

Completed acquisition by Claymore Dairies Limited of the milk business of Allarburn Farm Dairy Limited

The OFT's decision on reference under section 22 given on 3 May 2006. Full text of decision published 15 May 2006.

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**Please note that square brackets indicate text or figures which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.**

**PARTIES**

1. **Claymore Dairies Limited (Claymore)** is a processor and distributor of fresh milk in Scotland operating from a processing facility in Nairn and through a number of depots in Dingwall, Fort William and Wick. Its principal customer base is in the Highlands, but Claymore also has customers in Grampian, Tayside, Argyll and the Western Isles. Claymore is 75 per cent owned by Arla Foods UK plc (Arla), a dairy company operating throughout the UK with processing facilities, *inter alia*, in Lockerbie; the remaining 25 per cent is held by North Milk Co-op (NMC), a farmers' co-operative.
2. **Allarburn Farm Dairy Limited (Allarburn)** operates a dairy farm and milk processing facility from premises in Elgin, Scotland. It distributes around [ ] litres of fresh milk per annum (mlpa). Allarburn's UK turnover in the last financial year was around [ ].

**TRANSACTION**

3. On 2 February 2006, Claymore entered into an agreement to acquire the milk processing and milk distribution business of Allarburn; the seller will continue its dairy farming business (Allarburn Farm). The administrative deadline in this case expires on 3 May 2006.

## **JURISDICTION**

4. As a result of this transaction enterprises carried on by or under the control of Claymore (and its majority shareholder, Arla) and Allarburn have ceased to be distinct. The parties overlap in the supply of fresh milk and the share of supply test in section 23 of the Enterprise Act 2002 (the Act) is met since the merged entity's share of supply of fresh milk in Great Britain exceeds 25 per cent. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

## **RELEVANT MARKET**

5. The activities of the parties overlap in the supply of fresh milk to middle ground and doorstep customers in Scotland. NMC (minority shareholder in Claymore) is active in raw milk procurement and supply, an activity upstream from those of Claymore and Allarburn.

### **Product and geographic market – raw milk**

6. Raw milk is produced by dairy farmers and is then transported to be processed into either fresh milk or dairy products such as cheese, milk powder, etc. Milk processors procure milk either directly from individual dairy farmers (direct supply), or from cooperatives (such as NMC) or quota holding groups that collect milk from farmers and transport it to processors. On the demand side, fresh milk processors cannot substitute other products for raw cows' milk to produce fresh milk. On the supply side, switching from other farm activities to dairy farming is difficult and takes time since the latter requires specific plant, buildings, technical knowledge and land in an area with a suitable climate.<sup>1</sup> The appropriate frame of reference in this case is the procurement and supply of raw cows' milk.
7. Raw milk needs to be transported to the processor within 24 hours. In previous OFT decisions<sup>2</sup>, a 100 mile radius was considered, on average, to be a viable range for delivery of raw milk to processors and, as there are no clear geographic breaks, a chain of substitution was likely to operate across England, Scotland and Wales. The Competition Commission (CC) noted in the Scottish Milk Report<sup>3</sup> that a considerable amount of trade in raw milk between Scotland and the rest of Great Britain occurred. Sufficient evidence was believed to exist to conclude that

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<sup>1</sup> See OFT decision of 3 December 2004 on the completed acquisition by Dairy Farmers of Britain of Associated Cooperative Creameries and OFT decision of 26 February 2004 on the completed acquisition by Milk Link Limited, First Milk Limited and Dairy Farmers of Britain Limited of assets of United Milk Limited, namely the Westbury Milk processing plant.

<sup>2</sup> See footnote 1.

<sup>3</sup> Competition Commission report on the supply of fresh processed milk to middle-ground retailers in Scotland, December 2002 (Cm 5002).

Scotland was part of a continuous chain of substitution linking it with the English sector.

