply of buttermilk powder.

(g) The supply of concentrated buttermilk and buttermilk powder.

(h) The supply of skimmed milk powder.

Competitive assessment – horizontal unilateral effects

173. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.[73] Horizontal unilateral effects are more likely when the merger parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in a SLC in relation to unilateral horizontal effects in each of the frames of reference set out at paragraph 172 above.

Procurement of raw milk

174. Both Parties procure raw milk for their dairy operations.

175. Where the merger firms purchase the same products, the merged firm may enjoy greater buyer power (or monopsony power) than the merger firms could previously exert individually. In many cases, an increase in buyer power is not likely to give rise to unilateral effects, and some of the benefits to the firm from its greater buyer power may be passed on to the merged firm's customers.[74]

176. The CMA focused its assessment on whether the Merger would increase the combined entity's buyer power such that it is able to lower the amount it purchases so as to reduce the purchase price it pays (known as 'demand withholding'). Given that the Merger has been assessed against an alternative counterfactual, the buyer power that the combined entity would possess is compared to the buyer power of the Parties under the alternative counterfactual.

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[73] *Merger Assessment Guidelines*, from paragraph 5.4.1.
[74] *Merger Assessment Guidelines,* paragraphs 5.4.19–5.4.21

Parties' submissions

177. The Parties submitted that currently milk processors have no ability or incentive to drive procurement prices to unsustainable levels for farmers, and that the Merger will not change this situation because:

(a) the combined entity would have little ability to control raw milk demand and its share of procurement at national level would not be significant;

(b) farmers have a number of alternatives for their raw milk other than fresh liquid milk processors;

(c) the bargaining position of the farmers that supply the Parties has been materially improved by the emergence of the Voluntary Code,[75] which has enhanced the freedom for these farmers to switch; and

(d) raw milk price is heavily determined by wider global commodity prices.

Assessment

178. The Parties estimated that they have a current combined share of procurement at a national level of [20–30]% (with an increment of [5–15]% based on Dairy Crest's existing market share), including only the raw milk sourced directly from farmer (and not from brokers, which were considered as independent players on the procurement market). Including purchases of raw milk through brokers, the combined share would increase to [30–40]%, with a [10–20]% increment.

179. Aligned farmer arrangements – in which farmers have a direct commercial relationship with national multiples, which runs alongside the farmer-processor agreement – can impact procurement shares. This is because the price paid to aligned farmers is determined by the national multiples rather than by processors. When the volume procured from aligned farmers is deducted, the combined procurement share of the Parties falls to [10–20]% on a national basis.

180. The Severnside dairy is supplied with milk from a radius of around [✂]km (up to [✂] miles), including South, South West, Wales, West and the Midlands. The Müller's dairies that procure fresh milk from an area overlapping with the Severnside dairy are:

[75] See the Dairy Industry Code of Best Practice for Contractual Relations.

(a) Bridgewater, which is supplied by farmers located in the South, South West, Wales and the West within a radius of [✂]km; and

(b) Droitwich, which sources its milk from farmers located in Lancashire, Midlands and Wales and the West within a radius of approximately [✂]km.

181. Under the counterfactual, the Parties would therefore mainly overlap in the procurement of raw milk in the regions set out above. The Parties estimate that their share of procurement is less than [30–40]% in each of these regions (including only the raw milk sourced directly from farmer, but including both aligned and non-aligned farmers).

182. Although the Parties, post-Merger, will be important purchasers of raw milk in the regions where they overlap, farmers will have a number of alternative milk processors to sell their milk to, including Arla, Medina, Payne’s Dairies, Tomlinsons, Trewithen Dairy, and Yeo Valley. In addition there are a number of other types of purchasers of raw milk operating in the overlap regions, including cheese producers (eg Lactalis, Westcombe Dairy, Barber’s) and yoghurt producers, operating in these regions. In particular, [✂] procures raw milk [✂] from the regions where the Parties overlap, including the Southwest and the Midlands.

183. The standard contracts that Müller and Dairy Crest currently offer to farmers, in line with the Voluntary Code of Conduct, do not appear to prevent farmers from switching to other purchasers to take advantage of better terms. In compliance with the Voluntary Code, all relevant Müller and Dairy Crest contracts offer farmers a three month notice period on the occurrence of a price change. Where farmers are unsatisfied with a price change, they can switch. For instance, [✂].

184. Furthermore, the majority of the farmers that supply fresh milk to Müller are aligned farmers and Dairy Crest’s aligned farmers account for around [30-40]% of its direct raw milk procurement. The arrangements that national multiples have in place with these farmers have largely disintermediated dairy processors from price negotiations. As reflected in the Parties’ internal documents, these agreements have a material impact on raw milk farmgate prices, which outside the control of the processors.[76]

185. Finally, the CMA did not receive any concerns about the impact of the Merger on raw milk procurement from farmer associations.

[76] See, for instance, Annex IV.2 of the Merger Notice, [✂].

Conclusion on horizontal unilateral effects in the procurement of raw milk

186. The CMA therefore considers that the Merger will not give rise to a realistic prospect of an SLC in the procurement of raw milk, either at a national or regional level.

Supply of fresh milk to national multiple customers

187. The CMA has considered whether the Merger will lead to a realistic prospect of unilateral effects in the supply of fresh milk to national multiplies in the Dairy Crest Severnside catchment area. Specifically, whether:

(a) Dairy Crest Severnside as an existing competitor would have the incentive and ability to compete to supply fresh milk to national multiples; and

(b) the loss of rivalry between Dairy Crest Severnside and Müller would result in an SLC, taking into account the closeness of competition between them and other competitive constraints.

Dairy Crest Severnside's ability and incentive to compete for national multiple regional lots

188. The CMA has examined the extent of Dairy Crest's ability and incentive to compete for national multiple regional lots in the counterfactual.

