

# Anticipated acquisition by Irish Dairy Board (UK) Limited of FJ Need Foods Limited

## Decision on relevant merger situation and substantial lessening of competition

**ME/6652-16**

The CMA's decision on reference under section 22(1) of the Enterprise Act 2002 given on 24 March 2017. Full text of the decision published on 28 April 2017.

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

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### SUMMARY

1. The Irish Dairy Board (UK) Limited (**IDB(UK)**), a wholly-owned subsidiary of Ornua Co-operative Limited (Ornua Co-op), has agreed to acquire, via its subsidiary Ornua Nantwich Limited, the business of FJ Need (Foods) Limited (**FJ Need**) (the **Merger**). Ornua Co-op, IDB(UK), and Ornua Nantwich Limited are collectively referred to as Ornua. Ornua and FJ Need are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that the Parties will cease to be distinct as a result of the Merger, that the share of supply test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. The Parties overlap in the supply of hard cheese to the food service sector<sup>1</sup> in the UK. The CMA considered whether the frame of reference should be broadened to include supply to retail customers<sup>2</sup> but on the available evidence, and on a cautious basis, the CMA proceeded with a narrow frame of frame reference based on the supply of hard cheese to food service customers. The CMA considered whether the frame of reference should be narrowed by type of hard cheese and/or packaging format but concluded that this was unnecessary since the Parties' rival suppliers could switch between cheese types and formats in response to changes in demand, ie as a result of supply-side substitutability.
4. With respect to the geographic scope, the CMA carried out its assessment on the basis of a UK-wide frame of reference in light of evidence that suppliers which responded have warehousing facilities and access to a distribution network in the UK and most food services customers said that a UK presence was important.
5. The Parties also both have limited activities in providing contract packaging services for cheese. The CMA considered this as a separate product frame of reference with a UK-wide geographic scope for the same reasons as set out in the preceding paragraph.
6. The CMA therefore has assessed the impact of the Merger in relation to:
  - (i) the supply of hard cheese to the food service sector in the UK; and
  - (ii) contract packaging services for cheese in the UK.
7. In addition to the above frames of reference, there is a vertical relationship between the Parties' activities. Ornu (through its co-operative members which are cheese producers) is a significant upstream producer and supplier of cheese in large blocks which is then used for formatting by the Parties, and their downstream rivals, who will chop, grate, slice or blend and finally package the cheese for onwards supply to food service customers (or retail

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<sup>1</sup> Food service customers refers to those customers which use cheese as an ingredient, including the hospitality/catering sectors and suppliers who use cheese in manufacturing (eg prepared meals, pizza, pies, etc.). It also includes businesses (such as cash and carries who may supply cheese to these sectors.

<sup>2</sup> Eg supermarkets and convenience stores.

customers if active in this sector). This type of cheese supplied in large blocks is referred to as 'bulk cheese'. The CMA has therefore also considered the potential for input foreclosure of the supply of bulk cheese to wholesale packers and formatters as a result of the Merger.

8. The CMA considered whether it is or may be the case that the Merger may be expected to result in a substantial lessening of competition (**SLC**) as a result of unilateral effects in the supply of hard cheese to the food service customers. The Parties will hold a combined share of supply of 20 – 30 % in the supply of hard cheese to food service customers post-Merger, with an increment of 0 – 10 % brought about by the Merger. The evidence gathered by the CMA during its investigation indicated that a range of suppliers will continue to constrain the Parties post-Merger, including both larger players such as Arla, Dale Farm, Prima, Fayrefield and Dairy Partners, as well as a long tail of smaller suppliers. Moreover, almost all customers who responded to the CMA's enquiries indicated that they multi-source their requirements and the majority named at least two other alternative suppliers in addition to the Parties. On the basis of this evidence, the CMA concluded that the Merger would not give rise to a realistic prospect of an SLC in the supply of hard cheese to food service customers in the UK.
9. In relation to contract packaging services, the Parties only have [X] customers [X] and this is not the main focus of either of their businesses. The majority of the Parties' customers were not concerned about the potential impact of the Merger and indicated that there would continue to be a sufficient level of choice for contract packagers post-Merger. The CMA does not believe that there is a realistic prospect that the Merger may be expected to result in an SLC in relation to the supply of contract packaging services in the UK.
10. The CMA also considered whether it is or may be the case that the Merger may be expected to result in an SLC arising from vertical effects as a result of foreclosing the upstream supply of bulk hard cheese to cheese packers. Ornuia is estimated to supply around [10-20]% of hard in the UK (around [30-40] % of cheddar). The CMA found that there were a number of credible alternative suppliers of bulk cheese to whom downstream cheese packers and formatters could switch in response to a price increase (or refusal to supply) and, therefore, the Parties would be unlikely to have the ability to implement an input foreclosure strategy.
11. Ornuia's incentive to pursue a foreclosure strategy appears unlikely to increase significantly as a result of the Merger due to the modest increment created in the supply of hard cheese to food service customers. Although downstream margins are higher than upstream margins, data provided by the Parties indicated that, for a foreclosure strategy to be profitable, Ornuia would

need to recapture a very high proportion of customers switching from foreclosed downstream rivals, greatly exceeding its own share of the downstream market. On this basis it appears that a foreclosure strategy would not be profitable and, therefore, the Parties would not have the incentive to pursue such a strategy.

