OFFICE OF FAIR TRADING

Completed acquisition by Brake Bros Limited of the wholesale distribution business of Peter's Food Service Limited

The OFT's decision on reference under section 22 given on 29 November 2004

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

PARTIES

1. **Brake Bros Limited (Brakes)** is a distribution company supplying food, drink and other products mainly to the catering (or 'foodservice') industry in the UK and France. It provides delivered wholesale and contract logistical services and has its own manufacturing operation.

2. **Peter's Food Service Limited (Peters)** is also active in the wholesale distribution of food to the catering industry. In the last financial year, the UK turnover of Peters' wholesale distribution business was [...]. Peters also has a manufacturing operation which makes pies, and a van sales division.

TRANSACTION

3. On 17 September 2004 Brakes acquired that part of the Peters business – the wholesale distribution business - specialised in the supply of chilled and fresh food products to larger catering customers. Peters is retaining its van sales division and its pie manufacturing operation, which will continue to compete with Brakes after the merger.

4. The administrative deadline expires on 2 December 2004.

JURISDICTION

5. As a result of this transaction Brakes and Peters' wholesale distribution business have ceased to be distinct. The UK turnover of the acquired business exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002

(the Act) is satisfied. The OFT therefore believes that a relevant merger situation has been created.

RELEVANT MARKET

6. The parties overlap in the wholesale supply of food to the foodservice industry. In particular both parties supply chilled products to national and local catering customers.

7. The foodservice supply industry can be segmented in the following ways:
   - by temperature range (frozen, chilled/fresh and ambient);
   - by mode of supply (contract supply, wholesale, retail, cash and carry); or
   - by type of customer or type of contract (national or local).

8. Brakes is active in all temperature ranges and supplies customers via contract supply and wholesale distribution. Peters mainly supplies chilled products and only operates a wholesale service. Both parties supply local as well as national customers.

Product market

Segmentation by temperature range

9. From a demand perspective there is at least a degree of substitutability between the different temperature ranges. For example, a number of foodstuffs are available in both frozen and chilled form. However it is not clear whether there is sufficient substitutability between the three temperature ranges on the demand side to render a 5-10 per cent increase in the price of any one temperature range unprofitable for a hypothetical monopolist.

10. The parties maintain that there are relatively few barriers to switching between temperature ranges on the supply side. For example ambient products are typically transported at 0-12 degrees Celsius, and chilled/fresh products are typically transported at 0-5 degrees Celsius. Chilled and ambient products are therefore commonly transported in the same truck. Frozen products have to be transported below minus 20 degrees Celsius and therefore require different transportation conditions. However, many suppliers, including the parties' main competitors, now use multi-temperature trucks which can supply all ranges simultaneously.

Segmentation by mode of supply

11. With regard to mode of supply, the parties maintain that there is one overall market for foodservice supply, including all routes to market. In their view, wholesalers compete with logistics companies (i.e. contract supply), cash and carry outlets and supermarkets. Third party responses received by the OFT were

consistent in the view that there is little difference between contract supply and wholesale distribution and that it is easy to switch volumes between the two. However, cash and carry sources were generally not considered to be an adequate substitute because of the need to arrange delivery and because of the food safety risk of transporting chilled and frozen goods in un-refrigerated vehicles. Similarly, retail sources such as supermarkets were not considered an adequate alternative because of the large cost differential when sourcing in this way.

12. On the supply side, there are several differences between contract supply and wholesale distribution. A wholesaler will have a price list and discount structure for its products and will take title to the goods it supplies. In contract supply, the contractual relationship is between the food manufacturer and the end customer with in-built pricing mechanisms. The contract supplier therefore provides a 'wheels only' distribution service.

13. Despite these differences, the major wholesalers all provide a contract supply service as well as a wholesale service. It therefore seems relatively simple to switch from wholesale into contract supply. The reverse may be more difficult, since contract supply companies are more used to supplying higher volume items whereas wholesalers supply all types of foodstuffs including odd items for which volume demand may be low. Between these two extremes there are a large number of product lines that could be supplied on either a contract supply or on a wholesale distribution basis. A 5-10 per cent increase in price of wholesale products is therefore likely to make contract supply a viable option for some product lines.

Segmentation by type of customer

14. A number of respondents maintained that national customers require a foodservice supplier with national coverage. Our enquiries revealed that the majority of national customers source supplies from both national and local suppliers. Furthermore, there is a relatively wide variation in the level of spend that customers place with national and local suppliers[1]. It is therefore possible for customers to switch at least a proportion of their spend to local supply in the event of an increase in price, even if they do require the services of a national supplier for some of their requirements. It is unclear whether this would provide a sufficient constraint to make a 5-10 per cent increase in price unprofitable.

