

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

**ME/6524/15**

## **Contents**

Introduction .....	2
The CMA's SLC finding .....	3
Undertakings .....	6
Nominated Purchasers .....	10
Consultation .....	11
National multiples.....	11
Dairy processors .....	13
Industry organisation representing farmers.....	13
Assessment.....	13
Legal framework .....	13
Framework for analysis of the present case .....	15
Clear-cut remedy .....	19
Assessment of the Proposed Purchasers .....	25
Third party submissions .....	25
The CMA's assessment .....	26
Specific issues relating to the Undertakings .....	32
Competitiveness of the Nominated Purchaser .....	32
Duration .....	36
Risk of co-ordinated effects .....	38
Input foreclosure .....	43
Conclusion .....	44
Decision .....	45

## Introduction

1. Muller UK & Ireland Group LLP (**Müller**) has agreed to acquire the liquid milk, packaged cream, flavoured milk and bulk commodity ingredient business of Dairy Crest Group plc (**Dairy Crest**) (the **Merger**).
2. On 12 June 2015, the Competition and Markets Authority (**CMA**) decided under section 33(1) of the Enterprise Act 2002 (the **Act**) that it believes that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition (**SLC**) within a market or markets in the United Kingdom (**the SLC Decision**).
3. Under section 73 of the Act, the CMA may, instead of making a reference for a phase 2 investigation, accept from the parties, undertakings to take such actions for the purpose of remedying, mitigating or preventing the SLC which may be expected to result from the Merger.
4. On 19 June 2015, Müller offered undertakings to the CMA for the purposes of section 73(2) of the Act. The CMA gave notice to Müller, following consideration and preliminary negotiation of the undertakings, on 26 June 2015, under section 73A(2)(b) of the Act, that it considered that there are reasonable grounds for believing that the undertakings offered, or a modified version of them, might be accepted by the CMA under section 73(2) of the Act and that it was considering the offer.
5. The CMA stated in this notice that its decision whether to ultimately accept these undertakings would be informed by, among other things, views from third parties, including national multiples, as to whether the undertakings would be suitable to address the competition concerns identified by the CMA. It also noted that it must be confident that the undertakings would result in an effective and credible supplier to major grocery retailers with national scope (**national multiples**)<sup>1</sup> such that the competitive constraint provided by Dairy Crest under the counterfactual is replaced. The CMA therefore obtained initial comments from national multiples and other third parties in early July 2015 and took these into account in its discussions with Müller about the undertakings.
6. On 10 August 2015, the CMA issued a notice of consultation (the **First Consultation**) on the proposed undertakings (the **Original Undertakings**). The notice of consultation stated that the CMA would have regard to any

---

<sup>1</sup> In paragraph 115 of the SLC Decision and for the purpose of that decision, the CMA defined 'national multiples' as comprising: Tesco, Asda, Sainsbury's, Morrisons, Co-op, Aldi, Lidl, Iceland, Waitrose and M&S.

representations made in response to the First Consultation and Müller may make modifications to the Original Undertakings as a result. On the same date the CMA also extended the time available to reach a decision on whether to accept the undertakings offered by Müller under section 73A(4) of the Act, resulting in a statutory deadline to reach this decision by 19 October 2015.

7. Having taken into account comments received in response to the First Consultation and the CMA's further consideration of the Original Undertakings, Müller subsequently submitted modifications to the Original Undertakings designed to further strengthen its offer. The CMA considered that these were material modifications and, in accordance with paragraph 2(4) of Schedule 10 of the Act, on 30 September 2015 issued a notice of consultation (the **Second Consultation**) on the modifications to the Original Undertakings.
8. Under section 73(2) of the Act, the CMA is now making its decision on whether to accept the Original Undertakings as modified (the **Undertakings**). The CMA has carefully assessed the Undertakings throughout the assessment period, both in the light of submissions received from third parties and the potential new competitors taking advantage of the Undertakings, and applying its technical expertise and analysis across the CMA's legal, economic and specialist Remedies, Business and Financial Analysis teams. The CMA has taken into account the submissions it received from third parties, including those received prior to and in response to the Second Consultation.

### **The CMA's SLC finding**

9. The Undertakings must resolve the competition concerns identified in the SLC Decision in a clear-cut manner. Accordingly, the CMA's SLC finding is set out in this section, including a description of the relevant counterfactual.
10. 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 [X] billion litres of British milk per annum into liquid milk, butter, cream, yoghurt and desserts. In the last audited financial year, Müller made a £[X] million profit on turnover of £[X] million (trading profit to turnover ratio of [X]%).<sup>i</sup>
11. Dairy Crest is a British dairy products company. 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 Friij along with other private label products),

packaged cream, bulk cream, bulk butter, milk powders and buttermilk. The trading profit of Dairy Crest's dairies operation was £[redacted] million from revenues of £[redacted] million (trading profit to turnover ratio of [redacted]%).

12. On 5 November 2014, Müller entered into an asset purchase agreement to acquire Dairy Crest's dairy operations.<sup>2</sup> The assets being acquired include Dairy Crest's dairies at Severnside, Chadwell Heath, Foston and Hanworth, assets and equipment at Dairy Crest's Chard facility, and 72 Dairy Crest depots, of which 65 are operational.
13. The Parties currently overlap in the procurement of raw milk in the 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, bulk butter, skimmed milk powder and buttermilk in the UK.
14. The CMA assessed the impact of the Merger against a number of related product markets and at a national and regional level. The CMA found that there was no realistic prospect of an SLC in any of those markets, except for the supply of fresh milk to national multiples in the catchment area of Dairy Crest's Severnside dairy (the **Severnside dairy**). This area includes parts of the South West, West, Wales, South and Midlands.
15. As set out in the SLC Decision, the CMA assessed the Merger against a counterfactual in which Dairy Crest would downsize to one dairy, the Severnside dairy, absent the Merger. As part of the downsizing, Dairy Crest would focus its milk processing capacity at the Severnside dairy on the most profitable parts of its business, including flavoured milk, spreads and packaged butter (Dairy Crest's cheese, butter and spreads business, for example, recorded turnover of £[redacted] million and profits of £[redacted] million in the 2013/14 financial year, compared to a £[redacted] million profit from revenues of £944.8 million for its dairies operations). The CMA also assessed whether under the counterfactual Dairy Crest would inevitably exit the supply of fresh milk to national multiples.<sup>3</sup>
16. During the CMA's investigation of the Merger, Dairy Crest submitted that it would not supply national multiples or large middle ground customers because it would have no ability or incentive to compete for those contracts. Dairy Crest stated that it would produce fresh milk in significantly smaller

---

<sup>2</sup> 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.

<sup>3</sup> SLC Decision, paragraphs 76-81.

volumes after downsizing, effectively as a by-product of its more profitable business lines, and would focus on supplying this fresh milk to more profitable local middle ground and doorstep customers (for which it would earn higher margins than it currently earns on its national multiple customers). Dairy Crest also stated that it may prefer to dry any excess milk and sell it as skimmed milk powder on the EEA-wide or global market rather than sell it as fresh milk to national multiples.<sup>4</sup>

17. The CMA accepted that, absent the Merger, 'Dairy Crest's credibility as one of the three main suppliers capable of supplying across Great Britain to national multiples would be lost following its downsizing to the Severnside dairy.<sup>5</sup> This finding is relevant to the assessment of the acceptability of the Undertakings. The Undertakings are not designed to introduce a new national supplier of fresh milk to national multiples across Great Britain or in any other region outside the Severnside dairy catchment area. In the counterfactual, the downsized Dairy Crest could no longer operate as a national supplier across Great Britain and the SLC Decision did not identify competition concerns outside the catchment area of the Severnside dairy. As such, the CMA considers that the acceptability of the Undertakings should not depend on the extent to which either the downsizing of Dairy Crest's operations or the Merger may have an impact on the supply of fresh milk to national multiples outside the catchment area of the Severnside dairy.
18. The CMA did find, however, that national multiples 'may seek supplies from a regional dairy when faced with a reduced number of suppliers'.<sup>6</sup> The CMA found that the implications of the downsizing of Dairy Crest's operations under the counterfactual were 'not sufficiently certain for the CMA to conclude that it would be inevitable that Dairy Crest Severnside would cease supplying national multiples'. It concluded that, despite there being uncertainty as to whether Dairy Crest would continue to compete, Dairy Crest may have the ability and incentive to compete for the supply of fresh milk to national multiples through certain regional lots in the Severnside dairy catchment area.<sup>7</sup>
19. In particular, the CMA found that Dairy Crest may have had 55 million litres per annum (**mlpa**) of spare capacity, plus a potential further 45 mlpa of capacity [X], with which it could compete to supply certain regional lots of national multiples in the Severnside dairy catchment area.<sup>8</sup> The CMA could

---

<sup>4</sup> SLC Decision, paragraphs 34, 77 and 188-203.

<sup>5</sup> SLC Decision, paragraph 193.

<sup>6</sup> SLC Decision, paragraph 194.

<sup>7</sup> See paragraphs 79-81, 91-92 and 96 of the SLC Decision.

<sup>8</sup> SLC Decision, paragraph 200.

not rule out that Dairy Crest would have more spare capacity than this, given that doorstep supplies are in decline. Nevertheless, the CMA regards the figure of 100 mlpa as an appropriately conservative estimate of Dairy Crest's potential spare capacity, in particular given that Dairy Crest's intention was to put any spare capacity to its most profitable use, and therefore this capacity may also have been used to supply fresh milk to middle ground customers or otherwise used for its more profitable business lines in accordance with Dairy Crest's stated intentions.<sup>9</sup> As the total fresh milk processing capacity at the Severnside dairy is [X] mlpa, this spare capacity is [a relatively small proportion] of the total capacity of the dairy.

20. The CMA also found that Dairy Crest may have the incentive to use this capacity to supply national multiples, as Dairy Crest did not provide clear evidence to the effect that supplying fresh milk to national multiples would not make a contribution to its fixed costs.<sup>10</sup>
21. Based on the above counterfactual, the CMA concluded the Merger will result in a 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 catchment area of the Severnside dairy.

## Undertakings

22. The main provisions of the Undertakings are set out below. The Undertakings are intended to remedy the SLC which may be expected to result from the Merger based on the findings set out in the SLC Decision by replacing the constraint of the downsized Dairy Crest in the counterfactual. The Undertakings are designed to enable an existing supplier of fresh milk in Great Britain to serve national multiples in the Severnside dairy catchment area such that the constraint of the downsized Dairy Crest is replaced. Under the Undertakings,<sup>11</sup> Müller has agreed to sell a toll processing arrangement option (**TPAO**) to a specified third party (the **Nominated Purchaser**), on the basis of which the Nominated Purchaser will have the option to require Müller to process up to 100 mlpa of fresh milk from the Severnside dairy for the purpose of supplying this milk to national multiples.<sup>12</sup> The TPAO has an initial term of five years, plus the option to fulfil any ongoing national multiple

---

<sup>9</sup> SLC Decision, paragraph 197.

<sup>10</sup> SLC Decision, paragraphs 198-203.

<sup>11</sup> The Undertakings are available on the [CMA case page](#).