### **Product market – fresh milk**

8. On the demand side, the OFT and CC have in the cases mentioned above, found there is little substitutability between fresh milk and other products. On the supply side, processor evidence suggests that it is not easy to switch production from other types of dairy products to fresh milk without considerable investment and time. Therefore, the relevant frame of reference in this case is fresh milk.
9. In the Arla/Express Report<sup>4</sup>, the CC identified three different customer segments for fresh milk supply:
  - a. national multiples (larger supermarket chains)
  - b. middle ground customers – all customers who are neither national multiples nor doorstep customers, and
  - c. doorstep customers.
10. The parties agree that these segments are distinguishable and submit that the customer segments relevant to this case are middle ground customers and doorstep customers.
11. In our view, middle ground customers include a wide range of different customer types ranging from large and small retailers to institutional customers, such as schools and prisons, as well as wholesalers and bottled milk buyers (BMBs). The purchasing habits of these various groups differ in that larger middle ground customers may buy larger volumes of milk and may, therefore, have more supply options available to them. In the Arla/Express Report, the CC noted that larger middle ground customers may have similar purchasing habits to supermarkets, however, some differences (e.g. requirements relating to traceability, method of procurement, etc) distinguish the larger middle ground customers from the supermarkets. Middle ground customers with lower volume requirements may have fewer sources of supply (as it is uneconomical to transport small volumes over longer distances), but, on the other hand, they may be able to source from wholesalers.
12. Consistent with previous OFT decisions, the supply of fresh milk to (i) middle ground customers and (ii) doorstep customers will be considered separately. However, some consideration is also given to the differences between middle ground customers.

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<sup>4</sup> Competition Commission report on the proposed merger between Arla Foods amba and Express Dairies plc, September 2003 (Cm 5983).

## **Geographic market – fresh milk**

13. Allarburn and Claymore's dairies and depots are located in the north of Scotland; Arla has a processing facility at Lockerbie. The parties overlap in the supply of fresh processed milk to middle ground and doorstep customers; the geographic scope of supply to these customers is considered below.
14. The parties agree with the view that the middle ground segment is regional in scope, and that Scotland would be an appropriate geographic frame of reference in this case. Furthermore, they submit that any arguments for larger middle-ground customers procuring nationally are irrelevant in this case because the overlap is confined to the small local middle ground retailers that Allarburn is capable of serving.
15. In our view, the middle ground is not a homogeneous customer group; customers in this category range from individual stores to larger chains. As such, the geographic scope will vary. It may be quite narrow for smaller customers in the geographic area of overlap, e.g. the north of Scotland. However, evidence available to us in this case suggests that at least some of the parties' larger customers in the geographic area of overlap can source fresh milk from all over Scotland. In this case, the appropriate geographic frame of reference for middle ground customers is not considered to be wider than Scotland. As the geographic scope does not affect the outcome of this case, it has not been necessary to determine the issue.
16. For doorstep customers, the parties agree with conclusions of previous CC reports that each round operates effectively as a local monopoly since customers generally have only one option for doorstep delivery of bottled milk.<sup>5</sup> They also submit that it is possible for doorstep customers to buy milk from alternative sources, such as retailers. In our view, the appropriate geographic frame of reference for doorstep customers is local.

## **HORIZONTAL ISSUES**

### **Fresh milk - doorstep segment**

17. As noted above, the parties both supply fresh milk to doorstep customers. Their

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<sup>5</sup> See for example, Arla/Express Report paragraphs 2.63-2.64 and paragraphs 2.91-2.93.

combined share of supply for doorstep delivery in Scotland is less than three per cent. The parties submit that there is no overlap in the rounds supplied by each of them and therefore there was no actual competition between them prior to the merger. Third parties did not raise any concerns about the effect of the transaction on competition in this segment. In light of the above we consider that no competition concerns arise.

#### **Fresh milk - middle ground segment – non-coordinated effects**

18. The parties overlap in the supply of fresh milk to middle ground customers. Prior to the acquisition Allarburn did not have any larger middle ground customers (such as symbol groups).<sup>6</sup> Claymore supplies milk to a range of middle ground customers, including smaller middle ground customers. Prior to the merger the parties therefore competed for smaller middle ground customers in Scotland.
19. The market for fresh milk supply in Scotland is concentrated. The parties have identified a small number of processors/suppliers of fresh milk in the north of Scotland, namely: Arla/Claymore, Allarburn, Grahams, Mitchells and Wiseman. There are a number of other smaller milk processors in the Central Belt of Scotland, namely: Quothquan, Bonaly, Ballantyne, J Pollock & Sons (Pollock) and J Steel & Sons (Steel).
20. The parties have provided best estimates of shares of supply for various geographic areas, as shown in the table below.<sup>7</sup>

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<sup>6</sup> A symbol group is a commercial group of independently-owned shops or stores, which use a single name as a marketing mechanism and which, among other things, benefit from centralised procurement (e.g. Spar).

<sup>7</sup> The estimates are for final sales (i.e. including wholesalers as suppliers). The Arla/Express Report considered the share of supply from processors to middle ground customers, including sales to wholesalers (primary sales). However, they also noted that the concern was with supply options to middle ground customers, which may come directly from the processor, or be made through wholesalers/BMBs (final sales). Final sales appear to be a reasonable measurement of shares of supply here, because the parties mainly overlap in the supply of fresh milk to smaller middle ground customers who also source their milk from wholesalers.