12. Therefore, the CMA believes that there is no realistic prospect that the Merger may be expected to result in an SLC in relation to the supply of bulk cheese to rival cheese packers.
13. The CMA believes that these constraints, taken together, are sufficient to ensure that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral or vertical effects.
14. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

## ASSESSMENT

### Parties

15. The Irish Dairy Board Co-operative (UK) Limited (IDB(UK)), is a wholly owned subsidiary of Ornuia Co-operative Limited (Ornuia Co-op) (the latter itself formerly known as the Irish Dairy Board Limited). Ornuia Co-op is a dairy co-operative society owned predominantly by Irish dairy farmers. IDB(UK), Ornuia Co-op and Ornuia Nantwich Limited are collectively referred to in this decision as Ornuia. Ornuia Co-op has agreed to purchase FJ Need, though Ornuia Nantwich Limited, a newly-incorporated subsidiary of IDB(UK). Ornuia's activities include the purchase of dairy products from Irish co-operatives and their sale to customers in the UK, Ireland and internationally. The turnover of Ornuia Co-op in the year ended December 2015 was around £[~~3~~] million<sup>3</sup> in the UK.
16. FJ Need Limited (FJ Need) is a formatter and packer of cheese. It purchases cheese in large blocks which it 'formats' (cuts, slices, or grates), packages and supplies it to the UK food service sector. The turnover of FJ Need in the financial year ended February 2016 was around £36 million in the UK.

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<sup>3</sup> Based on an annual turnover of £[~~3~~] million Euros and a Euro/Sterling annual average spot exchange rate of 1.3782, Euros into Sterling (source: Bank of England).

## Transaction and rationale

17. Ornuia has agreed to acquire the business of FJ Need (the **Merger**). The Merger is conditional on CMA clearance. Ornuia and FJ Need are together referred to as the **Parties**.
18. Ornuia submitted that the rationale for the Merger is enable it to improve its competitive position through ensuring an additional route to market for the Irish dairy products produced by its members. FJ Need has recently invested in cheese formatting equipment. Ornuia submitted that it has [X] and [X].

## Jurisdiction

19. As a result of the Merger, the enterprises of Ornuia and FJ Need will cease to be distinct.
20. The Parties overlap in the supply of hard cheese to the food service sector, with a combined share of over 20 – 30% by volume, with an increment of around [0-10%] brought about by the Merger. The CMA therefore believes that the share of supply test in section 23 of the Act is met.
21. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 3 February 2017 and the statutory 40 working day deadline for a decision is therefore 30 March 2017.
22. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## Material influence

23. Ornuia Co-op is the parent company of IDB(UK) and is an Irish co-operative of dairy producers. Its members include companies belonging to the Glanbia and Dairygold groups of companies which both have subsidiaries that are suppliers of hard cheese and compete with the Parties. Entities within each of these groups each own around a [15-25]% share in Ornuia.<sup>4</sup> In addition, Glanbia and Dairygold are represented on the board of Ornuia.

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<sup>4</sup> According to the Parties: Dairygold Co-Op Society Limited owns [X] % of Ornuia Co-op; Dairygold ultimately owns 100% of Dairygold Food Ingredients, a downstream competitor to both Parties; [X] Glanbia owns [X]% of Ornuia Co-op. [X], owns [X]% in Ornuia Co-op. The Glanbia entity which directly competes with the Parties is Glanbia Cheese Limited, which is [X]% owned by Glanbia plc (which is itself [X]% owned by Glanbia Co-op).

24. The CMA has considered whether the relevant evidence (including shareholdings, voting entitlements and Board membership) shows that Glanbia or Dairygold possesses material influence over Ornuu,<sup>5</sup> for the purposes of deciding the scope of the relevant merger situation to investigate (as well as to ascertain the degree to which these companies compete with the Parties).
25. A finding of material influence can be based on an ability to influence policy through exercising votes at shareholders meetings together with, in some cases, any additional supporting factors that might suggest that the acquiring party exercises an influence disproportionate to its shareholding. It may also arise as a result of the ability to influence the board, and/or through other arrangements; that is without necessarily having the ability to block votes at shareholder's meetings.<sup>6</sup>
26. As explained in the CMA's guidance, a share of voting rights of over 25% is likely to confer material influence. Although there is no presumption of material influence below 25%,<sup>7</sup> the CMA may examine any shareholding of over 15% (or exceptionally lower) in order to assess whether the holder might be able materially to influence the Parties' policy.<sup>8</sup>
27. There are 15 members of the Ornuu board. Dairygold and Glanbia each have two directors. Votes relating to special resolutions are however taken on a 'one member one vote basis' with only one member per group entitled to vote.<sup>9</sup> As special resolutions require a 75% majority in order to be passed,<sup>10</sup> neither Dairygold nor Glanbia would have the power to block a special resolution. In any case, the Parties submitted that there has only been one special resolution in the last three years (which concerned a change of name).
28. The Parties submitted that Dairygold and Glanbia therefore do not have material influence over Ornuu on the basis of: (a) the above 'one member, one vote' feature of Ornuu; and (b) the pattern of the exercise of voting rights

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<sup>5</sup> See paragraphs 3.2.8 – 3.2.12 of the CMA's Merger Assessment Guidelines for further information on how the CMA assesses material influence.