189. Dairy Crest submitted that the downsizing of its dairies operations to Dairy Crest Severnside under Plan B would result in its complete exit from the supply of fresh milk to national multiples, including organic and conventional milk. However, Dairy Crest stated that it would no longer have the incentive to do so given that these contracts are loss-making, complex to serve and involve additional costs.[77] [✂].[78,79]

190. In support of its submissions, Dairy Crest referred to its internal documents relating to Plan B and noted that none refer to the continuing supply of national multiples (despite the plan envisaging some spare capacity).[80] Dairy Crest submitted that it would prefer the Severnside dairy to be underutilised

[77] Dairy Crest submits that it requires (among other things) segregation, processing complexity, dedicated sales support, customer marketing support, innovation, farmer liaison requirements, intensive/high cost tender procedures and often include direct to store distribution. See also Dairy Crest's response to the Supplementary Issues Paper, paragraph 1.6.4.
[78] Dairy Crest submits that its production process would involve [✂].
[79] Dairy Crest's response to the Supplementary Issues Paper, paragraph 4.9.
[80] Dairy Crest's response to the Supplementary Issues Paper, paragraph 4.4.

rather than to engage in competitive tenders to supply fresh milk to national multiples.[81]

191. The CMA has considered Dairy Crest's ability and incentive to supply these customers in turn below.

Ability to compete

192. Dairy Crest submitted that, under Plan B, while it would retain the technical ability to supply national multiples via both regional distribution centres (**RDCs**) and direct to store (**DTS**),[82] it would no longer be a credible supplier to national multiples following a downsizing to a single dairy [✂].[83]

193. The CMA considers, based on the evidence that it has received in its market test and from the Parties, that Dairy Crest's credibility as one of the three main suppliers capable of supplying across Great Britain to national multiples will be lost in the counterfactual following its downsizing to a single site. Given the confidential nature of Plan B, national multiples were not asked direct questions concerning their willingness to use Dairy Crest Severnside or a single site dairy. However, the evidence available to the CMA indicates that national multiples prefer to deal with a limited number of national suppliers. On the other hand, competitive dynamics in Scotland suggest that, when national multiples have insufficient supplier choice in a particular region, they may seek to procure milk from regional processors which can compete with national processors on price and quality terms, despite them not having a national presence (as explained in further detail at paragraphs 236 to 243 below).

194. The CMA considers that, in the counterfactual, national multiples may seek supplies from a regional dairy when faced with a reduced number of suppliers. In the South West and, to a certain extent, Wales, Müller would be the only active *national* supplier. In the Midlands, South, West and London, Arla would also be a credible supplier. The remaining regional processors in these regions are smaller than Dairy Crest Severnside and the evidence points to them being less efficient than Dairy Crest Severnside. As such, the CMA considers that Dairy Crest Severnside is more comparable to Graham's in Scotland than the smaller regional dairies, which a number of national multiples have confirmed are not credible suppliers to them nationally or specifically in the South West and Wales regions. Accordingly, national

[81] Dairy Crest's response to the Supplementary Issues Paper, paragraph 4.5.
[82] Dairy Crest's response to the Supplementary Issues Paper, paragraph 4.14.
[83] Dairy Crest's response to the Supplementary Issues Paper, paragraphs 4.17–4.19.

multiples may consider Dairy Crest Severnside to be a viable alternative to Müller and may seek to incentivise it to tender.

195. In addition, Dairy Crest is an existing supplier to national multiple customers in the South West, West, South, Midlands, London and Wales, and in the Plan B counterfactual would remain a supplier of these national multiple customers until their contract terms ended or were terminated. It also has the capability and capacity to supply these customers from the Severnside dairy.

196. Therefore, the CMA considers that Dairy Crest Severnside would remain a credible competitor for national multiple regional lots within the catchment area of its dairy.

Incentive to compete

197. Dairy Crest submitted that it would have no incentive to compete for national multiple contracts in the counterfactual where it would produce fresh liquid milk [✂] as profitably as possible [✂]. [✂].

198. Prioritising supply to customers according to their profitability is a rational business response. However, the evidence received by the CMA indicates that Dairy Crest Severnside may have the incentive to compete for certain regional lots of national multiples in the Severnside dairy's catchment area. This is because:

(a) Dairy Crest may have substantial spare capacity under the counterfactual; and

(b) the price received for selling milk to national multiples would likely make a contribution to Dairy Crest Severnside's fixed costs.

199. As such, in the presence of spare capacity it would be rational to bid to supply national multiples.

200. Dairy Crest's internal documents envisage a significant amount of spare capacity at the Severnside dairy under Plan B. Its total capacity to produce fresh milk would be [✂] Mlpa, and of that 55 Mlpa would be spare capacity (rising to 100 Mlpa [✂]). Based on the sizes of the recent tenders for national multiple regional lots, the CMA considers that 55 Mlpa would be sufficient to compete for various regional lots of national multiples in the catchment area of Dairy Crest Severnside.[84] Furthermore, given the uncertainty in relation to Dairy Crest Severnside's supply, the CMA cannot rule out that its spare

[84] Based on the tender data available to the CMA, the size of tender lots in the South West is in the range of 5Mlpa to 52 Mlpa. In Wales, the size of tender lots range from 0.7 Mlpa to 22 Mlpa.

capacity could be even greater. Any incremental spare capacity would increase Dairy Crest’s incentive and ability to bid for regional lots.[85]

Table 1: Dairy Crest Severnside capacity usage and spare capacity

Description	*Capacity*
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
[✂]	[✂]
Spare capacity [✂]	55–100 Mlpa

Source: Dairy Crest’s submission

201. In circumstances where a dairy has spare capacity, and the price received from selling to a customer would be sufficient to make a contribution to fixed costs (ie the price would be above short term marginal costs), the dairy may be motivated to supply to the customer. The CMA has therefore sought to understand whether the price that Dairy Crest receives for supplying national multiples is sufficient to make a contribution to its fixed costs. [86]

202. Dairy Crest has submitted that the economic benefits of supply to national multiples should be based on profit after distribution costs.[87] The CMA requested evidence from Dairy Crest showing that the price it would receive for selling to national multiples would not make a contribution to its fixed costs. Dairy Crest did not provide any such clear evidence. [✂].[88]

203. Accordingly, the CMA considers that there is a realistic prospect, based on the evidence available, that Dairy Crest may have an incentive to supply national multiples customers under the counterfactual in its catchment area.

Is there a realistic prospect of a SLC in the supply of fresh milk to national multiples?

204. The CMA has assessed whether the loss of rivalry between Dairy Crest Severnside and Müller would result in a SLC (relative to the level of competition that would have existed under the counterfactual), taking into account closeness of competition and other competitive constraints.

Shares of supply

205. Market shares of firms in the market, both in absolute terms and relative to each other, can give an indication of the potential extent of a firm’s market

[85] The CMA considers that supply to [✂].
[86] The Parties have submitted in several instances the importance of running dairy processing facilities close to full capacity. The CMA considers that there is generally an incentive to use all available capacity of a dairy processing plant to cover its fixed costs.
[87] See Dairy Crest’s response of 5 June 2015.
[88] Merger Notice Form, Appendix V.F. Annex 1.

power. The combined market shares of the merger firms, when compared with their respective pre-merger market shares, can provide an indication of the change in market power resulting from a merger.[89] Given that the Merger has been assessed against the counterfactual, the change in market power that the CMA concerned with is that between the market power of the firms under the counterfactual and the market power of the combined entity following the Merger.