<sup>12</sup> The TPAO agreement states that the Nominated Purchaser 'shall use its best endeavours to use the [fresh milk] supplied to it under the Agreement for the supply of national multiples (provided that this shall not restrict ... the Purchaser from selling and supplying such [fresh milk] or part of it to other customers)'. The CMA considered whether the terms of the TPAO should restrict the Nominated Purchaser to using the TPAO volumes to supply national multiples, but the CMA believes this would not be appropriate for the reasons set out at paragraph 88).

contract that is in place at the end of this initial term for an additional period of up to three years. In such circumstances, the overall term of the TPAO will be eight years.

23. The 'five plus three' year duration of the TPAO is designed to ensure that the Nominated Purchaser will be able to bid for a substantial number of national multiple contracts over a five-year period, and will also be able to fulfil any contract it wins during that period with the TPAO volumes. It is also designed to provide the Nominated Purchaser with a sufficient period to build relationships with national multiples by enhancing its credibility as a supplier, and to allow for the development of any processing capacity it will need to supply national multiples cost-effectively in the Severnside dairy catchment area by the end of the TPAO.
24. The price to be paid by the Nominated Purchaser for the TPAO consists of two elements. First, the Nominated Purchaser will pay a fixed sum for the TPAO.<sup>13</sup> This sum has been determined in an auction process with several potential Nominated Purchasers participating. The fixed sum is a design feature that incentivises the Nominated Purchaser to compete to win contracts, as it is a sunk cost that is recoverable only by earning revenue on contracts won. Secondly, the Nominated Purchaser will pay a toll processing fee, consisting of a per litre price for the fresh milk supplied under the TPAO based on variable cost, using as a benchmark Dairy Crest's variable costs of operating its fresh milk processing facilities at the Severnside dairy. This price will be subject to an annual review mechanism, in which the price is adjusted to reflect any actual increase (capped at RPIJ<sup>14</sup>) or decrease in the costs of processing fresh milk by Müller at the Severnside dairy. This adjustment mechanism will ensure that the Nominated Purchaser benefits from any reduction in variable costs at the Severnside dairy achieved as a result of efficiency gains.
25. The Undertakings also include obligations on Müller, if required by the Nominated Purchaser:
  - (a) to segregate milk where technically possible as required by the national multiple customer of the Nominated Purchaser;
  - (b) to use its best endeavours to facilitate access for the Nominated Purchaser to purchase raw milk directly from farmers and to negotiate

---

<sup>13</sup> Under the TPAO, the Nominated Purchaser has agreed to pay the fixed sum in instalments.

<sup>14</sup> Retail Price Index Jevons Method.

with the Nominated Purchaser a procurement contract on a commercial basis to procure required raw milk volumes for the TPAO;

- (c) to enter into ancillary agreements with the Nominated Purchaser for the collection of raw milk and distribution of processed milk (on terms to be agreed on a commercial basis); and
- (d) to process and package cream associated with the fresh milk volumes processed under the TPAO. The price for the processing and packaging of cream will be based on actual cost at the Severnside dairy (both fixed and variable costs) and will not include a margin for the cream that the Nominated Purchaser uses to supply national multiples as part of a contract to supply fresh milk. This price will be subject to a review mechanism based on the same principles as the price review mechanism for fresh milk.

26. Müller has also committed to establish a fund, capped at £20,000, on which the Nominated Purchaser can draw at Müller's cost to engage independent consultants to assist in developing the Nominated Purchaser's expertise in relation to the supply of fresh milk to national multiples.

27. In order to safeguard against the disclosure of confidential information between the employees of Müller involved in the commercial and financial aspects of national multiple tenders for fresh milk (and for packaged cream, if the Nominated Purchaser chooses to obtain supply of packaged cream) (**national multiples employees**) and Müller's employees involved in negotiating fees or other terms relating to the TPAO with the Nominated Purchaser (**TPAO employees**), Müller has committed to require its employees to sign non-disclosure agreements and also to implement the following firewall mechanisms:

- (a) to keep the TPAO employees and the national multiples employees physically separate at different Müller sites;
- (b) to implement an arrangement that will ring-fence the toll processing fee from Müller's national multiples employees, ensuring that detailed payment and billing information of the TPAO will not be visible within the wider Müller business;
- (c) to install appropriate IT firewalls, including password protection for electronic files and computers, and keep separate physical storage of documents to prevent national multiples employees accessing information about the Nominated Purchaser's specific requests for Müller to process fresh milk; and



- (d) to engage, at Müller's cost, during the first three months of the TPAO an independent third party to audit the firewall arrangements and, to the extent any concerns are identified, remedy those concerns to the extent that such suggestions are reasonable, proportionate and necessary in order for the firewall to be fully effective. The auditor will report to the CMA at the end of its appointment on the effectiveness of the firewall measures Müller has implemented.
28. The firewall mechanisms above will protect competitively sensitive information from flowing between Müller and the Nominated Purchaser, thereby ensuring competition between the two remains robust.
29. Müller will also be subject to the following further monitoring mechanisms throughout the duration of the TPAO, which will ensure that Müller complies with the terms of the TPAO and the Undertakings:
- (a) Müller is subject to a three-monthly reporting obligation under which it will be required to disclose to the CMA: (i) the milk volumes processed under the TPAO; (ii) Müller's management accounts for the Severnside dairy; and (iii) any change in the price of the fresh milk and packaged cream supplied to the Nominated Purchaser;
- (b) every three months, Müller must submit to the CMA a compliance statement, signed by a Müller senior employee, in which Müller confirms its compliance with the undertakings, including its obligations under the TPAO;
- (c) Müller will engage, at its own cost, an independent third party to audit, on an annual basis, Müller's compliance with the undertakings and the TPAO, based on the three-monthly written reports submitted to the CMA by Müller and any other information the auditor may reasonably require;
- (d) the CMA will require Müller to nominate a monitoring trustee if the CMA has reasonable grounds to suspect that Müller is in breach of the TPAO or the Undertakings; and
- (e) the Nominated Purchaser will have the right to appoint an auditor if it has reasonable grounds to suspect that Müller is in breach of the terms of the TPAO, which is at Müller's cost if the auditor finds such a breach and in other cases at shared cost.

### ***Nominated Purchasers***

30. Müller has proposed two potential Nominated Purchasers: Medina Dairy Limited (**Medina Dairy**) and Nijjar Group Holdings (Acton) Limited (trading as **Freshways**).
31. The CMA has concluded that Medina Dairy is a suitable purchaser of the TPAO. Freshways, however, does not meet the purchaser approval criteria. The CMA's considerations relating to the suitability of each of the potential Nominated Purchasers are discussed further below.

### ***Medina Dairy***

32. Medina Dairy has been processing fresh milk and cream since 2004 when it purchased the Watson Dairy in Hampshire, capable of processing [REDACTED] mlpa of fresh milk. It also has a processing facility in Yorkshire (acquired in 2007), capable of processing [REDACTED] mlpa.<sup>15</sup> Medina Dairy was established in 1980 as a business focussed on delivering milk, and has grown over time into a dairy processor, as well as a supplier of other dairy and bakery products.
33. Medina Dairy has a number of contracts with large national customers (eg Farmfoods, Home Bargains, Poundworld, SSP UK, Costco Wholesale, Reynolds, Parfett's and Caffè Nero) to process and deliver fresh milk and packaged cream to large customers on a daily basis. This includes both delivery to regional distribution centres and to the more difficult to serve direct to store. It supplies fresh milk under its own Watsons and Cymru brands as well as own-label fresh milk.
34. As well as its two processing facilities, Medina Dairy has a nationwide network of 18 depots, which includes depots in the Severnside dairy catchment area (including in Bristol and Cardiff).

### ***Freshways***

35. Freshways supplies fresh milk and cream to wholesalers and large customers (eg Londis, Costa Coffee, Buyco (Palmer & Harvey), and The Restaurant Group) and also to manufacturers for use in various products found in national multiples and high street stores.
36. Freshways operates a milk processing facility in Acton, West London, with [REDACTED] mlpa capacity, at which it currently processes around [REDACTED] mlpa of fresh

---

<sup>15</sup> [REDACTED].

milk. It has seven distribution centres and its delivery network currently covers the majority of the Severnside dairy catchment area.

37. Freshways recently acquired Dairystix in Plympton, which is currently configured to produce UHT<sup>16</sup> milk.

## **Consultation**

38. The CMA has conducted an extensive consultation on the Undertakings. The following provides an overview summary of consultees' views in relation to the Undertakings offered by Müller. As set out in the First Consultation, the views of third parties are highly relevant to the CMA's assessment of the Undertakings and have been considered carefully. National multiples are the defined group of customers which may be harmed as a result of the Merger in this case. In addition, the national multiples will be the businesses who would invite bids from the Nominated Purchaser, meaning that their views are highly relevant to the CMA's assessment as to whether the Undertakings restore the competitive constraint of the downsized Dairy Crest that would be lost as a result of the Merger. This decision sets out further below how the CMA has taken into account consultee responses in its overall assessment.

### ***National multiples***

39. In response to the First Consultation, the CMA received feedback from all ten national multiples operating in the UK, two dairy processors and one industry organisation. Four national multiples gave feedback prior to the Second Consultation and confirmed their position during the Second Consultation. One national multiple gave feedback during the Second Consultation. The following paragraphs summarise the feedback which is relevant to the Undertakings.
40. The majority of national multiples (eight out of ten) expressed no concerns with the Undertakings:
- (a) One national multiple told the CMA that the Undertakings 'commercially make sense' and that 'it is supportive' of the Undertakings. It stated that, given the Undertakings, both Medina Dairy and Freshways could be credible suppliers. It also said that any further delay for the Merger would be challenging as it [✂].

---

<sup>16</sup> Ultra-high temperature processed.

- (b) One national multiple said that it was ‘reasonably comfortable’ with the remedy, and commented that, if the Nominated Purchaser could meet its requirements (particularly for segregation) it would consider inviting it to tender. In that regard, it welcomed that the Undertakings envisage that Müller would be required to ensure segregation requirements would be met. [REDACTED].
- (c) One national multiple stated that it would be in a better position with the Undertakings than with a downsized Dairy Crest absent the Merger, in particular due to the uncertainty around the position of Dairy Crest as a supplier of fresh milk to national multiples in the future. [REDACTED]. [REDACTED] it said that both Medina Dairy and Freshways could probably meet its requirements and that, if Medina Dairy or Freshways can offer a competitive price, then that would help ensure the competitiveness of the bidding process.
- (d) Three other national multiples expressed no concerns with the Undertakings and indicated that they would consider inviting the Nominated Purchaser to bid or otherwise engage in negotiations. One of these told the CMA that it had recently met Medina Dairy, and noted that Medina Dairy was a potential credible alternative in the Severnside dairy catchment area should it be the Nominated Purchaser. Another national multiple said that [REDACTED], and therefore it would explore a commercial relationship with the Nominated Purchaser in the same way as it would have done with a downsized Dairy Crest.
- (e) Two other national multiples did not express any concerns about the Undertaking and [REDACTED].
41. Several of these eight national multiples who did not raise concerns and/or explicitly expressed support for the Undertakings said that they have been approached by one or both of Medina Dairy and Freshways seeking to establish a relationship. This is consistent with evidence that the CMA has received showing that Medina Dairy, in particular, has been proactive in approaching national multiples. For instance, the CMA received evidence that Medina Dairy is in [REDACTED] negotiations ([REDACTED]) with [national multiple(s)] in relation to the supply of fresh milk in the South West and South East of England, should Medina Dairy be the Nominated Purchaser.
42. However, one national multiple did not support the Undertakings and expressed strong concerns, which are addressed further below in this decision. In response to the Second Consultation, this national multiple stated

that modifications offered by Müller materially improved the Undertakings, but it continued to hold concerns regarding the effectiveness of the Undertakings.