<sup>6</sup> See paragraph 4.16 of Mergers: Guidance on the CMA's jurisdiction and procedure.

<sup>7</sup> Given the nature of the decisions that typically will require a special resolution, and which the holder could therefore block, a share of voting rights of over 25% is likely to be seen as conferring the ability materially to influence policy. (Mergers: Guidance on the CMA's jurisdiction and procedure, paragraph 4.19 to 4.20).

<sup>8</sup> Mergers: Guidance on the CMA's jurisdiction and procedure, paragraph 4.20.

<sup>9</sup> According to Rule 42 of Ornuu Co-operative Limited provided by the Parties. According to Rule 70, rules may be altered by a majority of two-thirds of the votes of members voting and present, at a Special General Meeting called for the purpose. Other resolutions are determined by a method which involves weighted voting calculated by reference to net sales by members to the co-operative.

<sup>10</sup> Section 51 of the Industrial and Provident Society Act, 1893. See also Rule 42 above.

in practice in relation to other matters, with most votes being passed by consensus and thus without reference to weighted voting.

29. On the specific facts of this case, the CMA does not consider that either of Dairygold or Glanbia is able to exercise material influence over Ornuia, and so has not considered further below whether either of Dairygold or Glanbia has acquired material influence over FJ Need as a result of the Merger.
30. However, the CMA has paid particular attention to the extent to which Dairygold and Glanbia exert a competitive constraint on the Parties, to the extent relevant, within its competitive assessment below.

## Counterfactual

31. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.<sup>11</sup>
32. In this case, there is no evidence supporting a different counterfactual, and the Parties have not put forward arguments in this respect. Therefore, the CMA believes the prevailing conditions of competition to be the relevant counterfactual.

## Frame of reference

33. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.<sup>12</sup>

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<sup>11</sup> [Merger Assessment Guidelines](#) (OFT1254/CC2), September 2010, from paragraph 4.3.5. The [Merger Assessment Guidelines](#) have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#) (CMA2), January 2014, Annex D).

<sup>12</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

34. The Parties overlap in the supply of:
- i) the supply of hard cheese to the food service sector; and
  - ii) contract packaging services for cheese.
35. There is also a vertical relationship between the Parties as Ornuu (through its members) is a significant upstream producer and supplier of cheese, including to FJ Need and other downstream rival cheese packers. This type of cheese in large blocks is referred to in this decision as 'bulk cheese'.

### ***The supply of hard cheese to the food service sector***

#### ***Product scope***

36. The Parties principally overlap in the supply of formatted/package hard cheese supplied to the food service sector.<sup>13</sup> They supply customers including food manufacturers, caterers and restaurants. The Parties sell a wide range of hard cheeses,<sup>14</sup> although around [the majority]% of each of their sales to food service customers consist of mozzarella (or mozzarella substitutes) and/or cheddar.

#### ***Supply to retail sector and food service sector***

37. The Parties submitted that the product frame of reference should include the supply of hard cheese to both retail and food service customers. The Parties argued that, on the supply-side, cheese production and packaging is the same regardless of which channel the cheese is sold into. They have also argued that suppliers sell into both channels and switch sales between them.
38. The Office of Fair Trading (**OFT**) has previously considered that supply of hard cheese to retail and food service customers could form a single frame of reference, on the basis that production assets can be used for both and that many producers/importers sell into both channels, although no conclusion was reached on this point.<sup>15</sup> In order to support their argument in this case, the Parties provided the CMA with evidence that Ornuu has previously

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<sup>13</sup> Ornuu also supplies to the retail sector but FJ Need does not. Therefore, the Parties do not overlap in relation to this.

<sup>14</sup> For instance they both supply: cheddar; Edam; Gouda; mozzarella; processed cheese; burger slices; and analogue cheese (a low cost cheese made with vegetable oil, starches and milk powder rather than fresh milk). The Parties consider that a hard cheese market additionally includes other hard and semi-hard cheese.

<sup>15</sup> Anticipated acquisition by Adams Foods Limited of the business for the sale and marketing of hard cheese in the UK of the First Milk Cheese Company Limited and Scottish Milk Products Limited, decision of 3 March, paragraph 43. 2014.



switched supply between the different sales channels, for example by selling more into the wholesale channel when retail demand was low.