206. The Parties provided their shares of supply by volume in fresh milk to national multiples in each of the UK regions for 2013/14.[90] Given that under the counterfactual Dairy Crest Severnside would have a very different customer base to now, these shares of supply are only of limited relevance to the CMA's assessment. However, the shares of supply show that in the South West and Wales & West[91] the Parties currently have a very high combined share of supply (with Arla holding only a very small share of the market at [10–20]% and [10–20]% respectively)[92] suggesting that the Merger would result in a reduction in credible competitors from two to one. Arla has a significant share of supply in all of the other regions in the Dairy Crest Severnside catchment area and in each case had a higher share of supply than Dairy Crest in 2013/14.[93]

'Ideal' bidding market

207. The CMA observes that high market shares can be an indication of market power.[94]

208. However, the Parties' submit that their shares of supply are not a good proxy for measuring the extent of competition in the supply of fresh milk in the UK. In particular, the Parties submit that the market for the supply of fresh milk fulfils the conditions of a 'true' or 'ideal' bidding market, which is characterised by a number of key factors, ie a homogenous product, spare processing capacity in the industry, and 'lumpy' tenders on a 'winner takes all' basis. In such a market, high market shares are not necessarily an indication of market power and competitive outcomes can be reached even with few competitors.

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[89] MAGs, paragraph 5.3.4.
[90] These data are based on the supply of fresh milk to national multiples in Great Britain for financial year 2013/14 (volume in megalitres). The regions are based on those used by Kantar Worldpanel for the purposes of its data analytics services.
[91] Kantar Worldpanel defines a single area grouping Wales and the West of England.
[92] Merger Notice Form, Table 22 (the CMA notes that these figures exclude Iceland, Aldi and Lidl).
[93] Merger Notice Form, Table 22.
[94] *Merger Assessment Guidelines,* paragraph 5.3.4.

209. The CMA considers the Parties' arguments as follows:

(a) **Products are homogenous** – while fresh milk in itself is a homogenous product, suppliers might be able to differentiate themselves to some degree through their ability to meet the non-price requirements of customers (eg in terms of milk segregation and delivery requirements, or more qualitative aspects such as farming expertise).

(b) **Spare capacity** – there is some spare capacity in aggregate in the industry. However, not all suppliers may have sufficient spare capacity at all times to bid for upcoming large contracts.[95]

(c) **Tenders are lumpy** – while tenders are relatively infrequent and are for high volumes,[96] a number of national multiple customers multi-source and divide their tenders into regional lots which in many cases reduces the amount of volume that a processor stands to lose at a given tender.

(d) **Tenders have a 'winner takes all' quality** – the CMA does not consider that tenders have a clear 'winner takes all' quality, as follows:

(i) The Parties acknowledge that the 'winner takes all' quality may be limited to regional lots within a national tender. The CMA notes that the results of previous tenders indicate that retailers tend to reallocate small proportions rather than switching the complete volume.[97]

(ii) There are criteria other than price that are relevant for national multiples.

(iii) Given the insecurity about other bidders' costs and bidding strategies, a reduction in the number of credible bidders increases the probability of winning the tender/tender lot. The CMA considers that unilateral effects may arise simply where the Merger significantly increases the perceived probability of either the merged entity or any of its competitors winning the tender process at a given price. When submitting a bid, suppliers in a bidding market face a trade-off between expected profits and the probability of winning the tender

[95] For example, the CMA understands that [✂]. Therefore, the CMA considers that this requirement for an 'ideal' bidding market is only partially met and certainly unlikely to be met in all cases.
[96] The tendered volume of fresh milk of the five largest retailers is in the range of 400 Ml pa up to over 1,000 Ml pa. The total volume of each of these tenders constitutes more than 20% of the overall sales volume of fresh milk of either Party [✂].
[97] For example, the terms of the [✂] invitation to tender requested bids from suppliers showing the prices where volumes were flexed by 10% upwards or downwards (although this did not preclude [✂] from moving additional volumes). Another example is that, [✂] moved some volume from [✂] to [✂] in its most recent tender.

process. A higher probability due to a reduced number of bidders may induce bidders to make a less attractive (but more profitable) bid.

210. Based on the evidence above, the CMA does not consider that the supply of fresh milk to national multiples fulfils the conditions of an 'ideal' bidding market.

Alternative ascending auction model

211. Müller submitted that, even if the CMA does not accept that the market is an 'ideal' bidding market, the key issue is whether the key drivers of today's market outcomes will remain post-Merger. Those key drivers included the need to drive volume to address high fixed costs and spare capacity.[98] Müller also submitted that the national multiple tender processes are akin to ascending (second-price) auctions where there are several rounds of the tender process and where, after each round, the buyer indicates that a bidder must lower its price by a certain amount to move into first place. The key outcome of this dynamic is that the winner of the auction supplies at a price determined by the runner up.[99]

212. The CMA does not accept these arguments for the following reasons.

213. First, Müller submitted that national multiples often know the cost of the different suppliers as they tend to request financial information as part of the bidding process. However, this information might not be sufficiently detailed to allow retailers to estimate the cost of supply for specific lots. Also, national multiples have told us they only provide general feedback to bidders on how competitive they are at various stages of the process; they do not disclose information about the costs or bids of other suppliers. Therefore, a supplier still has to make a guess about the likely best offer of its competitors when setting its price, and in that context the number of other competing suppliers might increase the uncertainty it faces.[100]

214. Secondly, while the CMA recognises that the Parties currently earn low margins and that the loss of volume will have an impact on a dairy's

[98] Müller's response to the issues statement of 20 May 2015, paragraph 1.4.
[99] Müller's response to the issues statement of 21 May 2015, page 1.
[100] This is supported by the Parties internal documents which show that suppliers only have imperfect information about the costs of other suppliers and their ranking in tenders. If bidders face some uncertainty about their relative competitiveness, then they can no longer simply bid up to the costs of the second most efficient supplier.

profitability, it has doubts regarding the significance of the impact of losing volume on overall profitability. In particular:

(a) the analysis is purely static – a dairy could try to win other contracts to compensate for lost volume. Also, it is likely that fixed costs can be reduced at least partly; and

(b) the Parties suggest that dairies need to be run at almost full capacity to cover their fixed cost and that a loss of 50 Mlpa is sufficient to deteriorate the overall profitability of the dairy substantially. However, it is difficult to reconcile this with the fact that Müller currently has overcapacity of [✄] Mlpa across the whole of the UK and still earns a [✄] profit.

Conclusion on the Parties' submissions regarding bidding markets

215. The CMA considers that the conditions for an 'ideal' bidding market are not met, in particular, the condition that national multiple tenders have a 'winners take all quality'. Nor does it consider that tenders in this market display the characteristics of an ascending auction model. Therefore, the CMA considers that the bidding behaviour will change progressively as the number of competitors changes, increasing the likelihood of unilateral effects with just two remaining bidders.

216. In any event, the CMA observes that, in a number of regions within Dairy Crest Severnside's catchment area, there would be a reduction in the number of credible competitors from two to one. The Parties arguments regarding bidding markets are not relevant in such circumstances.