43. One other national multiple told the CMA that it would not deal with either the Nominated Purchaser or a downsized Dairy Crest, [REDACTED]. It did not respond to the Second Consultation.

### ***Dairy processors***

44. Two dairy processors responded to the CMA's consultations. One dairy processor stated that it was an appropriate remedy to address the CMA's competition concerns and that both the potential Nominated Purchasers would be effective competitors. Another dairy processor was not supportive of the Undertakings, as it did not consider that the supply of up to 100 mlpa by a new entrant would have a material impact on competition, given the scale of the fresh milk market in Great Britain. The CMA notes that, while 100 mlpa is a small amount of the fresh milk market in Great Britain, the Undertakings are intended to replace the competitive constraint emanating from the downsized Dairy Crest.

### ***Industry organisation representing farmers***

45. One industry organisation representing approximately 70% of full-time farmers in the UK responded to the First Consultation expressing support for the Merger, but did not comment on the Undertakings. It stated that the Merger 'will generate increased efficiencies in the milk processing sector, which should benefit the entire supply chain – from farmers to consumers'.

## **Assessment**

### ***Legal framework***

46. Under section 73(2) of the Act, the CMA may, for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effect which may be expected to result from it, accept from the merging parties, undertakings in lieu of reference (**UILs**) to take such action as it considers appropriate. Under section 73(3) of the Act, the CMA must have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the SLC and any adverse effects resulting from it.
47. The Exceptions to the Duty to Refer Guidance (referred to as **UILs Guidance** for the purposes of this decision) published by the Office of Fair Trading (**OFT**, the CMA's predecessor dealing with phase 1 mergers) and adopted by the

CMA,<sup>17</sup> notes that the ability under the Act for parties to give undertakings in lieu of a reference allows for transactions to be structured to allow the benign or pro-competitive part of the merger to proceed whilst at the same time guarding against a potential SLC in markets representing a sub-set of the overall transaction.<sup>18</sup> It further notes that when deciding whether to accept UILs, the CMA's starting point is to seek an outcome that restores competition to the level that would have prevailed absent the merger, thereby comprehensively remedying the SLC.<sup>19</sup>

48. The UILs Guidance states that UILs are appropriate only where they are clear-cut and that this clear-cut standard has two dimensions:<sup>20</sup>
- (a) first, the CMA must be satisfied that, if the UILs are accepted, there is no material doubt about their overall effectiveness;<sup>21</sup> and
  - (b) secondly, the UILs must not be of such magnitude and complexity that their assessment and implementation would require unworkable resources at Phase 1.<sup>22</sup>
49. Since a merger involves a structural change to a market, the UILs Guidance states that structural UILs, or in appropriate cases quasi-structural UILs, will normally be the most appropriate remedy.<sup>23</sup> The CMA's Guidance on jurisdiction and procedure states that the CMA is highly unlikely to accept behavioural UILs<sup>24</sup> – that is, UILs aimed at moderating the scope for a merged company to behave anti-competitively by controlling outcomes, but without directly addressing the structural consequences of the merger.<sup>25</sup> Behavioural UILs are generally unlikely to be sufficiently clear-cut to address the SLC.<sup>26</sup> However, the UILs Guidance notes that the CMA will not inevitably refuse

---

<sup>17</sup> *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance* (OFT1122), December 2010. The UILs Guidance was adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

<sup>18</sup> UILs Guidance, paragraph 5.2.

<sup>19</sup> UILs Guidance, paragraph 5.11.

<sup>20</sup> UILs Guidance, paragraphs 5.7 and 5.8.

<sup>21</sup> UILs Guidance, paragraph 5.8. The UILs Guidance also notes that '[t]he more extensive the competition concerns in question in terms of magnitude of potential customer harm, the more significant the error costs of an ineffective remedy may be, and hence the greater the belief must be on the part of the OFT that the undertakings comprehensively resolve those concerns. Whilst the OFT will require that the clear-cut standard is applied to any remedy where the test for reference has been met, in those cases where the potential magnitude of harm is especially large (in absolute terms), the OFT will be particularly cautious in its approach to accepting undertakings in lieu'.

<sup>22</sup> As explained below in paragraph 74, since the OFT and Competition Commission (**CC**) merged to form the CMA in 2014, the UK merger control regime has access to the CMA's specialised Remedies, Business and Financial Analysis team already in the context of Phase 1 merger investigations. The CMA now has the ability to determine whether to allocate resources as between the two phases of merger investigations that did not apply to the OFT and CC as separate organisations.

<sup>23</sup> UILs Guidance, paragraphs 5.20 and 5.24.

<sup>24</sup> *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), paragraph 8.4.

<sup>25</sup> UILs Guidance, paragraph 5.38.

<sup>26</sup> UILs Guidance, paragraph 5.39.

behavioural remedy offers, and will consider behavioural undertakings in particular where a structural remedy would be clearly impractical or is otherwise unavailable.<sup>27</sup>

50. Under section 73(3) of the Act, it is also incumbent on the CMA to ensure that UILs are proportionate to the SLC and do not go beyond what is necessary to remedy the SLC.<sup>28</sup> This includes the obligation to select the least intrusive remedy where there is a choice of equally effective remedies.<sup>29</sup> Although the UILs Guidance considers the issue of proportionality in the particular context of the procedure which applied until the Enterprise and Regulatory Reform Act 2013 came into force,<sup>30</sup> the principle of proportionality is of general application.
51. Nevertheless, the CMA's obligation to accept undertakings only in so far as they are necessary to remedy its competition concerns does not mean that it will take a less effective remedy simply because its belief in the likelihood of the SLC is lower than in other cases. To the extent the duty to refer is met (that is, there is a realistic prospect of an SLC), any UILs must remedy the concerns identified to the clear-cut standard.<sup>31</sup>

### **Framework for analysis of the present case**

52. As has been noted above, the power to accept UILs under the Act means that a transaction may proceed without a reference to Phase 2 particularly in circumstances where a potential SLC finding affects customers in markets which represent only a sub-set of the overall transaction.
53. In the present case, the Merger concerned the acquisition of Dairy Crest's business in a wide range of product markets on a national basis amounting to

---

<sup>27</sup> UILs Guidance, paragraphs 5.38-43. Behavioural remedies may also be more suitable for mergers raising vertical rather than horizontal concerns and mergers in markets in which there already exists a significant degree of regulation.

<sup>28</sup> See also UILs Guidance, paragraph 5.15.

<sup>29</sup> UILs Guidance, paragraphs 5.15-19. This approach is in line with the proportionality test that was set out by the CAT in Phase 2 remedies cases, based on the CJEU's *Fedesa* judgment (see *Tesco plc v CC* [2009] CAT [6], paragraph 137; *BAA Limited v CC* [2012] CAT [3], paragraph 20; and *Ryanair v CC* [2014] CAT [3], paragraph 187). It is also consistent with the finding of the CAT in *British Sky Broadcasting PLC v Competition Commission* and *Virgin Media v Competition Commission* [2008] CAT 25, where the CAT rejected the assertion by Virgin Media that the Competition Commission should have required the full divestiture of BSkyB's shareholding in ITV. The Competition Commission had found that both full divestiture and partial divestiture would be effective remedies but that partial divestiture would be more proportionate. Accordingly, the Competition Commission was not required to adopt a remedy that went beyond what was necessary to ensure that there was no realistic prospect of an SLC persisting.

<sup>30</sup> That is, parties were required to submit UILs (and sometimes submitted a choice of UILs) to the OFT before the relevant Phase 1 decision had been published. In that situation, the OFT was potentially required to consider which of any of the UILs offered by the parties were most proportionate.

<sup>31</sup> UILs Guidance, paragraph 5.17.

revenues of £944.8 million.<sup>32</sup> In volume terms, the total fresh milk volume produced by Dairy Crest across all its business in the financial year 2014/15 was approximately [X] mtpa. The CMA has found a realistic prospect of an SLC in the market for the supply of fresh milk to national multiples in the Severnside dairy catchment area. Dairy Crest's total fresh milk processing capacity at the Severnside dairy is [X] mtpa, but the volumes covered by the SLC comprised only some 100 mtpa, which is approximately [5–15]% of the total fresh milk capacity of the Dairy Crest business as a whole and [a relatively small proportion] of the Severnside dairy's capacity. The CMA estimated that 100 mtpa of fresh milk processing accounts for around [10–20]% of the overall revenue potential of the Severnside dairy.

54. In the circumstances, the CMA notes that a significant proportion of the Merger is 'benign' (to use the language of the UILs Guidance) and that the SLC is confined to a sub-set of the customers which it affects, and indeed to only a limited proportion of the fresh milk capacity at the Severnside dairy. As set out above at paragraphs 14-17, the Undertakings are aimed at addressing the competition concerns identified in the SLC Decision which do not go beyond the supply of fresh milk to national multiples in the catchment area of the Severnside dairy.
55. In the light of the particular facts and circumstances of this case, the CMA has given careful consideration to the Undertakings and has consulted to obtain the views of market participants on whether the Undertakings should be accepted pursuant to the CMA's statutory powers.
56. As set out above, the CMA seeks an outcome that restores competition to the level that would have prevailed absent the Merger and has a preference for structural or, where appropriate, quasi-structural undertakings. The Undertakings offered by Müller (which are explained in further detail below) will provide the Nominated Purchaser with a contractual entitlement to up to 100 mtpa of processed fresh milk with which it can compete to supply national multiples in the Severnside dairy catchment area. This volume reflects a conservative estimate of the capacity which Dairy Crest may have used, depending on the incentives it faced, to compete for certain regional lots of national multiples within the Severnside dairy catchment area.
57. The Undertakings are designed to replace the competitive constraint that would have emanated from the downsized Dairy Crest absent the Merger by

---

<sup>32</sup> SLC Decision, for example paragraph 172.



enabling a new competitor to exercise this constraint in tenders for the supply of fresh milk to national multiples in the Severnside dairy catchment area.