**Table 1: Shares of supply by volume (%)**

	SCOTLAND		NORTH OF SCOTLAND		ALLARBURN'S AREA OF OPERATION	
	All customers	Middle ground	All customers	Middle ground	All customers	Middle ground
CLAYMORE	[0-10]	[0-10]	[25-35]	[5-15]	[10-20]	[5-10]
ARLA	[5-15]	[0-5]	[0-5]	[0-5]	[0-5]	[0-5]
ALLARBURN	[0-5]	[0-5]	[0-5]	[0-5]	[10-20]	[10-20]
<b>Combined</b>	<i>[15-25]</i>	<i>[0-5]</i>	<i>[25-35]</i>	<i>[10-20]</i>	<i>[15-25]</i>	<i>[15-25]</i>
GRAHAMS	[5-15]	[20-30]	[0-10]	[5-15]	0.0	0.0
WISEMAN	[60-70]	[50-60]	[50-60]	[55-65]	[60-70]	[55-65]
MITCHELLS	[0-10]	[0-10]	[0-10]	[0-10]	0.0	0.0
OTHERS	[0-10]	[10-20]	[0-10]	[0-10]	[0-10]	[10-20]
<b>Total</b>	100.0	100.0	100.0	100.0	100.0	100.0

Source: Based on information provided by the parties

21. The data indicates that on a Scotland-wide basis, the combined share of supply for middle ground customers is relatively modest and the increment is small, and that there are a number of other suppliers in Scotland, including Wiseman and Grahams who will constrain the merged entity. Therefore competition concerns do not arise at this level.
22. We note that some smaller middle ground customers may not require sufficiently high volumes of fresh milk to make sourcing milk from processors in the Central Belt of Scotland a viable option. However, considering a geographic frame of reference comprising the north of Scotland, the parties' combined share of supply, and the small increment resulting from the transaction, is not such as to raise competition concerns, in particular since Wiseman is the largest competitor in the area and Grahams is also present. The remaining competitors are considered to be a sufficient constraint on the merged entity.
23. In Allarburn's area of operation, the parties have a higher combined share of supply post-merger and the increment is more significant.<sup>8</sup> Wiseman has a significant presence in this area, but there are few other suppliers currently active in this area. We note that Wiseman supplies milk in Allarburn's area of operation, but Mitchells does not currently appear to have customers in that area. However, Mitchells is located between Wiseman and Allarburn, and although they are a small supplier, we consider that they could deliver milk to customers in this area.
24. We also note that the smaller customers in this area who cannot source milk from the Scottish Central Belt, can and do source fresh milk from wholesalers.

<sup>8</sup> Allarburn's area of operation broadly comprises Morayshire, the Highlands, and extends to the east as far as Gardenstown and Huntly.

Although wholesalers account for a modest proportion of sales overall (less than 15 per cent in Allarburn's area of operation), they will provide a competitive constraint post-merger.

25. The analysis of non-coordinated effects was also informed by third party inquiries and by switching data submitted by the parties. Customers of the parties who responded to our inquiries were not concerned; they generally identified Wiseman as an alternative supplier, but other suppliers/wholesalers such as Inverness Farmers Dairy, CJ Lang, Mitchells and Quothquan were also mentioned.
26. The data provided by the parties indicates a low level of customer switching (including switching between the parties pre-merger). Although the level of switching is low, customers who responded to our inquiries were unanimous in the view that they can switch supplier if they wish. There were no indications that customers did not switch because suppliers charged the same prices (and so there would be little point in switching), or that there were no alternative sources of supply. Evidence available in this inquiry indicates that the lack of switching is explained by customers' loyalty to local suppliers due to for example, (perceived) differences in quality of product, brand preference and the personal relationships between (local) supplier and retailer.
27. In summary, the parties operate in a concentrated market, and particularly in the north of Scotland, there are few fresh milk processors. Wiseman is the main supplier of fresh milk in Scotland, with a share of supply of around 60 per cent to middle ground customers (regardless of geographic scope). The merger may create a stronger competitor to this player since capacity utilisation at Claymore's processing facility will be increased, thereby enhancing efficiency. Customers have indicated that they are not concerned about the competitive effect of the merger and that they are able to switch to other small dairies in Scotland, and/or to wholesalers. While customer switching has been limited, the evidence available to us in this case indicates that the reason for the limited switching is customer loyalty and there is no indication that customers could not switch in response to a price increase post-merger. We therefore consider that no competition concerns arise as a result of the merger in fresh milk supply in Scotland, the north of Scotland or in Allarburn's area of operation.