Closeness of competition

217. The CMA first considered the closeness of competition between the Parties under the current conditions of competition on the basis that the current competitive interaction between the Parties in the catchment area of the Severnside dairy may be indicative of the conditions of competition under the counterfactual, but was mindful to consider also whether Dairy Crest Severnside would be likely to exert the same constraint in the counterfactual given its different structure and priorities.

- *Pre-Merger tender data*

218. Closeness of competition can be assessed on the basis of the number of competing bids or points of rivalry in tenders. Given the evidence submitted on the counterfactual, the Merger does not, based on the evidence available, raise national competition concerns.

219. Given the way in which national multiples divide national tenders into regional lots, an assessment has been undertaken of the extent of rivalry in tenders for national multiples for fresh milk on a regional basis and this has provided evidence as to how closely the Parties have competed pre-Merger.

220. The CMA received information regarding the most recent procurement processes held by ten national multiples; seven national multiples have provided information about recent tender processes.

221. The CMA has also considered these data from a regional perspective.

222. For the South West region, the procurement tenders of four national multiples included [✂] regional lots in the South West and Arla [✂]. Müller submitted bids [✂], whereas Dairy Crest [✂].

223. For Wales, five national multiples tendered eight regional lots for supply of fresh milk. Arla [✂]. Müller tendered for [✂]. Dairy Crest [✂]. [✂].

224. For the South region, the CMA assessed information from four national multiples that included seven regional lots. Arla bid for [✂] of these lots, the Parties for [✂]. Arla was successful with regards to [✂]. Müller [✂]. Dairy Crest won in [✂].

225. For the Midlands region, four national multiples tendered in total for nine regional lots. Arla bid for [✂] of them, the Parties for [✂]. Arla was successful in [✂], Dairy Crest [✂] and Müller in [✂] regional lots.

226. Based on the tender data set out above, the CMA considers that Dairy Crest and Müller are currently the only credible suppliers of fresh milk to national multiples in the South West and Wales. In the South of England and the Midlands, each of Arla and the Parties have bid for most of the regional lots and each of them has won at least one regional tender lot in each region. However, even in these regions, the Merger would result in a reduction in the number of suppliers from three to two. This suggests that the Parties are close competitors in these regions and that the Merger would result in a reduction of credible competitors from three to two.

- *Third party responses*

227. The CMA received concerns from four national multiple customers although these concerns related to the impact of the Merger against prevailing conditions of competition. Three national multiples consider that only Müller and Dairy Crest are currently viable suppliers in the South West and Wales regions and, of these, two raised significant concerns regarding competition in these areas specifically. The CMA observes that [✂]. Another national

multiple raised a concern that the Merger may result in the loss of competition for regionally sourced milk in Wales in particular. On the other hand, a number of national multiples were either less concerned or had no concerns and indicated that Arla may be able to supply them in these regions (although [✂]).

- *Conclusion on closeness of competition*

228. In the Severnside catchment area, the CMA considers that Müller and Dairy Crest Severnside will remain close competitors in the counterfactual. In the South West and Wales where there are no other credible competitors they would be each other's closest competitor.

Competitive constraints

229. The CMA has considered the competitive constraints that that the combined entity would face.

230. The Parties submit that national multiples will have two (and probably more) alternative bidders on which to call for each tender. Their submissions cite a number of alternative regional processors in the regions in Dairy Crest Severnside's catchment area.

231. The following section discusses first the competitiveness of Arla and then that of the regional processors regarding the supply of fresh milk to national multiples.

- *Arla*

232. The Parties submitted that Arla will act as a strong competitor and enjoys various competitive advantages over other processors. Furthermore, the Parties submitted that Arla is a closer competitor to each of Müller and Dairy Crest than they are to each other nationally and at a regional level. In particular, the Parties submit that Arla could compete in the South West and Wales regions by using subcontractors (as it does to serve [national multiple]) or by building a depot and/or using a third party logistics providers.

233. The CMA notes that the Aylesbury dairy has [✂] capacity at present and a capacity utilisation of [✂]. The capacity will be increased by another [✂] by [✂]. The CMA considers that Arla will have significant spare capacity within the near future creating an incentive for Arla to compete for additional volume. Its current catchment area includes [✂].

234. As regards the South West and Wales regions, [✂].[101] [✂] The CMA observes that, other than the subcontracting arrangement with [✂], Arla has [✂] regional lots in these regions and [✂].

235. Based on the evidence above, the CMA considers that Arla would continue to be an effective competitor to Müller and Dairy Crest Severnside in the South, Midlands, West and London. In particular, Arla will have strong incentive to compete for volume in the South East (including London), the Midlands, West and South regions of England to increase the utilisation of its Aylesbury dairy. However, for the reasons given above at paragraphs 232 to 235, the CMA does not consider that the presence of Arla alone would provide a sufficient competitive constraint on Müller following the loss of competition by Dairy Crest Severnside compared to counterfactual such as to prevent any realistic prospect of an SLC in the supply of fresh milk to national multiple customers.

- *Other processors*

236. The Parties submit that, in addition to Arla, there are a number of other processors that currently supply fresh milk to the national multiples (being Trewithen Dairy, Graham's and Tomlinsons Dairies)[102] and other regional processors (who do not currently supply national multiples) are also likely to be credible national multiple suppliers. In particular, Müller submits that Arla (through subcontracting arrangements with [✂]), Trewithen and Paynes (the latter of which has [✂]) are credible alternative suppliers to the Parties in the South West and Wales regions.[103]

237. Table 2 displays the geographic footprint and capacity data for the three regional suppliers of fresh liquid milk to national multiples. The CMA observes that Paynes does not supply any national multiple customers.

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[101] [✂].
[102] The CMA notes that [✂] does not supply milk for retail sale to national multiples and is therefore not considered further in this section.
[103] Müller's response to the supplementary issues paper of 5 June 2015, paragraph 1.2.

Table 2: Overview of regional processors supplying national multiples

	Grahams	*Tomlinsons*	*Trewithen*
National multiples supplied	[✂] ([✂]) [✂] ([✂]) [✂] ([✂]) [✂] ([✂]) [✂] ([✂])	[✂] ([✂]) ([✂])*	[✂] ([✂]) [✂] ([✂])
Region	Scotland	North Wales and parts of Shropshire and the North West	South West of England
Overall capacity	[✂] Mlpa*	[✂] Mlpa†	[✂] Mlpa
Spare capacity	[✂]	[✂] Mlpa	[✂] Mlpa

Source Third party submissions.
*Parties' estimate.
†[✂].

238. [✂] and [✂] both supply [a national multiple] as subcontractors and have spare capacity. However, in respect of direct supplies to national multiples, [✂] supplies [✂] Mlpa to [a national multiple] and [✂] supplies [✂]Mlpa to [a national multiple]. In addition, it is not clear that either of these processors would be as cost competitive as the larger processors and [✂]. With the exception of [✂] having bid for one lot of [national multiples], none of these suppliers have bid for any of the regional lots in the recent national multiple tenders cited above.