58. Consistent with the CMA's analysis in the SLC Decision, access to the volume of 100 mpla will enable the Nominated Purchaser to exercise a competitive constraint in tenders for various regional lots of national multiples in the Severnside dairy catchment area<sup>33</sup> such that the constraint from the downsized Dairy Crest (absent the Merger) is restored.
59. The Undertakings have been designed to provide the Nominated Purchaser with a sufficient period to build relationships with national multiples by enhancing its credibility as a supplier, and to allow for the development of any processing capacity it may need to competitively bid for national multiples' regional lots in the Severnside dairy catchment area by the end of the TPAO. As such, the Undertakings are designed to provide a structural solution to the competition concerns identified in the SLC Decision.
60. The TPAO creates a contractual entitlement, which has a commercial value and will complement other assets of any suitable purchaser. The provisions of the TPAO have been designed to allow for and enable a Nominated Purchaser with the right mix of skills, assets and experience to benefit from this contractual entitlement with a view to restoring the constraint from the downsized Dairy Crest absent the Merger. The CMA's purchaser approval process has rigorously sought to confirm that any selected Nominated Purchaser will be building on extensive existing experience supplying fresh milk in Great Britain. The 'step up' would therefore be much less than a new entrant to the supply of fresh milk or a party seeking to enter the market without the initial advantage of the TPAO.
61. Having regard to these characteristics of the Undertakings, the CMA described the Undertakings as akin to a quasi-structural remedy in its 26 June 2015 decision to conduct a detailed assessment of the undertakings offered by Müller. As with any quasi-structural undertaking, this involves arrangements of a behavioural nature during the life of the TPAO that regulate the conduct of Müller in processing fresh milk for supply to the Nominated Purchaser. Many of these arrangements form part of the TPAO and are therefore also enforceable directly by the purchaser of the TPAO.
62. One consultee has argued that the Undertakings should be regarded as behavioural and not quasi-structural. The CMA has considered these arguments and does not agree for the reasons given above. However, the

---

<sup>33</sup> SLC Decision, paragraph 200.

CMA also does not consider that this point has the significance which the consultee attributed to it. The central objective for the CMA is to meet the statutory test that the Undertakings prevent, mitigate or remedy the SLC. As such, the CMA notes that whether the Undertakings are regarded as structural, quasi-structural or behavioural in nature is not determinative of whether they should be accepted, either under the UILs Guidance or under section 73 of the Act.

63. Given that the Undertakings do contain certain behavioural components, the CMA first considered whether and how far the reservations expressed in the UILs Guidance (and other related Guidance) about behavioural UILs apply to the Undertakings offered by Müller.
64. First, the CMA notes that the UILs Guidance focuses on behavioural undertakings which are aimed at (and/or limited to) controlling outcomes, as referred to in paragraph 5.38 of the UILs Guidance. In contrast, the principal aim of the Undertakings is not limited to controlling competitive outcomes. The Undertakings are designed to provide a structural solution to the competition concerns identified in the SLC Decision in which outcomes will be determined by the market. This distinguishes the Undertakings from the behavioural undertakings described in paragraph 5.38 of the UILs Guidance.
65. Secondly, the UILs Guidance notes that behavioural remedies which control outcomes – typically price caps – create particular risks in relation to specification, distortion and monitoring. In this specific context, the CMA has addressed these risks through the design and market testing of the Undertakings, including the development of a monitoring framework that relies principally on independent auditors and on enforcement by the Nominated Purchaser of its contractual rights under the TPAO. In addition, the terms of the TPAO – which provides the Nominated Purchaser with access to milk on terms that enable it to compete effectively with Müller – do not seek to regulate the price or other terms on which either Müller or the Nominated Purchaser supplies milk to grocery multiples: this involves significantly less risk of market distortions compared with price caps or other measures to control outcomes.
66. Thirdly, although the UILs Guidance states that there is sometimes difficulty devising a workable and effective set of behavioural commitments within the context of a short-term Phase 1 timetable, that has not proven to be an insuperable obstacle in this case (as explained further below at paragraphs 74-76).

67. Fourthly, both under the UILs Guidance and under section 73 of the Act, the CMA must adhere to the principle of proportionality. Under that principle, the CMA is required to accept the least intrusive effective remedy.
68. Applying this principle, if the CMA is satisfied that proposed UILs are both effective and more proportionate than a more intrusive remedy which might be considered at Phase 2 (most obviously divestiture), the CMA may decide under section 73 to accept those UILs in lieu of a Phase 2 reference. This principle applies whether the proposed UILs are regarded as structural, quasi-structural or behavioural in nature.
69. In the present case, the Undertakings are clearly less intrusive than a divestiture remedy, particularly having regard to the scope of the SLC.
70. The CMA therefore considers that the Undertakings should be regarded as a quasi-structural remedy rather than an essentially behavioural remedy, notwithstanding that they have certain behavioural elements. However, even if the Undertakings are regarded as behavioural in nature, there are a number of distinct features of the present case which distinguish the Undertakings from the types of behavioural remedies which are the focus of the UILs Guidance, and the CMA's general concerns about behavioural undertakings.
71. As set out above, it is important to note that whether the CMA should accept the Undertakings does not turn on whether the Undertakings are classified as structural or behavioural, but on whether they effectively remedy the realistic prospect of an SLC to the clear-cut standard, taking into account all the relevant circumstances of the present case.
72. The CMA's assessment of the effectiveness of the Undertakings is set out below.

### ***Clear-cut remedy***

73. As noted above, the clear-cut standard that applies to UILs has regard to their effectiveness and the practical workability of their assessment and implementation. The CMA's assessment of the Undertaking against these points is considered below (taking the question of practical workability first).

### ***Workability of assessment and implementation***

74. As set out above, the UILs Guidance states that, for an undertaking to be clear-cut, it must not be of such magnitude and complexity that its assessment and implementation would require unworkable resources at Phase 1. This guidance was drafted in the context of the previous institutional

structure where there was a first phase agency (OFT) and a second phase body, the Competition Commission (**CC**) reviewing mergers under the Act. The institutional and statutory context under which this decision is taken is different. In taking this decision, the CMA has, with the resources available to it and in the timeframe provided under section 73A of the Act, been able to carry out a detailed assessment of the Undertakings. This includes being able to call upon the expertise and resource of the CMA's specialised Remedies, Business and Financial Analysis team (**RBFA**). The CMA now has the ability, in appropriate cases, to determine whether to allocate resources as between the two phases of merger investigations that did not apply to the OFT and CC as separate organisations. In doing so the CMA will (in accordance with the UILs Guidance) take into account the extent to which any proposed UILs allow the benign or pro-competitive part of the merger to proceed whilst at the same time guarding against a potential SLC in markets representing a sub-set of the overall transaction.<sup>34</sup> In this case, RBFA has been closely involved in the investigation.

75. In terms of resources needed to implement and monitor the Undertakings, Müller's compliance throughout the lifetime of the TPAO is ensured through a monitoring system that largely relies on independent auditors and on enforcement by the Nominated Purchaser of its contractual rights under the TPAO. The CMA's only ongoing obligations are to review compliance materials every three months, the initial auditor's report on the implementation of the firewalls, and the annual auditor's report on Müller's compliance with the Undertakings and the TPAO. This limited intervention by the CMA will allow it to become aware of any non-compliance and take the necessary measures to address it through the appointment of a monitoring trustee. This relatively limited monitoring role is consistent with the resources available to RBFA to monitor the CMA's portfolio of merger and market remedies.<sup>35</sup>
76. Taking into account the particular facts and circumstances of this case, the CMA therefore considers that the Undertakings do not require unworkable resources at Phase 1 and is workable in terms of assessment and implementation.

### *Effectiveness of the remedy*

77. As mentioned above, the SLC identified by the CMA relates to a possible loss of competition in one specific and well-defined market segment: namely, the

---

<sup>34</sup> UILs Guidance, paragraph 5.2.

<sup>35</sup> RBFA's current project to review extant markets and mergers remedies, and to retain only those that remain necessary, will free up resources such that RBFA can conduct the monitoring that the Undertakings envisage.

supply of fresh milk to national multiples in the Severnside dairy catchment area. The CMA did not find any competition concerns in relation to any other geographic or product markets, which represent the majority of the operations of the acquired business.

78. The Undertakings are intended to address the competition concerns which the CMA identified in its SLC Decision in the following way:
- (a) by replacing Dairy Crest with a new competitor which has the ability, incentive and intention to supply fresh milk to national multiples in the Severnside dairy catchment area. As discussed below in paragraphs 106-116, the CMA believes that Medina Dairy, as Nominated Purchaser, has the ability, incentive and intention to compete in the SLC market;
  - (b) during the lifetime of the TPAO, the Nominated Purchaser has the capability of using capacity up to 100 mlpa at the Severnside dairy to bid in regional lots of national multiples tenders, providing an equivalent competitive constraint to that which may have been provided by the downsized Dairy Crest absent the Merger; and
  - (c) the Undertakings enable the Nominated Purchaser to use the period of the TPAO to continue to build relationships with national multiples and enhance its credibility as a supplier, and to develop any processing capacity it will need to cost-effectively bid for national multiples' regional lots in the Severnside dairy catchment following the end of the TPAO.
79. As regards the effectiveness of this remedy, the CMA notes the following.
80. The design of the TPAO takes account of the fact that the competition concerns identified in the SLC Decision do not relate to the entirety of Dairy Crest's capacity at the Severnside dairy – in fact, they relate to [a relatively small proportion] of that capacity. The Undertakings do not therefore involve a transfer of the Severnside dairy to the Nominated Purchaser but are rather designed to create a competitor able to exert an equivalent competitive constraint in the relevant market as the downsized Dairy Crest absent the Merger.
81. Given that the Nominated Purchaser would not acquire physical assets pursuant to the Undertakings, the CMA's assessment of suitable purchasers involved an examination of the existence of robust business plans, including plans for the development of such further physical assets as may be required to continue to competitively bid for the supply of fresh milk to national multiples in the Severnside dairy catchment area at the end of the TPAO. As

noted above, the Undertakings have been designed to allow a sufficiently long period for such development to occur.

82. The CMA has held extensive discussions with the two potential Nominated Purchasers to test and interrogate their business plans. As set out further below at paragraph 131, Medina Dairy in particular told the CMA that the terms of the TPAO, including the toll processing fee, will enable it to compete in the national multiples fresh milk market. Medina Dairy provided the CMA with plans to invest in existing facilities and/or for developing new capacity such that it could continue to compete effectively following the expiry of the TPAO.
83. The CMA further notes that, in some respects, the Undertakings place the Nominated Purchaser in a more advantageous position than the purchaser of assets under a divestiture remedy. That is because the Nominated Purchaser will be in a position to develop business relationships with national multiples without having responsibility for the physical production of fresh milk during the initial period of its business. Under the Undertakings, the Nominated Purchaser will then have a period of up to eight years within which it can, if necessary, spread out its investment in additional capacity (including through applying profits generated from its contracts with national multiples). This mechanism provides a cost-effective and relatively low risk opportunity for the successful Nominated Purchaser to expand its operations with the national multiples, while investing further in its own facilities.
84. The success of the Nominated Purchaser's entry into the market will depend on whether it wins contracts with national multiples during the lifetime of the TPAO in order to support its business plans. As noted above, the terms of the TPAO are designed to allow the Nominated Purchaser to compete effectively with Müller for such contracts, in particular by providing for the Nominated Purchaser to be supplied with fresh milk at variable cost and through a number of ancillary provisions.
85. The CMA also notes that Dairy Crest told the CMA that it planned to exit the supply of fresh milk to national multiples. Although the CMA was not sufficiently certain that this would occur to exclude the prospect of an SLC, that is indicative of a level of uncertainty as to the strength and duration of the competitive constraint provided by Dairy Crest in the counterfactual scenario. The Nominated Purchaser will be a new entrant into the market for the supply to national multiples and can be expected to compete keenly for new business with a view to achieving its business plan. Further, the Nominated Purchaser's incentives to compete during the lifetime of the TPAO and beyond will be

strengthened by its initial investment in the TPAO and by any further investment in new capacity.