39. The CMA received mixed evidence during the course of its investigation evidence as to the extent of supply-side switching between the retail sector and food service sector.
40. For instance, three suppliers told us that they would switch capacity from supplying the retail sector to supplying the food service sector in response to a 5% price increase in the food service sector. However, it was not clear how much switching would be likely to occur in practice: two of the respondents currently supply relatively low product volumes to the retail sector and another said that additional investment would first be required to supply sliced/grated cheese to food service customers. Other suppliers into the retail sector indicated that they would not have the ability or incentive to switch capacity to the food service sector.
41. Competitors told the CMA that food service customers and retail customers have different requirements and that the food service sector was highly competitive. The CMA also noted the existence of higher gross margins in the retail sector, which may reduce the incentive to switch capacity to supply into the food service sector.
42. On a cautious basis, given that the evidence was mixed on this issue, the CMA has considered the supply of hard cheese to the food service sector separately from supply into the retail sector.

#### *Types of cheese*

43. The CMA considered whether the market should be segmented further by the type of hard cheese.
44. The Parties argued that there is significant demand-side substitution from food service customers between types of hard cheese and that all types of hard and semi-hard cheese should form part of the same market including natural cheeses such as mozzarella, cheddar and processed cheeses/analogue cheese. In support of this position, the Parties submitted evidence which they argued showed that Ornu's sales of processed cheese increased as market prices of natural cheese increased, indicating that customer demand switched from natural cheese to processed cheese in response to the price rise.
45. The majority of food service customers of the Parties who responded to the CMA indicated that they source multiple types of hard cheese to meet their demands. Most customers said that, from a demand-side perspective, they

would not switch away from purchasing a particular type of cheese if its price increased by 5% relative to other types of cheese.

46. Almost all competitors told the CMA that they supply both cheddar and mozzarella, which indicates that they could switch between different types of hard cheese in response to changes in demand.<sup>16</sup> Supply-side substitutability was generally high as a result of many rival suppliers operating a re-packer/distributor model allowing them to more flexibly change their upstream sourcing requirement from producers. Consistent with a high degree of supply-side substitutability, customers indicated that the type of hard cheese supplied was not generally a differentiating factor between rival formatters and that conditions of competition were broadly similar across different types of hard cheese.
47. The CMA gathered some evidence that a minority of suppliers do specialise in supplying certain types of hard cheese and that, for this reason, they would not necessarily be suitable alternatives to the Parties for all types of hard cheese. For instance, some customers said that since Kerry and Glanbia specialise in supplying analogue cheese and mozzarella, respectively, and therefore they would not be suitable alternatives to the Parties for all their requirements.
48. Overall, the CMA considered that it was not necessary to delineate the supply of hard cheese by type of hard cheese in order to assess the Merger as result of the high degree of supply-side substitutability described above. Any differentiation in the cheese offerings supplied by the Parties' rivals has been taken into account, to the extent relevant, within the CMA's competitive assessment.

#### *Packaging format*

49. The CMA considered whether the market should be segmented further by the cheese format, that is, its pack size, and whether cheese is grated or sliced.
50. From the demand-side, a significant proportion of the cheese supplied by the Parties is in grated form (Ornua said grated cheese accounts for the vast majority of its supply) although it is also sold sliced or in blocks. Grated cheese is sold separately or in blends.<sup>17</sup> All customers that responded to the

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<sup>16</sup> The large majority of both Parties' sales consist of mozzarella (or mozzarella substitutes) and cheddar.

<sup>17</sup> Around [X]% of Ornua's sales to the foodservice sector are blends. The proportion of different cheeses within the blend varies according to individual customer specifications.

CMA reported buying at least some grated/shredded cheese, although the majority also bought sliced and/or block cheese as well.

51. The Parties submitted that no distinction should be drawn according to format of cheese as a result of supply-side substitutability. They submitted that firms have the capability to switch packaging format (whether cheese formatting is carried out in-house or outsourced to contract packagers, as described further below). Most rival suppliers of hard cheese to food service customers confirmed that they were able to supply hard cheese in a full range of formats.
52. Accordingly, the CMA does not consider it necessary to delineate the product frame of reference by the format of hard cheese because of the high degree of supply-side substitution described below.

#### *Conclusion on product scope*

53. For the reasons set out above, the CMA has considered the impact of the Merger in the supply of hard cheese to food service customers. However, it was not necessary for the CMA to reach a conclusion on the product frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

### **Contract packaging services**

#### ***Product scope***

54. Suppliers of cheese to the food service (and/or retail) sector may format and pack their cheese in-house. Some suppliers, however, enter into third party agreements whereby the formatting/packing is outsourced to a third party. The Parties overlap in the supply of these cheese packing services to third parties.
55. In Adams Foods/First Milk<sup>18</sup> the OFT considered cheese packing services as a separate frame of reference. Consistent with this approach, the Parties considered that the appropriate frame of reference is the supply of contract cheese packing services (ie excluding in-house packing services).
56. The CMA received no evidence to indicate that it was necessary to adopt a different frame of reference to the supply of contract cheese packing services (ie excluding in-house packing services). The CMA has considered the impact

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<sup>18</sup> Paragraph 49.

of the Merger in the supply of contract packaging services to cheese suppliers excluding in-house packaging.