239. A Müller internal document states that smaller competitors in fresh milk face '[✂]'.[104]

240. Third party responses to the CMA's market test indicate that none of the regional processors except for [✂] has tendered for significant volumes of fresh milk (in excess of 10% of the requirements) with a national multiple. A few supply small volumes (sometimes as subcontractors as discussed above). [✂] mentioned Yeo Valley for the South West and South Carmarthen Creameries and Tomlinsons for Wales. [✂] mentioned Trewithen and Medina as possible suppliers for parts of South West and Wales. [✂] considers Cotteswold to be an alternative supplier for South West and Llaeth Cymreig Cyfyngedig, Dhaliwal Dairies and Tomlinsons for Wales. However, since these suppliers have not yet participated in a tender process for national multiples (with the exception of [✂]), it is unclear to what extent these suppliers would be able to meet the quality and other requirements of national multiples. In addition, [✂] confirmed that they did not consider that they were are able to compete for national multiple contracts at present.

[104] Müller's Strategic Plan 2014-2016 (July 2013).

241. In fact, the majority of national multiple customers' responses to the CMA's market enquiries indicated that they:

(a) did not consider regional processors (other than [✄]) to be credible suppliers principally because of their capacity and their geographic reach; and

(b) would not consider restructuring their tender lots further to facilitate bidding from a regional dairy and/or dividing their business across multiple smaller suppliers.

242. In summary, see the following:

(a) The CMA considers that [✄] and [✄] exert only limited competitive pressure in their respective regions since they [✄], they have not been identified as credible competitors to the Parties, and the CMA has doubts as to how price-competitive these processors are.

(b) All other regional processors have not competed for significant national multiple volumes in the catchment area of Dairy Crest Severnside (or, indeed, elsewhere). It is unclear to the CMA whether these processors would be price-competitive and to what extent these processors would meet the high requirements of the national multiples in terms of quality and service. In addition, a number of regional processors confirmed that they would not compete for national multiple volumes.

243. Overall, the CMA considers that the remaining regional processors would be able to exert only limited competitive pressure on the Müller and Dairy Crest Severnside. Therefore, Arla would continue to remain as the only credible competitor to the Müller and Dairy Crest Severnside in those regions where it is active.

Conclusion on unilateral effects in the supply of fresh milk to national multiples

244. The evidence set out above indicates that in the Severnside catchment area:

(a) the Merger may result in the reduction of the number of effective competitors for national multiples from two to one and result in a significant increment to Müller and Dairy Crest Severnside's combined share of supply in these regions;

(b) the Parties would likely remain close competitors under the counterfactual in these regions;

(c) third parties responding to the CMA's market test expressed concerns about competition in these regions; and

(d) there are no credible alternative suppliers to Müller or Dairy Crest Severnside in these regions.

245. Accordingly, the CMA concludes that the Merger will result in the realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of fresh milk to national multiples in the South, Midlands, West and, in particular, in the South West and Wales regions resulting in higher prices and/or the worsening of non-price conditions of competition.

Entry and expansion

246. The Parties submit that regional processors could grow to supply national multiples, in particular, because any improvements to meet any quality requirements or standards of national multiples would be straightforward (to the extent that they do not already meet these standards) and national multiples are well placed to sponsor entry of new processors or support the expansion of smaller processors.

247. The CMA asked the national multiples whether this was a strategy that they would engage in. The responses of eight national multiples stated that they would not consider sponsoring the entry of regional processors or consider vertical integration of their dairy supply chain. Only two national multiples could envisage sponsoring the entry of a regional processors and these were at a general level and were predicated on that supplier being commercially viable (indeed, one noted that the conditions that it would require to do so had not been met to date).[105]

248. The CMA also asked regional processors whether they had any expansion plans to supply national multiples and what the cost of expansion would be. The majority of responses of regional processors indicated that expansion of capacity would require significant investment and take a number of years to complete (for example one processor indicated that doubling its capacity would cost £25 million and take five to ten years). Some processors also identified access to raw milk as a barrier to expansion. The responses of smaller processors do not, therefore, suggest that it is realistic to expect any expansion from regional processors in the short or medium term.

[105] The CMA refers to its assessment of the credibility of these suppliers as an alternative to the Parties and Arla, paragraphs 229–242 above.

249. Based on the evidence above, the CMA does not consider that any expansion of regional processors' respective capacities is timely or likely such as to mitigate the realistic prospect of an SLC in the supply of fresh milk to national multiples.

Buyer Power

250. The Parties submit that national multiples can, and will continue to, manipulate tendering structures and processes in order to drive increased competition. Müller submits that national multiples control timing, structure and duration of tenders as wells as imposing an onerous set of contractual and service requirements.

251. The CMA notes that various national multiples confirmed that they could [✂]. However, under the counterfactual, the Merger will lead to a reduction of credible suppliers in the South West and Wales from two to one and national multiples may be unable to switch between processors in these regions. Even if tender lots are restructured, Müller would remain the only price-competitive supplier. If national multiples were to attempt to incentivise Arla to bid for these regions, this would come at a significant cost (as [✂]) and Müller may still have the incentive to increase prices above the pre-Merger level. Additionally, the reduction of credible suppliers from three to two in other regions also reduces national multiples' alternatives, and therefore their bargaining power.

252. Accordingly, the CMA does not consider that the national multiples would have sufficient countervailing buyer power to mitigate the realistic prospect of an SLC in the supply of fresh milk to national multiple customers following the Merger.

Supply of fresh milk to middle ground customers

253. The CMA has assessed whether the loss of rivalry between Dairy Crest Severnside and Müller would give rise to a realistic prospect of a SLCin the supply of fresh milk to middle ground customers (relative to the level of competition that would have existed under the counterfactual), taking into account closeness of competition between the Parties and other competitive constraints. The assessment contains the following sections:

(a) Shares of supply.

(b) Closeness of competition.

(c) Alternative competitive constraints.

Shares of supply

254. The Parties provided their shares of supply by volume in fresh milk to middle ground customers in each of the UK regions for 2013/14.[106] Given that under the counterfactual Dairy Crest Severnside would have a very different customer base to the prevailing situation, these shares of supply are only of limited relevance to the CMA's assessment. However, the shares from this period demonstrate that regional processors and Arla currently supply more than [50–60]% (and in most cases significantly more) of the middle ground market in each region in Dairy Crest Severnside's catchment area.

Closeness of competition

255. The evidence received by the CMA indicates that Müller and Dairy Crest compete for middle ground customers and would, under the counterfactual, continue to compete for those customers in the catchment area of the Severnside dairy, [✂].