86. The CMA notes that the TPAO includes a number of further provisions to allow its effective operation. These include:
- (a) firewall mechanisms which require the physical separation of those Müller employees involved in the operation of the TPAO and those involved in supplies of the relevant products to national multiples, as well as protections against the leakage of information from one group of employees to the other;
  - (b) monitoring mechanisms to ensure that the firewalls and other provisions of the TPAO are adhered to; and
  - (c) the provision of consultancy support to the Nominated Purchaser up to a value of £20,000.
87. Some of these provisions were not in the Original Undertaking offered by Müller but were included after the CMA, having considered carefully the Original Undertakings and taking account of consultee responses, negotiated their inclusion. The monitoring provisions strike an appropriate balance between ensuring compliance with the Undertakings and TPAO on the one hand and, on the other, undue interference in the commercial operations of both Müller and the Nominated Purchaser. The CMA considers that, given the clarity of the firewall mechanisms established in the TPAO, appropriate monitoring of those arrangements is both practicable and proportionate in the present case.
88. The CMA considered whether the terms of the TPAO should restrict the Nominated Purchaser to supplying only national multiples with fresh milk supplied subject to the TPAO. The CMA believes this would not be appropriate. First, absent the Merger, Dairy Crest would also have had the option to supply middle ground customers and the Undertakings are designed to restore the competitive constraint that may have emanated from a downsized Dairy Crest absent the Merger. Second, imposing an inflexible limitation on how the Nominated Purchaser uses the milk supplied under the TPAO could reduce its overall effectiveness as a competitor. Instead, the CMA evaluated the risk that the Nominated Purchaser would not use the TPAO to supply national multiples by assessing the two potential Nominated Purchasers' plans and incentives to supply national multiples, as discussed below. This is similar to the approach that the CMA generally adopts in assessing and managing equivalent risks in relation to the divestiture of a

multi-product facility (such as a milk processing plant) which supplies a variety of customer types.

89. In assessing the effectiveness of the TPAO as a remedy to the prospect of an SLC in the present case, the CMA has had particular regard to the views of the national multiples – being the potential customers of the Nominated Purchaser in the market affected by the prospect of an SLC. These customers are a defined class of particularly sophisticated purchasers who have each been given the opportunity to comment on the Undertakings as a remedy to the SLC. The CMA notes that, as set out above, of those customers, all but two had no concerns about the Undertakings, and of those two, one would not have dealt with Dairy Crest in the counterfactual in any event. One customer expressed the view that the Undertakings were preferable to the continued presence of Dairy Crest and a majority expressed willingness to consider supply by the Nominated Purchaser.
90. The CMA notes that one customer in particular expressed strong concerns about the Undertakings. The views of customers were not therefore unanimous. However, the success of the Nominated Purchaser does not depend on it obtaining business from all national multiples.
91. The points made above support the view that the TPAO creates an effective mechanism for restoring competition to the level that would have prevailed absent the Merger. However, before drawing conclusions as regards the effectiveness of the TPAO, it is necessary to address the following further matters:
  - (a) First, whether either or both of the potential Nominated Purchasers meets the CMA's purchaser approval criteria. The CMA's assessment of the suitability of the potential Nominated Purchasers of the TPAO is an important component of the overall assessment of the effectiveness of the Undertakings. This is because, for the remedy to be effective, the Nominated Purchaser must exert an equivalent competitive constraint to that of Dairy Crest absent the Merger. This will depend on the credibility of the Nominated Purchaser. The CMA must have no material doubt that the Nominated Purchaser has the ability, incentive and intention to compete for this business, exerting an equivalent competitive constraint as that of Dairy Crest absent the Merger. This includes an assessment of their plans both during and after the lifetime of the TPAO.
  - (b) Secondly, the CMA addresses some specific issues relating to the effectiveness of the Undertakings. Specific points of feedback from third parties are also addressed in this section.



## Assessment of the Proposed Purchasers

92. The CMA has considered whether the Nominated Purchasers proposed by Müller are suitable purchasers of the TPAO such that the SLC is resolved. The CMA therefore considered whether each of the potential Nominated Purchasers met its purchaser approval criteria:
- (a) the acquisition by the proposed purchaser remedies, mitigates or prevents the SLC concerned;
  - (b) the proposed purchaser is independent of and unconnected to the merger parties;
  - (c) the proposed purchaser has the necessary expertise, financial resources, incentive and intention to maintain and operate the TPAO as an effective competitor in the marketplace;
  - (d) the proposed purchaser is reasonably expected to obtain all necessary approvals, licences and consents from any regulatory or other authority; and
  - (e) the acquisition of the TPAO by the proposed purchaser does not itself create an SLC within any market or markets in the UK.<sup>36</sup>
93. The comments made by third parties about the two potential Nominated Purchasers are summarised below before the CMA's assessment of their suitability.

### ***Third party submissions***

94. As mentioned above, six national multiples indicated that they would consider inviting Medina Dairy or Freshways as the Nominated Purchaser to bid or otherwise engage in negotiations. One national multiple told the CMA that it would not deal with the Nominated Purchaser or a downsized Dairy Crest. The remaining three did not indicate whether they would invite the Nominated Purchaser to bid or otherwise engage in negotiations, although the CMA received evidence showing that [redacted].
95. Of those national multiples that said they would consider dealing with the Nominated Purchaser, most said that it would be important to conduct normal

---

<sup>36</sup> UILs Guidance, paragraphs 5.25–5.30.

due diligence with the Nominated Purchaser before entering into a commercial relationship.

### ***The CMA's assessment***

96. The CMA has concluded that, for the reasons set out below, Medina Dairy is a suitable purchaser of the TPAO but that Freshways does not meet its purchaser approval criteria.

#### *Medina Dairy*

##### *Financial resources*

97. The CMA assessed Medina Dairy's financial position by reviewing its statutory accounts and management accounts (including profit and loss, balance sheet position and cash flows) covering five years, and Medina Dairy's three-year financial projections based on the TPAO.
98. In the financial year ending 30 April 2015, Medina Dairy's revenue was £[redacted] million with an operating profit of £[redacted].<sup>ii</sup> The operating profit shows an improving financial position. This is confirmed by Medina Dairy's results in May to June 2015, which show an operating profit of £[redacted], a significant improvement over the same period in the previous year. The CMA examined the financial challenges faced by Medina in recent years, in particular in 2011 to 2013, but the CMA is satisfied that these challenges have been resolved.
99. Medina Dairy also provided evidence that it has strong financial support from its shareholders. It is a family business and the owners have told the CMA they are committed to Medina Dairy's long-term success. Medina Dairy therefore has access to significant equity funding from its shareholders (up to £[redacted] million, as evidenced by specific assets and other business interests that Medina Dairy's shareholders would use to invest), which will enable it to develop its business during and after the period of the TPAO and to compete to supply fresh milk to national multiples. Further, Medina Dairy told the CMA that it had in recent years significantly strengthened its balance sheet and that it was operating with low debt levels of around £[redacted] million and the CMA saw evidence that Medina Dairy would likely have access to additional lending. Therefore, the CMA considers that Medina Dairy has sufficient funds to

support the operation of the TPAO and the required investment in its own facilities to supply national multiples.<sup>37</sup>

100. Medina Dairy submitted that the upfront fee for the TPAO will be funded using its existing cash resources.
101. The CMA is satisfied, on the basis of the evidence provided, that Medina Dairy's financial position, particularly its increasing operating profit, strong shareholder support and strengthened balance sheet, will enable it to compete in the national multiples fresh milk market and would fund the expansion of its existing facilities referred to below.

### *Expertise*

102. As set out above (see paragraphs 32-34), Medina Dairy has engaged in milk processing since 2004, when it purchased the Watson dairy in Hampshire. Its current processing facilities have a combined capacity of [redacted] mtpa ([redacted] mtpa in its Hampshire facility and [redacted] mtpa in its Yorkshire facility). Medina Dairy currently processes around [redacted] mtpa of fresh milk. In its Hampshire facility, Medina Dairy currently has spare capacity of [redacted] mtpa (with additional spare capacity of [redacted] mtpa at its Yorkshire facility).
103. Medina Dairy submitted that, while it does not currently supply fresh milk to national multiples, it has considerable experience in supplying large and sophisticated customers on a daily basis. Its current key customers include Home Bargains, Farmfoods, Poundworld, SSP UK, Costco Wholesale, Reynolds, Parfett's and Caffè Nero. In supplying these customers, Medina Dairy has gained expertise in milk segregation, farm management services and delivery to both regional distribution centres and direct to store nationally. Much of this expertise can be applied in supplying national multiples.
104. Medina Dairy's commitment to entering the national multiples fresh milk market is demonstrated by its recent recruitment of senior management staff with significant national multiples experience. Its [redacted] was previously a senior executive at the large dairy processor [redacted] and has extensive experience in milk supply and aligned retailer milk pools as well as in maintaining national multiple relationships. Medina Dairy's governance advisors also include a member with [redacted] years' experience with [redacted] as commercial director for

---

<sup>37</sup> A national multiple raised a concern that Medina Dairy would not be in a position to support investment because the public versions of Medina Dairy's accounts suggest it has a concerning liquidity ratio, particularly compared with dairies of similar size, and a poor profitability position. However, more recent versions of Medina Dairy's accounts show that its liquidity ratio has improved considerably and is no longer significantly out of line with the liquidity ratios shown in the public accounts of similar-sized dairies. Medina Dairy's profitability is also significantly improving, as noted above.

national multiples and another with over [redacted] years' experience in the dairy industry (eg [redacted]). In addition, Medina Dairy is advised by [redacted] former senior [redacted] executive in the upgrade of its Hampshire facility to meet the requirements of national multiples.

105. The CMA is therefore satisfied that Medina Dairy has the necessary expertise to commence supplying national multiples both during the TPAO and on its own after the TPAO.

*Ability, incentive and intention to compete*

106. The CMA considered whether Medina Dairy, as Nominated Purchaser, would have the ability, incentive and intention to compete at such a level that it would impose a constraint that was equivalent to that which may have been exerted by a downsized Dairy Crest.
107. Medina Dairy submitted that its strategy in recent years has been focused on increasing its penetration into the larger customer segment in the UK, including national multiples. For example, Medina Dairy has shown the CMA its forecasts prior to the TPAO for the period 2016 to 2018, which include securing [redacted] million litres in 2017 and [redacted] million litres in 2018 from new national multiple accounts through an investment of £[redacted] million in existing processing facilities.
108. Medina Dairy submitted that the TPAO would significantly accelerate the implementation of its pre-existing strategic objective of expanding into the supply of fresh milk to national multiples, and provided sales targets within the TPAO period in relation to national multiples.<sup>38</sup> Medina Dairy further told the CMA that it has been approaching national multiples recently (and in some cases prior to the CMA's decision of 26 June 2015 to consider Müller's offer of undertakings) seeking to establish commercial relationships, with a focus on those national multiples whose requirements most closely resemble the large middle ground customers it already serves. These approaches have been confirmed to the CMA by the relevant national multiples. The CMA also received evidence showing that Medina Dairy is already having discussions with [multiple] national multiples towards preparing a possible future commercial relationship should Medina Dairy be the Nominated Purchaser. Discussions are [redacted].