57. However, it was not necessary for the CMA to reach a conclusion on the product frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

## **The supply of bulk cheese to cheese formatters/packers**

### ***Product scope***

58. Ornuia is active upstream as a supplier of bulk cheese to cheese packers and formatters. It is (through its members) a cheese producer and, more generally, supplies bulk hard cheese to downstream rival cheese formatters including FJ Need who format it (ie make into blocks, slice, grate and/or blend it) and pack it ready for resale to, for instance, food service customers. FJ Need is a cheese packer/formatter and is not integrated with cheese production<sup>19</sup>.
59. The Parties submit that the narrowest candidate product market in relation to this vertical relationship is the supply of bulk cheese for onward supply. The Parties submit that producers of cheese sell it not only to formatters/packers but also to cheese traders, which then sell on to cheese formatters/ packers for processing. This means that hard cheese does not always have a direct route from producer to processor and therefore that not taking account of supply to traders would risk underestimating the total traded volume of bulk cheese.
60. As the relationship between the Parties is vertical and the potential concerns resulting from the Merger primarily relate to input foreclosure in the upstream market for the supply of bulk cheese to rival cheese formatters, the CMA does not consider it necessary to conclude on the precise market definition.
61. On a cautious basis, the CMA has assessed the prospect of vertical effects arising with reference to the supply of bulk hard cheese to cheese formatters and packers. It was not necessary to conclude on the precise product scope in this respect as no concerns arise on any plausible frame of reference.

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<sup>19</sup> FJ Need did supply a very small volume of bulk hard cheese in 2016 ([REDACTED] metric tonnes). However, as FJ Need is not a cheese producer and these resold volumes are estimated to represent only around [0-5]% of the total volume of hard cheese used in the UK food service sector the CMA considers that it is only necessary to consider the supply of bulk cheese in relation to the vertical relationship.

### *Conclusion on product scope*

62. For the reasons set out above, the CMA has considered the impact of the Merger in the supply of bulk hard cheese to rival formatters.
63. However, it was not necessary for the CMA to reach a conclusion on the product frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

### *Overall conclusion on product scope*

64. For the reasons set out above, the CMA has considered the impact of the Merger within the following product frames of reference:
- (a) the supply of hard cheese to the food service sector;
  - (b) contract packaging services for cheese; and
  - (c) the vertical supply of bulk cheese to cheese packers.
65. However, it was not necessary for the CMA to reach a conclusion on the product frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

### ***Geographic scope***

#### **Supply of hard cheese to the food service sector**

66. The Parties submitted that the geographic frame of reference for the supply of hard cheese to the foodservices sector was at least EEA-wide.
67. In Adams Foods/First Milk, the OFT considered the effects of the merger on the supply of cheddar in the UK (including imports from the Republic of Ireland). Similarly, in First Milk/Milk Link the OFT considered that the geographic frame of reference for the supply of cheddar and hard territorial cheeses was the UK (including substantial imports from the Republic of Ireland and, to a lesser extent, from other countries). The majority of third parties who responded to the CMA (including both customers and competitors) indicated that a UK presence of suppliers, including the presence of warehousing and a distribution system, is important to them in selecting a supplier. Two customers specifically stated that a UK presence is important with regard to reducing delivery/lead times.
68. On a cautious basis, the CMA has considered the supply of hard cheese to the food service sector in the UK. However, it was not necessary for the CMA

to reach a conclusion on the geographic frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

### **Contract packaging services for cheese**

69. The Parties submitted that it is cost effective to transport cheese for packaging in other countries before re-importing back to the UK after it has been packaged although they only provided two examples of this occurring in practice. They consider that the geographic frame of reference that should be used in relation to the supply of contract packaging services should be at least EEA-wide.
70. The CMA understands that the Parties provide these contract packaging services to UK customers from the UK. Other suppliers of contract packing services for cheese that the CMA spoke to also provide these services from the UK. Two customers indicated that that they did or may have a preference to use a supplier based in the UK.
71. Overall, and on a cautious basis, the CMA considered that it was appropriate to assess the Merger in relation to the supply of contract packaging services for cheese in the UK.

### **Supply of bulk cheese to rival cheese packers**

72. The Parties indicate that the supply of bulk cheese is international, with customers able to source from across the EU and the rest of the world.
73. The CMA received evidence that indicates that cheese formatters source hard cheese from Europe or even further afield (eg New Zealand). However, with regard to cheddar, the Parties provided data indicating that in 2015, only around a third of cheddar consumed in the UK was imported and, of imports, a high proportion came from the Republic of Ireland.<sup>20</sup>
74. The CMA has considered the frame of reference for the supply of bulk cheese to rival cheese packers as UK-wide (including imports from countries including the Republic of Ireland) on a cautious basis. However, it was not necessary for the CMA to reach a conclusion on the geographic frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

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<sup>20</sup> The Parties estimated that 322,498 tonnes of cheddar were consumed in the UK in 2015 and provided Eurostat data that 101,589 tonnes of cheddar (excluding grated or powdered and for processing) were imported in 2015, of which 87,981 tonnes were imported from Ireland.