256. Responses to the CMA's market testing indicate that, at a national level, the Parties currently compete most closely in relation to customers requiring large volumes (greater than 6 Mlpa) that often require national distribution. However, Dairy Crest provided evidence showing that, in the South West and West & Wales, it supplies [✂] customers with requirements over [✂] Mlpa, indicating that customer volume requirements in the area are generally small.[107]

257. The CMA considers that in the counterfactual, Dairy Crest Severnside would face an incentive to compete for middle ground volumes given the need to utilise the fresh milk generated at the Severnside dairy (particularly local foodservice customers). In terms of its capability, the Severnside dairy would have a significantly larger capacity than the other regional processors in its catchment area. The only processor with a similar capacity would be Müller's Bridgwater and Droitwich dairies and Arla's Aylesbury dairy. Competitive constraints

258. The Parties submitted that they are constrained by a large number of regional processors which have significant spare capacity. They provided switching data and a large volume of internal documents which they claimed demonstrated the competitive constraint of regional processors on the Parties.

[106] These data are based on the supply of fresh milk to national multiples in Great Britain for financial year 2013/14 (volume in megalitres). The regions are based on those used by Kantar Worldpanel for the purposes of its data analytics services.
[107] Dairy Crest's response of 5 June 2015 to the CMA's supplementary issues paper, paragraph 5.5 and Appendix 3.

259. The evidence showed that both Parties have lost large middle ground customers to regional processors. For example, Dairy Crest lost [✂] and Müller lost [✂].[108] Moreover, the Parties provided examples of losses to regional processors in each of the regions in which Dairy Crest Severnside would compete:[109]

(a) In the South West, [✂] and [✂] in particular, including [✂].

(b) In the Wales & West, [✂] and [✂]in particular, including [✂].

260. The CMA understands from the responses of third party processors that, given the significance of logistics costs in the cost of delivered fresh milk, the competitive constraint of processors is most significant up to a distance of 80 to 100 miles from their dairies although a number of regional processors indicated that they could supply significantly further (for example, [✂] indicated that it could compete in a [✂] miles radius from its dairy).

261. Therefore, the CMA considers that the processors with facilities that are sufficiently close to supply middle ground customers competitively are the following:

(a) In the South West: Trewithen, Medina, Pensworth and Cotteswold. [✂] is likely to become less competitive the further it supplies from its core areas in Cornwall and Devon, whereas the other suppliers would likely be less competitive in Cornwall and Devon, as would Dairy Crest Severnside.

(b) In Wales: Tomlinsons and Cotteswold supply to North Wales. Medina, Pensworth and Cotteswold supply to South Wales. In addition, Freshways has a depot in South Wales but this is a considerable distance from its dairy near London.

(c) In the West: Arla, Medina, Pensworth and Cotteswold.

(d) In the Midlands: Medina, Cotteswold, Tomlinsons, Freshways and Arla.

(e) In the South: Medina, Pensworth, Freshways and Arla.

262. These regional processors have significant spare capacity and therefore have the ability to compete for middle ground customers.

263. The CMA has also assessed the credibility of regional processors to supply middle ground customers based on the tender data and third party responses. While the tender data received by the CMA is not a sufficiently large sample

[108] Merger Notice Form, at Annex V B.63 and Appendices V K.
[109] Parties' response of 15 May 2015 to the CMA's issues paper, slide 56.

to draw firm conclusions on a regional basis, these data show regional processors winning customers in competition with the Parties (particularly for smaller customers). Fourteen regional dairies won at least one tender in the 26 procurement processes on which the CMA received evidence.

264. While not reflected in the tender data, the CMA has also received evidence from third parties and the Parties to suggest that the [✄] has won multiple supply contracts (as have [✄] and [✄] but these processors do not appear to compete strongly (if at all) in the Severnside dairy catchment area).

265. Arla was invited to participate in [✄] of these [✄]. While some respondents indicated that Arla was a credible supplier, other third parties indicated that their volumes were too small for Arla to consider bidding for them. However, the CMA considers that except for South West and Wales, Arla is a credible competitor for larger middle ground customers for the reasons set out above in relation to national multiple customers.

Third party comments

266. The CMA received responses to its market enquiries from 36 middle ground customers, the large majority of which did not raise concerns regarding the Merger. Nine customers raised concerns regarding possible price increases following the Merger. However, as set out above, the CMA considers that there is sufficient remaining competition for these customers.

Conclusion on horizontal unilateral effects

267. The evidence demonstrates that Müller and Dairy Crest Severnside would continue to face strong competition from a number of regional processors in each region in the Severnside dairy's catchment area. There is evidence of significant switching to regional dairies away from the Parties, and regional dairies have been successful in securing a number of significant contracts with middle ground customers.

268. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of fresh milk to middle ground customers.

Supply of packaged cream to middle ground customers

269. The Parties submitted that, in general, sales of packaged cream in the middle ground segment are strongly aligned to the sales of fresh milk in that segment. Therefore, its submissions regarding the supply of fresh milk to middle ground customers are applicable equally to the supply of packaged cream.

270. The CMA considered the closeness of competition between the Parties and other competitive constraints in its assessment of the impact of the Merger in the supply of packaged cream to middle ground customers.

Closeness of competition

271. Dairy Crest submitted that, under the counterfactual, [✂].

272. [✂]. However, given that some middle ground customers (eg local foodservice customers) prefer to procure both fresh milk and packaged cream from a single supplier, Dairy Crest may need to continue to supply some packaged cream to serve such customers.

273. [✂], the CMA considers that Dairy Crest Severnside would not be a significant competitor to Müller for the supply of packaged cream to middle ground customers under the counterfactual.

Competitive constraints

274. The Parties submitted that, similarly to fresh milk, there is a large number of regional and mid-sized processors that have the capacity and the ability to service middle ground customers' packaged cream requirements.

275. The CMA notes that most middle ground customers that responded to the CMA's market enquiries procure milk and cream together. The CMA therefore considers that the degree of competitive constraint provided by regional processors in the supply of fresh milk to middle ground customers would also exist in the supply of packaged cream to middle ground customers.

Third party responses

276. The CMA notes that, as packaged cream is largely procured with fresh milk, the comments raised by middle ground customers regarding fresh milk are likely to apply equally to packaged cream. Five parties raised concerns but the large majority of middle ground customers did not. Those that did were predominantly larger customers.

Conclusion on horizontal unilateral effects

277. The CMA considers that the evidence above demonstrates that Müller and Dairy Crest Severnside would continue to face strong competition from a number of regional processors in the counterfactual scenario in each region in the Severnside dairy's catchment area.

278. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of packaged cream to middle ground customers.

Supply of flavoured milk drinks

279. The CMA has assessed whether the Merger would result in a realistic prospect of an SLC in the supply of flavoured milk drinks, focusing on whether the Merger would give rise to horizontal unilateral effects.