---

<sup>38</sup> Internal documents from Medina Dairy of April 2014 refer to the strategic imperative of targeting new customers segments and identify the engagement with national multiples on a regional basis as offering a significant potential for growth.

109. Medina Dairy provided the CMA with detailed plans to invest in its Hampshire facility to make it suitable for supply to national multiples. Medina Dairy told the CMA that the prospect of supplying [redacted] has accelerated planning for this investment. As shown by internal emails provided to the CMA, Medina Dairy is actively engaged in planning this investment with support [redacted]. This entails ensuring the Hampshire facility meets the standards of a national retailer technical audit, which includes changing some processes and investing in the facility (such as [redacted]).<sup>39</sup> Medina Dairy has provided capex estimates for these investments (at a total of around £[redacted] million) and, as noted above, has provided evidence that it has access to sufficient funds.
110. Medina Dairy has told the CMA that it will make the necessary investment to upgrade its Hampshire facility by 2016, with an internal target to achieve this by [redacted] 2016.<sup>40</sup> This investment will mean that the current capacity of this facility ([redacted] mlpa, with current spare capacity of [redacted] mlpa) could be used to supply fresh milk to national multiples. Medina Dairy has told the CMA that the entire Severnside dairy catchment area can be served from its Hampshire facility, as evidenced by the fact that it is already supplying its existing customers in this area, including through its depots in Bristol, Cardiff and Swansea. Medina also plans to expand its depot network as it gains national multiple contracts and noted that [redacted], its existing third party logistics provider, is based in the South West.
111. Medina Dairy's forecasts for the TPAO show that it believes it will make an operating profit, and it told the CMA that the processing fee to be paid to Müller is reasonable. As discussed below at paragraphs 129-132, the CMA believes the processing fee is set at a level which enables the Nominated Purchaser to competitively bid to supply fresh milk to national multiples in the Severnside dairy catchment area.
112. The upfront fee offered by Medina Dairy is indicative of its commitment to using the TPAO to facilitate and accelerate its original plans to expand into the national multiples segment, as it is a sunk cost which would be recoverable only by profitably operating under the TPAO.
113. Although initially Medina Dairy is likely to procure raw milk via Müller whilst it explores its supply options, in the longer term it will seek direct supply from farmers. Medina Dairy anticipates that it will take around 18 months to secure additional direct raw milk supply. Its forecasts for the TPAO period include investment in farmer recruitment and farmer support (including hiring [redacted])

---

<sup>39</sup> For example, [reference to internal documents].

<sup>40</sup> [Reference to internal document].

additional staff members). Medina Dairy will only require Müller's services for the collection of raw milk in the first three years of the TPAO and will use its existing or another third party logistics provider for the distribution of processed milk. Medina Dairy has also planned for the recruitment of further staff to support inbound and outbound supply chain management. Medina Dairy plans to require Müller to process and package the cream that is a by-product of the fresh milk processing under the TPAO.

114. In order to be confident that Medina Dairy would continue to compete in the national multiples fresh milk market following the expiry of the TPAO, the CMA considered Medina Dairy's longer term strategy and its plans to invest in processing capacity to supply national multiples.
115. As noted above, Medina Dairy has detailed plans to enable it to supply national multiples from its existing Hampshire facility from 2016, with a current spare capacity ([redacted] mlpa) exceeding the TPAO volume. Medina Dairy said that it would further seek to continue to supply fresh milk to national multiples following the expiry of the TPAO by investing in further processing capacity, either by acquiring an existing facility or building a new facility. Medina Dairy supplied plans for investment in a new processing facility, which it estimated would take approximately [redacted] months to construct at a cost of approximately £[redacted] million. As mentioned above, Medina Dairy submitted that it has access to significant funding from its shareholders (£[redacted] million) for this investment, in addition to further lending and funding from retained profits from operating the TPAO. Medina Dairy's plan is for this dairy to be located in the Severnside dairy catchment area.
116. Given the considerable evidence that Medina Dairy provided, in particular demonstrating its commitment to the supply of fresh milk to national multiples, its plans to upgrade its existing Hampshire facility by 2016 and invest in additional processing capacity, the CMA is satisfied that Medina Dairy has the ability, incentive and intention to compete to supply national multiples in the Severnside dairy catchment area, and to continue to do so following the expiry of the TPAO.

#### *Independence*

117. Medina Dairy submitted that there are no significant financial, ownership, management or personal links between Medina Dairy and the merging parties which would influence Medina Dairy's or Müller's incentive to compete.

118. The only relevant commercial link between Medina Dairy and Dairy Crest is a contract under which Dairy Crest supplies Country Life milk and glass bottles. [REDACTED].
119. Medina Dairy submitted that this contract was negotiated at arm's length. [REDACTED]. Medina Dairy stated that it has already identified other possible alternative suppliers of glass bottles. It further submitted that if it had to discontinue this supply arrangement, this would not have a material impact on its business. Information submitted by Dairy Crest indicates that, while in the financial year ending in April 2015 Medina Dairy bought around [REDACTED] mlpa of fresh milk, its annualised purchases to date in the current financial year imply an annualised total of [REDACTED] mlpa.
120. The CMA considers that this commercial link does not influence Medina Dairy's incentive to compete with Müller after the Merger.<sup>41</sup> The CMA is therefore satisfied that this criterion is met.

*Regulatory requirements and likelihood of competition concerns*

121. Medina Dairy submitted that it does not require any consents or approvals to complete the acquisition and commence trading, other than CMA approval. The acquisition of the TPAO by Medina Dairy does not raise competition concerns as Müller and Medina Dairy do not overlap in the supply of fresh milk to national multiples in the Severnside dairy catchment area. Given this, the CMA is satisfied that this criterion is met.

*Freshways*

122. The CMA considered whether Freshways meets the purchaser approval criteria (see paragraph 92 above). Shortly before the Second Consultation, Freshways informed the CMA that following its discussions with Müller, its view was that it would not be able to compete profitably to supply fresh milk to national multiples under the TPAO. Freshways stated that this was because the toll processing fee is based on costs at the Severnside dairy, which, according to Freshways, is inefficient compared to Müller's Bridgwater dairy. Freshways also stated [REDACTED].
123. The CMA assessed the profitability calculations underlying Freshways' view and found that, although this calculation showed a lack of profitability for one type of SKU (2 pint packs), it was not clear that Freshways had used the appropriate allocation of costs across different SKUs. It may therefore be that

---

<sup>41</sup> See paragraph 5.28 of the UILs Guidance.

Freshways could in fact profitably operate the TPAO, taking account of a different SKU mix and profits from selling packaged cream. However, the CMA considers that Freshways' statements to the CMA give rise to significant doubts about Freshways' intention to compete with Müller in the supply of fresh milk to national multiples and its ability and incentive to do so. The CMA accordingly considers that Freshways does not meet the relevant purchaser approval criterion.<sup>42</sup>

124. The CMA assessed whether Medina Dairy's suitability as a purchaser was affected by Freshways' submissions about profitability under the TPAO. However, as noted below (see paragraph 129-131), the CMA considers that Medina Dairy's submission that it can effectively compete on the basis of the processing fee is credible.
125. While the CMA considers that Freshways may meet other purchaser approval criteria, it was not necessary for the CMA to reach a view on this.

### **Specific issues relating to the Undertakings**

126. In assessing the Undertakings, the CMA identified a number of issues which are relevant to their effectiveness. These issues are addressed in the following paragraphs. Some additional issues were highlighted to the CMA, mainly by one national multiple, and these issues are also addressed below.

### ***Competitiveness of the Nominated Purchaser***

127. In the following paragraphs the CMA addresses a number of issues concerning how the terms of the TPAO will allow the Nominated Purchaser to compete with Müller. These issues are as follows:
  - (a) that the processing fee is at a level which enables the Nominated Purchaser to competitively bid to supply fresh milk to national multiples in the Severnside dairy catchment area;
  - (b) that the Nominated Purchaser is able to access ancillary services (collection of raw milk and delivery of fresh milk) at competitive prices;
  - (c) that the processing fee paid by the Nominated Purchaser does not increasingly diverge from the actual costs of Müller as it makes efficiency improvements;

---

<sup>42</sup> See UILs Guidance, paragraph 5.26, third bullet.



(d) that the Nominated Purchaser also has the ability to supply packaged cream to national multiples in the Severnside dairy catchment area, given that national multiples often procure the two products together.

128. In considering these issues, the CMA notes that a national multiple submitted that Müller has a strong incentive to deny the Nominated Purchaser the 'gateway' of experience by competing particularly aggressively during the TPAO to win contracts.

### *Processing fee*

129. The level at which the processing fee is set (and will move over time) is a critical component of the effectiveness of the Undertakings. The fee is set with reference to the variable costs of processing fresh milk at the Severnside dairy, and does not include any fixed cost component. The absence of any fixed cost component provides a potential competitive advantage for the Nominated Purchaser compared to Dairy Crest in the counterfactual, which would have needed to take into account its fixed costs when bidding.

130. The CMA required Dairy Crest to provide it with detailed information on both the variable and fixed-cost components separately for fresh milk and cream processing. This information was assessed by the CMA's specialist RBFA team, which concluded that the cost components included within the variable costs appeared reasonable and consistently applied over the two years for which the CMA received the relevant data.

131. The CMA also asked Medina Dairy and Freshways whether they considered the process fee was set at a level which would enable them to competitively bid. Medina Dairy, who, as discussed above at paragraph 104, is staffed and advised by executives with considerable experience in the supply of fresh milk to national multiples, told the CMA that it would be able to competitively bid on the basis of the processing fee. Medina Dairy's [redacted] negotiations with [redacted], which are on the basis that it would be the Nominated Purchaser, appear to confirm Medina Dairy's assessment.

132. As mentioned above at paragraphs 122-123, Freshways told the CMA that it would not be able to compete profitably to supply fresh milk to national multiples under the TPAO, as the toll processing fee is based on costs at the Severnside dairy, which, according to Freshways, is inefficient compared to Müller's Bridgwater dairy. For the reasons given above in paragraph 123, the CMA does not consider that Freshways' assessment of the processing fee, and the implications for its ability to compete, is robust.

### *Ancillary services*

133. Medina Dairy plans to establish its own inbound and outbound logistics arrangements – either through own capabilities or through third parties other than Müller. Medina Dairy expects only to use Müller’s in-bound logistics services during the first three years of TPAO while it is setting up its own logistic arrangements.
134. The CMA believes that third party logistics providers are price-competitive relative to in-house supply and meet all required standards to serve national multiples. This is supported by the fact that, as the CMA found during its investigation of the Merger, several dairy processors, [X], use third party logistics providers for their collection and delivery of milk. Consequently, the Nominated Purchaser will have access to competitively priced logistics in any event.
135. The evidence available to the CMA therefore does not indicate that having these logistic services provided in-house gives the vertically integrated dairy processor a competitive advantage.
136. The CMA did not consider it to be necessary to include in the TPAO any benchmark or to ‘regulate’ the cost at which Müller will provide, if requested by the Nominated Purchaser, in-bound and out-bound delivery services (as suggested by one national multiple). The price of these services would therefore be determined through an arm’s length commercial negotiation, which is expected to result in competitive rates.<sup>43</sup>
137. Furthermore, in contrast to the supply of in-bound and out-bound delivery services, there are efficiencies associated with processing the packaged cream in the same facilities in which the fresh milk is processed and Müller is in a better position than other third parties to process and supply packaged cream to the Nominated Purchaser.
138. The CMA also notes that in many cases the cost of raw milk procurement is borne directly by the national multiples, not by the processors, so this cannot be a source of competitive advantage for Müller.
139. A national multiple submitted that the Nominated Purchaser would have a disadvantage compared to Müller as regards the ancillary services (collection of raw milk and delivery of fresh milk). This would apply when Müller provides

---

<sup>43</sup> The CMA notes further that under the TPAO, Müller and the Nominated Purchaser shall in good faith seek to agree the remaining terms of the supply of these ancillary services that are not part of the TPAO and such agreement shall not be unreasonably refused, withheld or delayed.

it with these services, as Müller can manipulate their price and apply a mark-up, and also when the Nominated Purchaser procures these services from a third party, as Müller is likely to benefit from its own optimised distribution systems when competing with the Nominated Purchaser. The CMA considers that this submission has been addressed above in paragraphs 134-137.