### *Overall conclusion on geographic scope*

75. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:
- (a) the supply of hard cheese to the food service sector in the UK;
  - (b) contract packaging services for cheese in the UK; and
  - (c) the vertical supply of bulk cheese to rival cheese formatters in the UK.
76. However, it was not necessary for the CMA to reach a conclusion on the geographic frame of reference, since, as set out below, no competition concerns arise on any plausible basis.

### **Conclusion on frame of reference**

77. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:
- (a) the supply of hard cheese to the food service sector in the UK;
  - (b) the supply of contract packaging services to cheese suppliers in the UK; and
  - (c) the supply of bulk cheese to cheese suppliers in the UK.

### **Competitive assessment**

#### ***Supply of hard cheese to the food service sector - Horizontal unilateral effects***

78. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.<sup>21</sup> Horizontal unilateral effects are more likely when the merger parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in a substantial lessening of competition in relation to unilateral horizontal effects in the supply of hard cheese to the food service sector, and the supply of bulk cheese to rival cheese packers in the UK.
79. The Parties submitted that most contracts for the supply of cheese are awarded on a short-term basis lasting between three and six months. This is because cheese is a commodity product and its price can fluctuate

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<sup>21</sup> [Merger Assessment Guidelines](#), from paragraph 5.4.1.

significantly. The Parties submitted that contracts of a relatively short duration guard against the danger that suppliers are tied into supplying at a price which fluctuates below the price at which they purchase bulk cheese from producers. Third parties confirmed that contracts can often be relatively short. The Parties submitted that some customers used a system of formal tenders, but this represented a minority of sales. Several customers and competitors noted that supply was often dependent on good relationships between suppliers and customers and not on formal processes.

### *Shares of supply*

80. Ornu and FJ Need are estimated to have a combined share of supply of around 20 – 30%, with an increment of around [0 - 10%] in the supply of hard cheese to the food service sector brought about by the Merger. As noted in paragraph 47, some customers told the CMA that some suppliers specialise in supplying certain types of hard cheese. The CMA notes that, even if Dairygold and Glanbia (which are members of Ornu and therefore may have a diminished incentive to compete with the Merged firm) were excluded from the share of supply calculations, the Parties' estimated share of supply would remain below 40%. Consistent with the CMA's Merger Assessment Guidelines<sup>22</sup>, combined shares at this do not typically give rise to unilateral effects concerns in an undifferentiated market.

### Estimated shares of supply

<b>Supplier</b>	<b>Estimated share of supply, % (based on value of sales)</b>
Ornu	15-25
FJ Need	5-10
Combined	25-30
Glanbia	15-20
Arla	5-10
Kerry	5-10
Dale Farm	5-10

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<sup>22</sup> Paragraph 5.3.5



<b>Supplier</b>	<b>Estimated share of supply, % (based on value of sales)</b>
Prima	5-10
Dairy Partners	5-10
Fayrefield	5-10
Dairygold	0-5
JS Bailey	0-5
Extons	0-5
Nantwich	0-5
GRH	0-5

Source: Parties, third parties, and CMA calculations

81. There are several competitors of the Parties who will remain in the market which appear to offer a similar range of products and are of a similar size to FJ Need. These include Arla, Dale Farm, Prima, Fayrefield and Dairy Partners. There is also a long tail of smaller suppliers, who many customers confirmed that they considered as viable alternatives to the Parties.
82. The CMA faced some difficulties in obtaining reliable data to calculate shares of supply, and on the total size of the market. The value and volume data used to calculate the above shares of supply was verified by the Parties' competitors in the majority of cases. Nevertheless, the CMA considered other evidence, in particular the level of choice that customers have, in order to assess the possibility of horizontal unilateral effects arising as a result of this Merger.

*The nature of the competitive constraint provided by Dairygold and Glanbia*

83. As described above in paragraph 21, Dairygold and Glanbia are members of Ornu. Given the this relationship between them and Ornu and that they both operate in hard cheese production, the CMA has given careful consideration to the extent that they fully compete with Ornu and can be expected to exercise a competitive constraint on the merged firm post-merger.
84. The CMA has given particularly careful consideration to the position of Dairygold, which several customers listed as an alternative supplier to the

Parties. By contrast, few food service customers identified Glanbia as an alternative to the Parties.

85. The evidence available to the CMA shows that Ornuia has consistently sought to compete with [REDACTED].
86. In any case, whether or not Dairygold or Glanbia are excluded as competitors does not make a difference to the outcome of the CMA's competitive assessment of the Merger because other competitors will continue to sufficiently constrain the Parties post-Merger.