Shares of supply

280. Dairy Crest supplies fresh dairy drinks under its brand, Frijj, to national multiple and middle ground customers. It also supplies on a private label basis to its national multiple customers. In the UK, Müller supplies dairy drinks to middle ground customers in Scotland, primary and secondary schools in particular.

281. Given that Dairy Crest would continue to supply flavoured milk drinks under the counterfactual, its existing share of supply is likely to be a reliable indicator of its share of supply under the counterfactual. The Parties estimated that the combined share of the Parties in the supply of dairy drinks in Great Britain is [30–40]%, with an increment of [0–5]% (Müller's share of supply).[110] At the EEA level, the Parties estimate that the Merger would in a combined share of supply of [10–20]% (by volume of sales) with an increment of [0–10]% (Dairy Crest's share of supply).

282. While Dairy Crest's share of supply in Great Britain is relatively large, the increment is small.

Closeness of competition

283. The Parties submitted that they are not close competitors. Whereas Dairy Crest is solely active in branded fresh dairy drinks through sales to retailers and wholesalers, Müller is active in the branded segment but via an entirely different and unique distribution channel, namely primary and secondary schools in Scotland.

284. Dairy Crest's internal documents that discuss relevant competitors in the dairy drinks market do not mention Müller.

[110] The Parties used as a starting point for market size but have uplifted the figure by 25% because they believe that Nielsen data is not likely to include many of the sales to corner shops, garages and non-retail outlets (such as schools, hospitals and the HoReCa segment).

285. Furthermore, Müller's [✂], stated that Dairy Crest did not tender for its requirements.

286. The responses of the Parties' customers to the CMA's market enquiries confirmed that the Parties are not considered as close competitors. Third parties did not express any concerns regarding the effect of the Merger in this frame of reference.

Competitive Constraint

287. The Parties submitted that Dairy Crest's Frijj brand will be constrained by dairy drinks offered by Starbucks, Mars, Yazoo, Emmi, Dunns River, Galaxy and other relevant competitors.

288. Internal documents of the Parties suggest that there are at least five significant competitors of dairy drinks in the UK: O/L, Yazoo, Mars, Starbucks and Dunns River.[111]

289. Therefore, the CMA considers that the combined entity will face significant competitive constraints in the supply of flavoured milk drinks post-Merger.

290. Based on the evidence set out above, the CMA does not believe that the Merger will result in an SLC in the supply of flavoured milk drinks either in the UK or at EEA level.

Supply of buttermilk

291. The CMA has assessed whether the Merger would result in a realistic prospect of an SLC in the supply of concentrated buttermilk and buttermilk powder, focusing on whether the Merger would give rise to horizontal unilateral effects.

292. The Parties submitted that they do not hold any information regarding shares of supply for concentrated buttermilk. However, Dairy Crest did not sell any concentrated buttermilk in 2013/14, suggesting its position on the market is *de minimis*.

293. While Dairy Crest's sales of buttermilk powder are focused in the UK (with some sales in the EEA including Germany), Müller supplies buttermilk powder outside the UK (mainly in Germany). While the Parties did not provide any share of supply estimate for the EEA, the Parties estimate that each of the Parties' share of supply of buttermilk powder in Germany is less than 1%.

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[111] See Annex VII.19, slide 3. These competitors have shares of supply between 6 and 21% in 'flavoured milk' based on Nielsen data.

Furthermore, the Parties provided an estimated share of supply of bulk butter in the EEA of [0–5]%. While bulk butter is a separate frame of reference, the CMA notes that buttermilk is a by-product of butter production and therefore provides some indication that the Parties are unlikely to have a significant share of supply in any buttermilk product at EEA-level.

294. No third parties have raised concerns with the Merger regarding the supply of any type of buttermilk.

295. The CMA considers that the Merger does not raise competition concerns in the supply of any type of buttermilk, given Dairy Crest's *de minimis* presence in the supply of concentrated buttermilk in the UK and the small presence in the supply of buttermilk powder (or both buttermilk products) in the EEA.

Supply of skimmed milk powder

296. The CMA has assessed whether the Merger would result in a realistic prospect of an SLC in the supply of skimmed milk powder, focusing on whether the Merger would give rise to horizontal unilateral effects.

297. The Parties estimated that their combined share in the supply of skimmed milk powder is less than [0–5]% at EEA level.

298. No third parties raised concerns regarding the effects of the Merger on the supply of skimmed milk powder. One competitor confirmed that the Parties' combined market share in this market is very small.

299. The CMA does not believe that Merger will result in an SLC in the supply of skimmed milk powder at EEA level.

Competitive assessment – coordinated effects in the supply of fresh milk to national multiples

300. Coordinated effects may arise when firms operating in the same market recognise that they are mutually interdependent and that they can reach a more profitable outcome if they coordinate to limit their rivalry. The following conditions must be satisfied for coordination to be possible:

(a) Firms must be able to reach and monitor the terms of coordination.

(b) Coordination must be internally sustainable among the coordinating group, ie firms have to find it in their individual interests to adhere to the coordinated outcome.

(c) Coordination must be externally sustainable, in that there is little likelihood of coordination being undermined by competition from outside the coordinating group.[112]

301. The CMA assessed whether the Merger makes it more likely that firms supplying fresh milk to national multiples will coordinate or makes coordination more stable or effective.[113]

302. The Parties submitted that the current structure of competition in the supply of fresh milk to national multiples acts as an effective tool to prevent coordination among processors, and that the Merger would not alter the market characteristics enabling coordination to occur.

303. The CMA found that, on a national basis, there would be no merger-specific effects. This is because, under the counterfactual, Dairy Crest Severnside would no longer be a credible supplier to national multiples on a national basis. Therefore, the same participants – Müller and Arla – would supply national multiples on a national basis absent the Merger, and where the Merger proceeded.

304. The CMA also found that, on a regional basis, the Merger would not make it more likely that the firms supplying fresh milk to national multiples would coordinate, or make coordination more stable or effective. In the counterfactual, Müller and Dairy Crest Severnside would be the main suppliers of fresh milk to national multiples in the South West and West & Wales. Under the Merger, the combined entity would become sole credible supplier of national multiples in most of South West and Wales & West. In a situation where there is only one supplier, no coordination concerns arise.

305. Therefore, the CMA does not believe that the Merger will give rise to an SLC through coordinated effects in the supply of fresh liquid milk to national multiples.

Efficiencies

306. While mergers can harm competition, they can also give rise to efficiencies. Efficiencies arising from a merger may enhance rivalry, with the result that the merger does not give rise to an SLC. For example, a merger of two of the smaller firms in a market resulting in efficiency gains might allow the merged entity to compete more effectively with the larger firms.[114]

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[112] *Merger Assessment Guidelines,* paragraphs 5.5.1–5.5.19.
[113] *Merger Assessment Guidelines,* paragraphs 5.5.4.
[114] *Merger Assessment Guidelines*, paragraph 5.7.1–5.7.2.