#### *Divergence between processing fee and actual costs at Severnside dairy*

140. As discussed above at paragraph 24, the processing fee will be subject to an annual review mechanism, in which the fee is adjusted to reflect any actual increase (capped at RPIJ) or decrease in the costs of processing fresh milk by Müller at the Severnside dairy. This adjustment mechanism will ensure that the Nominated Purchaser benefits from any reduction in variable costs at the Severnside dairy achieved as a result of efficiency gains, and that the Nominated Purchaser does not, therefore, suffer a competitive disadvantage in relation to Müller.
141. Müller told the CMA that it will process fresh milk for the Nominated Purchaser using the same processing lines it will use for its own operations. Therefore, Müller will not be able to ring-fence the efficiencies it might achieve for itself from its operations under the TPAO.
142. Further, although processing efficiencies achieved by Müller will benefit the Nominated Purchaser, the CMA considers this will not deter the pursuit of efficiencies by Müller because the TPAO covers only a relatively small proportion of volumes processed at the Severnside dairy (see paragraph 53 above). Müller therefore has a strong incentive to secure efficiencies at Severnside dairy, which will benefit Müller to an even larger extent.
143. Two national multiples also submitted that the processing fee should be adjusted downwards to reflect efficiency gains at the Severnside dairy. The processing fee adjustment mechanism addresses these submissions.

#### *Packaged cream*

144. The CMA notes that two national multiples also told the CMA that it would be important for the competitiveness of the Nominated Purchaser to tender for both fresh milk and packaged cream. Accordingly, the Undertaking requires Müller to process into packaged cream the cream associated with the fresh milk processed under the TPAO. Packaged cream that is supplied to national multiples in conjunction with fresh milk will be processed at cost by Müller. The processing fee for packaged cream will be subject to a review

mechanism based on the same principles as the processing fee review mechanism for fresh milk.

### *Müller's incentive*

145. Whilst the CMA notes the national multiple's argument that Müller would have a strong incentive to prevent the Nominated Purchaser from winning any contracts which might be a 'gateway' to business in the sector, the terms of the TPAO are designed to ensure that the Nominated Purchaser has both the ability and incentive to compete effectively for certain national multiple lots. The CMA did not consider it necessary for the TPAO to address any perceived risk that Müller might engage in unlawful and anti-competitive (below cost) price strategies to preclude effective entry.

### **Duration**

146. The CMA carefully considered whether the finite duration of the Undertakings would result in the competitive constraint imposed by the Nominated Purchaser ending on expiry of the TPAO. This issue is addressed above in paragraphs 81-85 (and also in paragraphs 106-116 which deal with Medina Dairy's ability, incentive and intention to compete) and is further considered in the following paragraphs.
147. A concern about the finite duration of the TPAO compared with the indefinite duration of the SLC identified in the SLC Decision was also expressed by a national multiple. One other national multiple initially raised the issue of duration, but subsequently told the CMA that, given the uncertainty around the position of Dairy Crest as a supplier of fresh milk to national multiples in the future, it would be in a better position with the Undertakings than with a downsized Dairy Crest absent the Merger.
148. The purpose of the TPAO is to restore competition to the level which would have existed absent the Merger. During the lifetime of the TPAO, the Nominated Purchaser is able to compete effectively with Müller on the basis of the supply of fresh milk at cost, and is therefore in an equivalent position to that of Dairy Crest in terms of its ability to win certain regional lots of national multiples and operate as a competitive constraint vis-à-vis Müller in that regard. The duration of the TPAO will enable the Nominated Purchaser to participate in up to two tenders per national multiple in the Severnside dairy catchment area, allowing the Nominated Purchaser to establish relationships with national multiples. For the reasons set out in paragraphs 129-145, the CMA does not believe the Nominated Purchaser will be at a competitive disadvantage in this regard. In fact, the TPAO places the Nominated

Purchaser in (in some respects) a more advantageous position than if it had purchased the plant, as it is able to supply national multiples in the initial period of its business without responsibility for the physical production of milk.

149. The Nominated Purchaser is accordingly in a position to win the business of National Multiples over the 5 to 8 year period of the TPAO and so implement its business plan, including investment in additional production capacity. The CMA's review of those plans has been a critical aspect of its approval as Medina Dairy as a suitable purchaser.
150. As mentioned above, Medina Dairy's business plans are to invest in its existing facilities (in particular its Watson's dairy in Hampshire), both expanding its capacity and improving its infrastructure with an estimated required investment of £[redacted] million. These plans have been accelerated and have an internal target completion date of [redacted] 2016. Medina Dairy also has plans for the construction of a new processing facility located in the Severnside dairy catchment area, which is estimated to take around [redacted] months to construct, at an estimated cost of £[redacted] million. Medina Dairy submitted that its investment in its existing facilities would occur independently of the TPAO as part of its strategy to broaden its customer base to national multiples and that, under the TPAO, it will accelerate the implementation of that strategy because it anticipates securing greater volumes with national multiples, which can be financed in part from its revenue under the TPAO. This is supported by Medina Dairy's statement to the CMA that the prospect of securing volumes with [redacted] has accelerated planning to upgrade its Hampshire facility.
151. Medina Dairy submitted evidence to the CMA that it has access to the necessary funds to make the investments required to expand and upgrade its infrastructure and strengthen its capability to serve national multiples, as explained in more detail above in paragraphs 99, 109 and 115. Medina Dairy already has experience in processing fresh milk to large middle ground customers, some of them with segregation requirements.
152. The CMA notes that Medina Dairy has also already taken steps to contact national multiples prior to it becoming aware that it was one of the potential Nominated Purchasers (for example, Medina Dairy met with [redacted] national multiples in [redacted] 2015), and it can be expected that the Undertakings will enhance its credibility with such customers even after the duration of the TPAO.
153. The CMA considers that whilst Medina Dairy would, in the absence of the TPAO, potentially develop into a credible competitor to Müller, the TPAO

would provide it with an opportunity to realise that constraint and to improve and accelerate the implementation of its plans.

154. The CMA therefore found that the duration of the TPAO is sufficient to allow Medina Dairy to implement its plans and to gain further experience and expertise to build the relationships and infrastructure required to continue to compete for the supply of fresh milk to national multiples on an ongoing basis. Medina Dairy has the ability, incentive and intention to continue to compete for this supply following the expiry of the TPAO.
155. One of the national multiples identified in paragraph 147 above suggested a modification to the Undertakings such that the CMA could, upon reasonable request by the Nominated Purchaser, extend the length of the TPAO to allow the Nominated Purchaser additional time to develop its own capacity to compete. That modification to the Original Undertakings was not offered by Müller, and the CMA notes that there would be potential disadvantages to a further extension of the TPAO, as such an extension might dampen the Nominated Purchaser's incentives to make the necessary investments to accelerate its entry and expansion into this market at an earlier stage of the lifetime of the TPAO. Therefore, and for the reasons given above, the CMA considers that such a modification is not necessary to allow the Nominated Purchaser to continue to compete for the supply of fresh milk to national multiples after the TPAO's expiry.

### ***Risk of co-ordinated effects***

156. The CMA considered the potential co-ordinated effects risks arising under the Undertaking relating to cost and capacity transparency.

#### ***Cost transparency***

157. The particular risk considered by the CMA was that Müller might know the Nominated Purchaser's processing costs ('fixed' in the form of the upfront fee and 'variable' in the form of the processing fee). The CMA also considered whether Müller may have some insight into the following fresh milk cost components:
- (a) raw milk procurement costs: if Müller assists the Nominated Purchaser with procurement, Müller will know these costs;
  - (b) raw milk collection costs: if Müller provides collection of raw milk for the Nominated Purchaser, Müller will know these costs; or
  - (c) delivery costs to national multiples: the same applies as for (b).

158. The CMA believes that the firewalls required under the Undertakings sufficiently address any risk relating to cost transparency, as the firewalls will prevent the flow of cost information (including the fixed option fee, processing fee and other cost components) between Müller's national multiple employees and the TPAO employees.
159. The CMA is alive to the risk of inadvertent breach of firewalls, but believes that the following specific features of the firewalls provided for address this particular risk. In addition to the physical and IT separation and ring-fencing, each of these employees has signed, or will sign, a confidentiality undertaking to the effect that no confidential information relating to their respective functions will pass between them. Further, TPAO employees will not participate in the preparation, negotiation, and/or decision-making with respect to the formulation of any Müller bid for a national multiple fresh liquid milk tender in the UK until the expiry of two years after the end of the TPAO. The effectiveness of these firewall measures will be monitored by an auditor when they are first set up, and then once every year thereafter.
160. The CMA also notes that, independently of the firewall mechanisms, Müller's visibility of the Nominated Purchaser's costs will reduce over time:
- (a) Medina Dairy, as Nominated Purchaser, is planning to use third party suppliers to distribute fresh milk to national multiples from the start of the TPAO. Medina Dairy is likely to require the supply of raw milk via Müller for 18 months, but will begin to independently source its raw milk thereafter and will no longer use Müller to collect raw milk after at most three years;
  - (b) Medina Dairy has well-developed plans early in the lifetime of the TPAO to invest in its existing Hampshire facility to process fresh milk for supply to national multiples. Therefore, its average cost base is likely to diverge from the Severnside dairy's cost base.
161. In terms of the Nominated Purchaser's visibility of Müller's costs, the Nominated Purchaser has no indication of the fixed costs of the Severnside dairy. Also, it cannot assess to what extent Müller will use its other plant in the South West, at Bridgwater, to supply milk to the national multiples. It is not therefore realistically possible for the Nominated Purchaser to use the processing fee it pays to Müller as a focal point for collusion.

162. One national multiple expressed a concern about co-ordinated effects relating to cost transparency.<sup>44</sup> The CMA considers that its concern is addressed above in paragraphs 158-161.