#### **Middle ground segment - coordinated effects**

28. As outlined in the Wiseman/SMD decision, the milk industry has characteristics that indicate that the sector could lend itself to collusion.<sup>9</sup> However, in a merger

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<sup>9</sup> OFT decision of 19 October 2005, Anticipated acquisition by Robert Wiseman Dairies PLC of Scottish Milk Dairies Limited, paragraphs 33-38. See also paragraphs 4.11-4.16 of the OFT's Substantive Assessment Guidance, May 2003.

context the relevant consideration is whether the merger substantially lessens competition by increasing the probability that, post merger, firms may tacitly (or explicitly) coordinate their behaviour to raise prices.

29. Although this merger will further concentrate the market for the supply of fresh milk in Scotland, the OFT does not consider that coordinated effects arise or are enhanced as a result of the merger. Allarburn was a small, local supplier of milk with limited excess capacity pre-merger; there is no evidence to suggest that Allarburn was a 'maverick' supplier that would, absent the merger, have disrupted collusive conduct, therefore the merger does not enhance the sustainability of coordinated behaviour by removing a destabilising influence. Moreover, the type of leader-follower conduct referred to in Wiseman/SMD is not facilitated by this merger because we have not identified significant fringe competition in the geographic area affected by the merger (therefore the merger does not result in a reduction in fringe v fringe competition) and the transaction does not enhance the market position of the leader.<sup>10</sup>
30. Evidence available to the OFT of the relationship between Claymore/Arla and Wiseman, the main milk suppliers in Scotland, indicates that they have a history of competing aggressively against one another.<sup>11</sup> It is not expected that this merger will create or enhance the incentive for Wiseman and Claymore/Arla to coordinate their conduct. Rather, the strengthening of Claymore's position may increase competition between Claymore and Wiseman (see paragraph 27 above).
31. In light of the above we consider that the merger does not give rise to coordinated effects by making tacit coordination more successful or more likely. We therefore consider that no competition concerns arise as a result of the merger in fresh milk supply in Scotland, the north or Scotland or in Allarburn's area of operation.

## **VERTICAL ISSUES**

32. This transaction removes the vertical integration between Allarburn's dairy farming and milk processing/distribution activities, but gives NMC the ability to exercise material influence over the commercial policy of Allarburn via its 25 per cent shareholding in Claymore.<sup>12</sup> However, in view of the modest increments to share of supply that result from the transaction, the merger does not create or enhance incentives for NMC to raise rival's costs, foreclose the raw milk market, or grant Claymore/Arla more favourable terms of supply.

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<sup>10</sup> See Wiseman/SMD, paragraph 40 and following.

<sup>11</sup> See, for example, Wiseman/SMD.

<sup>12</sup> Neither NMC nor Claymore has an interest in the seller's retained business.

33. For [ ] following implementation of the merger, all of the raw milk produced by Allarburn Farm will be sold to Claymore. This will not materially reduce the volume of raw milk available to the market because prior to the merger the raw milk produced by Allarburn was processed internally. After this time, it is understood that Allarburn Farm will [ ]; this does not lead to any competition concerns in the market for raw milk.
34. Third parties have not raised concerns in relation to the vertical aspects of the transaction.

### **THIRD PARTY VIEWS**

35. Third parties who responded to our inquiries in this case did not raise competition concerns.

### **ASSESSMENT**

36. The parties overlap in the supply of fresh milk to middle ground retailers and doorstep customers, mainly located in the north of Scotland. Allarburn is a small dairy, so the overlap in the middle ground segment is limited to smaller middle ground customers.
37. The parties' combined share of supply of fresh milk, for the geographic areas considered, ranges from [0-10] per cent to [25-35] per cent, with increments from [0-5] per cent to [10-15] per cent. Although the market is concentrated, evidence indicates that customers have alternative supply sources and the parties will be constrained by the presence of remaining suppliers; no competition concerns were raised by third parties.
38. Certain characteristics of the milk industry indicate that it may be susceptible to coordination. However, the OFT does not consider that coordinated effects arise or are enhanced as a result of the merger. This is due to the limited competitive constraint exercised by Allarburn pre-merger and the absence of any evidence suggesting that it was a 'maverick'. Furthermore, the leader-follower conduct referred to in Wiseman/SMD is not facilitated by the merger. Finally, evidence available to the OFT of the relationship between the main milk suppliers in Scotland (Claymore/Arla and Wiseman) indicates that it is not expected that they will collude and the merger does not affect their incentives or ability to change their historic behaviour.
39. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

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