307. To form a view that the claimed efficiencies will enhance rivalry so that the merger does not result in an SLC, the CMA must be satisfied, on the basis of compelling evidence, that the following criteria will be met:[115]

(a) The efficiencies must be timely, likely and sufficient to prevent an SLC from arising (having regard to the effect on rivalry that would otherwise result from the merger).

(b) The efficiencies must be merger-specific, ie a direct consequences of the merger, judged relative to what would happen without it.

Parties' submissions

308. The Parties submitted that the Merger will give rise to substantial synergies which will allow the merged firm to compete more effectively. In particular, the Parties claimed that the Merger will enable cost savings in the following areas:[116]

(a) **Logistics** – the Parties submitted that the Merger will enable the merged entity to optimise its outbound logistics of transporting milk from the dairy to the customer, resulting in expected savings of £[✂] million per year.[117] The Parties also submitted that the Merger will enable the merged entity to optimise its inbound logistics of moving milk from the milk field to the dairy, resulting in expected savings of £[✂] million per year.

(b) **Processing** – the Parties submitted that the Merger would enable significant scale economies in processing. It was claimed that, to the extent that there is sufficient spare capacity, the Merger would allow the merged entity to concentrate production at more modern and efficient facilities. The Parties estimated that such improvements could save up to £[✂] million in costs.

Assessment

309. The CMA does not consider that the Parties have provided compelling evidence showing that the Merger will result in efficiencies that would be

[115] *Merger Assessment Guidelines*, paragraph 5.7.4.
[116] The Parties also submitted that, in addition to cost savings in logistics and processing, the Merger will generate additional benefits in the form of procurement efficiencies, fixed cost savings, and enhanced scope for investment. It was claimed that the Merger would also enable Müller to improve its milk balancing ([✂]).
[117] Dairy Crest submitted that savings would be delivered by: *(a)* reducing the overall mileage to deliver to customers in areas where there is currently duplication between the Parties (ie where currently two vehicles deliver to one postcode); *(b)* reducing 'stem mileage' (ie distance from depot to first customer served) as with a greater number of dairies the merged entity would be able to deliver milk from dairies located closer to customers; and *(c)* increased fleet efficiency, as vehicle utilisation rates are projected to increase from [✂]. The Parties also submitted that the Merger may enable further depot rationalisation.

timely, likely and sufficient to prevent an SLC in the supply of fresh milk to national multiple from arising.

310. Firstly, the evidence provided by the Parties to support their submissions on efficiencies is not of the standard needed at phase 1 to meet the compelling evidence threshold.

311. The main piece of evidence submitted by the Parties to support their efficiencies claim is a draft presentation prepared by KPMG titled '[✂]' (the **KPMG Report**).

312. The KPMG Report estimates that a joint-venture between the Parties would generate synergies amounting to £[✂] million in total. However, this estimate has not been subject to external validation. The KPMG Report notes that the contents '[✂]'.

313. The KPMG Report itself highlights several sources of uncertainty and presents many of its conclusions as provisional. For example, with respect to inbound logistics, the report notes that:

> '[✂]'.

314. With respect to mileage reduction in outbound logistics, the KPMG Report gives an estimate of £[✂] million without any discussion of the methodology or assumptions used. The report states that:

> '[✂]'.

315. The CMA therefore considers that the evidence provided by the Parties does not constitute sufficiently compelling evidence to conclude on efficiencies in a Phase 1 investigation.

316. Secondly, any synergies resulting from the Merger would not be rivalry enhancing given that, with the Merger, Müller would be the only credible supplier of fresh milk to national multiples in some of the regions where the Parties overlap under the relevant counterfactual, as set out above. In this sense, there would be no rivalry to enhance.

317. Thirdly, it is uncertain whether the synergies arising from the Merger would be sufficient, particularly because the evidence available does not support that those efficiencies will be passed through to the consumer:

(a) The Müller presentation discussing the rationale for the Merger and the scope for synergies assumes that [✄].[118] The document does not factor in any degree of pass through to customers.

(b) At least a share of savings estimated in the KPMG Report for outbound logistics relates to the fixed costs of the depot network rather than the short-run variable cost of production. The KPMG presentation indicates that, of the £[✄] million of savings expected for this [✄] item, £[✄] million is due to mileage reductions with the remaining being due to fleet rationalisation (which is more likely to be a variable cost) and depot rationalisation (which is more likely to be a fixed cost).

Conclusion

318. While the CMA cannot rule out the possibility that the Merger will give rise to efficiencies of the type suggested by the Parties, it has not been provided with compelling evidence showing that the Merger will result in efficiencies that would be timely, likely and sufficient to prevent an SLC in the supply of fresh milk to national multiples from arising.

Exceptions to the duty to refer

319. The Parties also put forward that, to the extent the efficiencies are not rivalry enhancing, they would qualify as relevant customer benefits under the Act. The CMA notes that the same evidentiary threshold applies to relevant customers benefits than to efficiencies. Therefore, for the reasons explained above, the CMA does not consider that the evidentiary threshold for applying the RCB exception to its duty to refer is satisfied.

Third party views

320. The CMA contacted customers and competitors of the Parties. Four of the ten national multiples and nine of the 36 middle ground customers that responded raised concerns regarding the Merger. Two national multiples raised concerns specifically regarding the South West specifically. However, for reasons of commercial confidentiality, the CMA was unable to ask customers if they

[118] Annex II.37 – slide 15.

would have been concerned regarding the Merger given the downsizing of Dairy Crest's dairies operations in the counterfactual.

321. The CMA received responses from a number of other interested parties such as farmers' unions, dairy sector trade and representative bodies, and Members of Parliament and Members of the House of Lords. All of these responses were in favour of the Merger and in general highlighted structural issues with the UK dairy sector, the need for consolidation and the likely benefits to consumers from a more efficient dairy sector that would result from the Merger.

322. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

323. Consequently, the CMA believes that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

324. The CMA therefore considers that it is under a duty to refer under section 33(1) of the Act. However, the duty to refer is not exercised pursuant to section 33(3)(b) whilst the CMA is considering whether to accept undertakings under section 73 of the Act in lieu of a reference. Pursuant to section 73A(1) of the Act, the Parties have until 19 June 2015 to offer an undertaking to the CMA that might be accepted by the CMA under section 73(2) of the Act. If the Parties do not offer an undertaking by this date, if the Parties indicate before this date that they do not wish to offer an undertaking, or if pursuant to section 73A(2) of the Act the CMA decides by 26 June 2015 that there are no reasonable grounds for believing that it might accept the undertaking offered by the Parties, or a modified version of it, then the CMA will refer the Merger for a phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act.

Sheldon Mills
Senior Director
Competition and Markets Authority
12 June 2015