### *Capacity transparency*

163. The CMA considered whether Müller might have insight into the spare capacity of the Nominated Purchaser to supply national multiples in the Severnside dairy catchment area because Müller might know the maximum capacity available under the TPAO and may also be aware of any volumes that the Nominated Purchaser is having processed under the TPAO.
164. This risk was also raised by a national multiple, which submitted that any insight by Müller into the Nominated Purchaser's spare capacity would allow Müller to bid a monopoly price once it knows the Nominated Purchaser is drawing down the maximum capacity under the TPAO of 100 mlpa. This national multiple was concerned that the firewalls provided under the Undertakings would not prevent information about the Nominated Purchaser's spare capacity becoming known to Müller's national multiple employees, because, given the lack of other credible suppliers in part of the Severnside dairy catchment area, Müller's national multiple employees will become aware that the Nominated Purchaser will use capacity if Müller has competed for but lost a national multiple tender (in addition, these employees would become aware of remaining spare capacity because Müller would want to use it to bid for national multiple contracts).
165. For the reasons set out above in relation to cost transparency, the CMA considers that the firewalls provide protection from Müller's national multiple employees being directly informed about the Nominated Purchaser's spare capacity. The CMA acknowledges the risk that Müller will become aware of the level of capacity which does or does not remain, for example by drawing inferences based on the outcome of a tender. However, the CMA does not consider that this issue will undermine the effectiveness of the Undertakings.
166. First, the national multiple's submission is that the Undertakings do not restore competition to the level of the counterfactual. It therefore assumes that Müller would not have significant insight into Dairy Crest's spare capacity in the counterfactual.

---

<sup>44</sup> This national multiple also submitted documents indicating that [REDACTED]. The CMA notes that [REDACTED]. Furthermore, as mentioned above, [REDACTED].



167. However, the evidence received by the CMA during its merger investigation indicates that Müller would have been able to form a reasonably accurate view of the spare capacity of Dairy Crest in the counterfactual. During that inquiry, Müller and Dairy Crest (the **Parties**) submitted a number of internal documents showing that they constantly monitor the spare capacity of their competitors. [REDACTED].
168. In general, dairy suppliers have many ways of assessing the spare capacity of their competitors. Large milk processors publicly communicate their milk production and total capacity of their plants, and suppliers and customers routinely make announcements about new contract wins (and loss) for fresh milk, especially for large national multiple contracts. Suppliers also communicate on the volumes of other products they supply (eg cream, butter), and their competitors can use this information to ‘back-calculate’ the amount of fresh milk processed at certain plants. This explains why suppliers are able to form reasonably accurate views of the spare capacity of their competitors.
169. Estimating the spare capacity of Dairy Crest’s Severnside dairy in the counterfactual would be particularly straightforward. Any information published by Dairy Crest on its fresh milk operations would be directly attributable to its only plant at Severnside (whereas for larger groups analysts need to ‘allocate’ any information on aggregate volumes between plants).
170. The concern that Müller can behave as a ‘monopolist’ once the Nominated Purchaser has drawn down the maximum capacity under the TPAO therefore also applies in the counterfactual given Müller’s significant insight into Dairy Crest’s spare capacity.
171. Second, Medina Dairy’s plans to invest in additional capacity early in the TPAO mean that its spare capacity under the TPAO will not be determinative of whether it is in a position to bid for further contracts. It also means that Müller will face uncertainty as to the availability, timing and extent of that capacity. Indeed, as noted above, Müller’s insight may in fact, be less than it would have had in relation to Dairy Crest.
172. As mentioned above in paragraphs 109-110, Medina Dairy is actively engaged in planning to upgrade its Hampshire processing facility in 2016 (with a target of [REDACTED] 2016), which will add an additional [REDACTED] mlpa (with [REDACTED] mlpa current spare capacity) with which it can compete to serve national multiples

in the Severnside dairy catchment area. This is in time to serve most national multiple contracts that arise during the TPAO period ([REDACTED]<sup>45</sup> [REDACTED]).

173. More generally, as the CMA noted in its SLC Decision in relation to a volume of 55 mpa, such a volume would be sufficient to compete for various regional lots of national multiples in the Severnside dairy catchment area.<sup>46</sup> For instance, the tender data available to the CMA showed that tender lots in the South West range from 5 mpa to 52 mpa, and in Wales from 0.7 mpa to 22 mpa, when compared with a TPAO volume of 100 mpa.
174. In the circumstances, whilst Müller might infer that any new facilities would take some time to come on stream, it would only have limited information on Medina Dairy's ability to optimise its production between its volumes available through the TPAO and its upgraded Hampshire facility, and it is likely to bid more aggressively when faced with this uncertainty.
175. The CMA also notes that, as a new competitor in the market, Medina Dairy's strategic direction, and the implications of that direction for the way it bids, may not be as well-understood as Dairy Crest's, which would (in the counterfactual) have downsized on the basis that it no longer wished to compete to supply national multiples.
176. Third, the CMA notes that if Müller was to allow the Nominated Purchaser to win a contract or contracts (so enabling Müller to bid a monopoly price for subsequent contracts) that would provide a platform for the Nominated Purchaser to implement its business plan and support investment in additional plant. In other words, the effect of the strategy would be to facilitate the entry of the Nominated Purchaser. The CMA notes that the same national multiple had also argued that Müller would have the incentive to prevent the Nominated Purchaser winning any contracts because it would provide a 'gateway' for its business. The CMA agrees that Müller would have the incentive to compete with the Nominated Purchaser and accordingly does not think that the concern was a real one, for the reasons set out above.

### *Conclusion*

177. In conclusion, the CMA considers that any potential co-ordination risks relating to cost or capacity transparency are sufficiently addressed under the Undertakings.

---

<sup>45</sup> [REDACTED].

<sup>46</sup> SLC Decision, paragraph 200.

### ***Input foreclosure***

178. The CMA considered the risk that Müller may have the ability and incentive to flex non-price factors to the Nominated Purchaser's disadvantage, for example in the event of 'maintenance' or other 'disruption' at the plant. This risk was also raised by a national multiple, which additionally argued that Müller could degrade the Nominated Purchaser's non-price offering.
179. To address this risk, the TPAO contains detailed key performance indicators (**KPIs**). Breach of these KPIs would incur a financial penalty and would breach the UILs, which could lead to the appointment of a monitoring trustee and allows the CMA to impose an order to remedy the breach. The Nominated Purchaser also has the right to appoint an auditor if it has reasonable grounds to suspect that Müller is not adhering to its commitments. In addition, Müller submitted that a degradation strategy would carry significant reputational risk for Müller because it is likely to supply the national multiple that is harmed by this degradation elsewhere in the country.
180. Regarding the national multiple's concern that Müller could degrade the Nominated Purchaser's non-price offering, and despite Müller not having an incentive to do so (as discussed above), the CMA considers that the TPAO includes the necessary safeguard to address this issue. In particular, the TPAO sets out mechanisms that ensure that Müller will have no ability to undertake any non-price discrimination. This will be due to the agreement of KPIs covering all services provided by Müller. In line with industry standards, failure to fulfil the standards set out in the KPIs will be subject to a financial penalty. Therefore, non-price discrimination would be a breach of those contractual obligations and therefore of the Undertakings, which would expose Müller to all the consequences of non-compliance.
181. Further, the required standards set out in the KPIs will be underscored by a more general audit right for the Nominated Purchaser to appoint an independent auditor if there are reasonable grounds to suspect that Müller is not adhering to its commitments (at Müller's cost if the auditor finds a breach, and otherwise at shared cost).
182. The CMA therefore considers that any input foreclosure risks have been sufficiently addressed under the Undertakings.

### ***Mechanism to ensure compliance***

183. As mentioned above in paragraph 87, the monitoring provisions in the Undertakings strike an appropriate balance between ensuring compliance with the Undertakings and TPAO, and undue interference in the commercial

operations of both Müller and the Nominated Purchaser. One national multiple submitted that Müller's compliance with the Proposed Undertakings should be monitored by a monitoring trustee for the duration of the TPAO, at Müller's expense.

184. The CMA considers that, in light of the monitoring mechanisms described above, the appointment of the monitoring trustee for the duration of the TPAO is not necessary to ensure Müller's compliance with the Undertakings. The TPAO involves supply to a single customer, meaning that it is more practicable to rely on 'self-enforcement' by the Nominated Purchaser on an ongoing basis. Nevertheless, the Undertakings do require periodic review and audit including by third parties. Furthermore, a monitoring trustee may be appointed in the event of a breach of the Undertakings. In the CMA's view, further monitoring mechanisms are not necessary or proportionate.

## **Conclusion**

185. The CMA notes that the Undertakings are intended to remedy the prospect of an SLC found in the SLC Decision, which does not concern the whole of the capacity of the Severnside dairy but only that proportion of Dairy Crest's capacity which is spare for the supply of fresh milk to national multiples. The CMA has carried out a careful assessment of the effectiveness of the Undertakings.
186. As part of this assessment, the CMA has market tested the effectiveness of the Undertakings with all national multiples, being the customers affected by the prospect of an SLC. The large majority of them have not expressed concerns about the effectiveness of the Undertakings and have told the CMA that they would consider the Nominated Purchaser as a potential supplier. While one national multiple has expressed significant concerns about the Undertakings, the CMA has considered the issues raised by this party.
187. The CMA has also carried out extensive discussions with the Nominated Purchasers put forward, and has approved Medina Dairy as a suitable purchaser. Medina Dairy's business plans evidence their commitment and strategy to serve national multiples both during and beyond the lifetime of the TPAO. The TPAO will accelerate its existing plans to enter and expand in the supply of fresh milk to national multiples in the Severnside dairy catchment area and allows Medina Dairy to build a relationship with them.
188. For the reasons set out above, the CMA has no material doubt that the Undertakings are effective to restore competition to the level that would have prevailed absent the Merger.

189. The CMA has reached this conclusion whether the Undertakings are viewed as a quasi-structural remedy or as behavioural in nature. The CMA is satisfied that a remedy in the form of the Undertakings will be effective to remedy the prospect of an SLC in the particular circumstances of the present case.
190. Therefore, based on the CMA's assessment of purchaser suitability, the feedback from the national multiples and the CMA's own assessment, the CMA is satisfied to the clear-cut standard that the Undertakings should be accepted.
191. On 16 October 2015, the CMA notified Müller that it approved of Medina Dairy as the Nominated Purchaser. Müller has notified the CMA that it has entered into an agreement to sell the TPAO to Medina Dairy, conditional only upon acceptance by the CMA of the Undertakings and completion of the Merger.

## **Decision**

192. The CMA found in its SLC Decision that the Merger would be referred for a Phase 2 investigation if Müller failed to give suitable undertakings in lieu of reference pursuant to section 73 of the Act to address the competition concerns identified in the SLC Decision.
193. The CMA has no material doubt that the Undertakings are effective to remedy, mitigate or prevent the SLC identified in the SLC Decision and any adverse effects resulting from it. The CMA has also found that the Undertakings do not require unworkable resources at Phase 1. The CMA has therefore found that the Undertakings satisfy the clear-cut standard.
194. The CMA has therefore decided to accept the Undertakings offered by Müller pursuant to section 73 of the Act. The Merger will therefore not be referred for a Phase 2 investigation.
195. The Undertakings, which have been signed by Müller, will come into effect today.

**Sheldon Mills**  
**Senior Director**  
**Competition and Markets Authority**  
**19 October 2015**

---

<sup>i</sup> The figures in paragraph 10 refer to the financial year ending in 31 December 2013.

<sup>ii</sup> In paragraph 98, the results of the financial year ending on 30 April 2015 results are based on unaudited accounts submitted by Medina to the CMA in July 2015.