#### *Closeness of competition*

87. The Parties have submitted that they are not each other's closest competitors. They state that cheese supplied into the food service sector is largely homogenous and that the Parties do not compete with each other more strongly than their respective shares would indicate. They provided the names of 17 other hard cheese suppliers that they consider to be rivals.
88. The CMA found that customers of Ornuia regularly named FJ Need as an alternative supplier (and vice versa) which is consistent with the Parties being competitors. Notwithstanding this, the CMA found evidence that the Merger Parties would continue to be constrained by rival formatters post-merger who were also cited by customers as credible alternatives to the Parties. In particular:
  - (a) As set out above, the CMA has found that there are several competitors that offer a similar range of products and are of a similar size to FJ Need, including Arla, Dale Farm Prima, Fayrefield and Dairy Partners, as well as a long tail of smaller suppliers.
  - (b) Customer switching and tender data was limited but generally consistent with the proposition that the Merger Parties will continue to be constrained post-merger. One FJ Need customer provided details of a recent tender in which six suppliers had submitted bids ([REDACTED]). FJ Need won the tender and [REDACTED] was the runner up, consistent with [REDACTED] being FJ Need's closest constraint in that instance. Furthermore, although two Ornuia customers reported switching volumes to FJ Need, the CMA also found examples of customers switching from Ornuia to Fayrefield and from Ornuia to Dale Farm. Another Ornuia customer provided data on four recent tenders, each of which involved seven bidders and in which FJ Need did not participate.
  - (c) Almost all customers who responded indicated that they multisource cheese products and so are never reliant on a single source of supply. No

respondents sourced their cheese products solely from both Parties. In terms of alternative suppliers to the Parties, the majority of customers who responded indicated that they use at least 2 or 3 other suppliers other than the Parties. Competitors named by customers include Fayrefield, Arla, Dale Farm, and JS Bailey. Almost half of respondents named Prima as an alternative.

(d) The majority of customers and competitors who responded were not concerned about the Merger.

89. Only two food service customers who responded to the CMA had some concerns about the Merger. One of these customers expressed a general concern that the Merger would mean that they would have one less choice of supplier. As noted above, the CMA considers, based on its market investigation, that there are sufficient remaining players in the market which will ensure that customers will have several choices of supplier of hard cheese.
90. Both customers expressed a specific concern that the Merger would further limit the pool of approved suppliers of cheese that they can use to produce food products for particular retailers. One customer indicated that their choice was particularly limited in relation to one retailer which, they argued, had a very limited approved supplier list. The CMA notes, however, that FJ Need is not currently approved by that retailer and therefore that no Merger-specific arises. In addition, when contacted by the CMA, the retailer also named a number of alternative suppliers who were approved for use as an ingredient supplier in its products (including Dairygold, Ash Manor, Dairycrest and Arla) and indicated its willingness to approve other suppliers.

*Conclusion on horizontal unilateral effects in the supply of hard cheese to the food service sector*

91. As set out above, the CMA believes that, post-Merger, customers will continue to have a range of alternative credible suppliers.<sup>23</sup> Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of horizontal unilateral effects in relation to the supply of hard cheese to the food service sector.

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<sup>23</sup> Even if the CMA were to disregard Dairygold and Glanbia as genuine competitors there would still remain a sufficient number of other competitors in the market acting as an effective constraint on the Parties.

## **Supply of contract packaging services**

92. The Parties were unable to provide reliable market share data in relation to their and competitors' supply of contract packaging services to cheese suppliers, although they submitted that their combined share of supply was considerably below 25%. The Parties largely carry out these activities to service their own in-house demand and have only four third party customers for these services.
93. The CMA contacted each of the customers of the Parties to seek their views on the impact that the Merger would have on their existing supply options choices that they currently have. Three of them indicated that they had no concerns and that a sufficient number of alternative contract packaging services would still be available to them if the Merger proceeded. Several competitors to the Parties who format cheese also confirmed that they had capacity to increase their supply of packaging services should there be an increased demand for this.

### *Conclusion on horizontal unilateral effects in the supply of contract packaging services*

94. As set out above, the CMA believes that, post-Merger, customers will continue to have a range of alternative credible suppliers.<sup>24</sup> Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of contract packaging services.

## **Supply of bulk cheese to rival cheese packers**

95. Ornu estimates that it has a share of around [10-20]% in the supply of bulk cheese to the food service sector (or [30-40]% share of supply of bulk cheddar).<sup>25</sup> FJ Need supplies a small amount of bulk cheese and only as a reseller (it is not a producer). FJ Need generally only sells bulk cheese where it has excess cheese and/or the price it can obtain through onward sale is high. As a result of this, the CMA did not consider a horizontal unilateral effects theory of harm in relation to the supply of bulk cheese to rival packers.

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<sup>24</sup> Even if the CMA were to disregard Dairygold and Glanbia as genuine competitors there would still remain a sufficient number of other competitors in the market acting as an effective constraint on the Parties.

<sup>25</sup> The Parties submitted that shares of supply in this market should be treated with some caution as Ornu is itself a customer through its purchases of bulk cheese from its members rather than a provider.

96. In light of Ornuu's upstream supply of bulk cheese, the CMA considered an input foreclosure theory of harm as part of its competitive assessment.

### ***Vertical effects***

97. Vertical effects may arise when a merger involves firms at different levels of the supply chain, for example a merger between an upstream supplier and a downstream customer or a downstream competitor of the supplier's customers.
98. Vertical mergers may be competitively benign or even efficiency-enhancing, but in certain circumstances can weaken rivalry, for example when they result in foreclosure of the merged firm's competitors. The CMA only regards such foreclosure to be anticompetitive where it results in a substantial lessening of competition in the foreclosed market(s), not merely where it disadvantages one or more competitors. The CMA's approach to assessing vertical theories of harm is to analyse (a) the ability of the merged entity to foreclose competitors, (b) the incentive of it to do so, and (c) the overall effect of the strategy on competition.
99. In the present case, the CMA has considered whether the Merger would lead to input foreclosure by providing the Parties with the ability and incentive to foreclose the supply of bulk hard cheese, which is an essential input required for formatting cheese, to rival suppliers of hard cheese to food service customers post-Merger. The CMA did not need to consider the overall effect of such a strategy as it did not consider that either the ability or incentive to do so were present.<sup>26</sup> This is discussed below.

### ***Ability***

100. The Parties estimate that Ornuu has around around [10-20]% in relation to all hard cheese and [30-40]% of the supply of bulk cheddar to the food service sector. The CMA considers that Ornuu's share of supply may be higher because: (i) the estimate for the total size of the market provided by the CMA is higher than that estimated by the Parties on the basis of evidence from competitors on the volumes they supply; and (ii) comments from some third parties are consistent with Ornuu being a significant supplier of bulk hard cheese to the food service sector.<sup>27</sup> On the basis of uncertain shares of

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<sup>26</sup> [Merger Assessment Guidelines](#), paragraph 5.6.6.

<sup>27</sup> For instance, two rival cheese formatters stated that their other supply options are very limited and another estimated that Ornuu accounts for around 70-80% of supply of hard cheese to the UK food service sector. A large food service customer told the CMA that Ornuu is one of two main suppliers of cheese to UK cheese formatters.

supply, and some third party comments, the CMA considers that it is unable to discount the possibility that Ornuia is a significant upstream supplier of bulk cheese to the UK food service sector.

101. The CMA considers that there is, however, considerable evidence to suggest that the Parties are unlikely to have the ability to foreclose downstream rivals including:
- (a) the Parties submit that several producers and traders will remain as sources of bulk hard cheese including: Arla; First Milk; Lactalis; Kerry; Dale Farms; Dairy Crest; Fayrefield Foods, Greenfields, Geris and others. Third party responses from downstream customers confirmed several of these players, as well as other players including Glenstall, DMK, South Caernarfon and St Paul, as potential alternative suppliers not all of which are based in the UK but which do supply the UK<sup>28</sup>. Four downstream rivals (that were not vertically integrated as cheese producers) confirmed to the CMA that other suppliers could meet their hard cheese requirements and they did not raise any vertical concerns about the Merger;
  - (b) the Parties themselves purchase significant volumes of bulk hard cheese from other suppliers. For instance, Ornuia supplied only [0-10]% of FJ Need's total hard cheese requirements in 2015. It sourced larger quantities of cheddar from [redacted] and [redacted]. Ornuia itself purchased bulk cheese from: [redacted], [redacted]. [redacted], [redacted] and [redacted]; and
  - (c) the Merger will not increase the ability of the Parties to engage in a foreclosure strategy as FJ Need trades only a very small volume of bulk hard cheese and on a re-seller basis.
102. Overall, the CMA considers that the evidence indicates that the Parties would not have the ability to foreclose rivals as a result of the Merger.

### *Incentive*

103. Ornuia's incentive to pursue a foreclosure strategy appears unlikely to increase significantly as a result of the Merger due to the modest increment created in the supply of hard cheese to food service customers. Although downstream margins are higher than upstream margins, data provided by the Parties indicated that, for a foreclosure strategy to be profitable, Ornuia would need to recapture a very high proportion of customers switching from foreclosed downstream rivals, greatly exceeding its own share of the

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<sup>28</sup> In addition, customers also identified non-UK suppliers including Belgomilk, Dansko Foods.

downstream market. On this basis it appears that a foreclosure strategy would not be profitable and, therefore, the Parties would not have the incentive to pursue such a strategy.

### *Effect*

104. Given the CMA does not consider it credible that the Parties' are likely to have either the ability or incentive to foreclose rivals, it has not considered it necessary to consider the potential effects of any such strategy.

### *Conclusion on vertical effects*

105. For the reasons set out above, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of vertical effects in relation to the supply of bulk cheese to cheese packers.

### ***Barriers to entry and expansion***

106. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no substantial lessening of competition. In assessing whether entry or expansion might prevent a substantial lessening of competition, the CMA considers whether such entry or expansion would be timely, likely and sufficient.<sup>29</sup>
107. However, the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

### **Third party views**

108. The CMA contacted customers and competitors of the Parties. The vast majority of customer and competitors who responded did not raise concerns about the Merger.
109. Third party comments have been taken into account where appropriate in the competitive assessment above.

### **Decision**

110. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

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<sup>29</sup> [Merger Assessment Guidelines](#), from paragraph 5.8.1.

111. The Merger will therefore **not be referred** under section 33(1) of the Act.

**Colin Raftery**  
**Director of Mergers**  
**Competition and Markets Authority**  
**23 March 2017**