15. National suppliers will also supply local customers, so switching from national to local supply is relatively easy. Switching from local supply to national is more difficult, although not impossible. Local or regional suppliers have two options: firstly they could open a new depot and so increase their geographic coverage, and secondly they could form a network with local suppliers in other regions and compete for national contracts in that way. There are two examples of such

1 For example, a national hotel group sources 30 per cent of its requirements locally whereas a national pub chain sources only 5 per cent locally.

networks currently in operation: Fairway Foodservice and Country Range Foodservice, consisting of networks of 18 and 19 independent regional wholesalers respectively.

16. To conclude, substitution on both the demand and supply side does seem to occur to some degree within each segment. As a result, the boundaries within the different segments of the foodservice supply sector are blurred. Since it is not possible to say with certainty that switching would be sufficient to satisfy the hypothetical monopolist test, each potential segment in which the parties have overlapping activities is considered separately for the purpose of this case.

Geographic market

17. In Bidvest/Brakes[2], the geographic frame of reference was taken to be Great Britain due to supply side differences in Northern Ireland. As in that case, neither Brakes nor Peters is active in Northern Ireland. The OFT has not received any new evidence that would suggest a departure from this view, so the geographic frame of reference is taken to be Great Britain.

HORIZONTAL ISSUES

Market shares

18. The assessment of horizontal issues in the foodservice sector is difficult because of the lack of independent data; all of the figures relied upon in this case were supplied by the parties and represent their best estimates.

19. The parties overlap in the wholesale supply of chilled products to both national and local customers. Horizontal competition issues are considered for each of the relevant segments described above.

20. With regard to segmentation by temperature range, the parties estimate that the chilled products sector is worth approximately £2,340 million per annum (see note 1). Brakes' turnover in chilled produce was [...] in 2003, representing [5-10] per cent of this segment. All of Peters' [...] turnover is in chilled products; this represents [0-5] per cent of the chilled segment. The parties will therefore have a post merger combined share in the chilled segment of [10-15] per cent.

21. The parties estimate the shares of supply for themselves and their main competitors in the wholesale sector (excluding cash and carry and retail, but including contract supply) to be as follows:

2 ME/1196/02, Proposed acquisition by Bidvest plc of Brake Bros plc.

Table 1: Shares of supply for wholesale and contract supply of foodstuffs to the foodservice industry

	Turnover (£m)	**% Share**
Brakes	[...]	15-20
Peters	[...]	0-5
Combined	[...]	***20-25***
3663	[...]	15-20
DBC	[...]	0-5
Woodward Foodservice	[...]	0-5
Others	[...]	50-55
Total	**5,793.3**	**100.0**

Source: the parties, based on estimates and Horizons Foodservice Intelligence report 2003.

22. The parties supply both national and local customers. With regard to local customers, the parties submit, and third parties concur, that there is a very large number of independent local suppliers, and in addition, local customers can source from the large national players. Therefore horizontal issues do not arise with respect to local customers.

23. For national customers, the number of suppliers with national coverage is more limited. The parties estimate that the size of the national sector is approximately £2,576 million. This would result in shares of supply in the national segment of [30-35] per cent for Brakes and [0-5] per cent for Peters, giving a combined share of [35-40] per cent[3].

24. Consolidation therefore raises the possibility that competition concerns may arise in the wholesale supply of food to national customers. However customers can switch to other existing national wholesalers such as 3663, DBC or Woodward Foodservice. In addition, general logistics firms currently active in the contract supply segment have national coverage, and there are two networks of regional suppliers that are able to supply national customers.

25. The OFT asked customers who they regarded as the closest competitor of each of the parties. For Brakes, the majority of customers cite 3663 as the main competitor and the most likely alternative supplier in the event of a Brakes price rise. For Peters, views were more mixed. No third party cited Brakes and Peters

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[3] The parties state that [60-70] per cent of Brakes' turnover is with national customers (including education and healthcare customers) and [80-90] per cent of Peters' business is with national customers. On that basis the parties' respective turnovers in the national segment are [...] for Brakes and [...] for Peters. See note 2.

as close competitors. It therefore appears that, although Brakes and Peters both supplied national customers, the incidence of direct competition between Brakes and Peters was in fact very low. This suggests that the parties were not a significant competitive constraint upon each other.

26. The parties submitted bidding data for all of the national and multi-regional contracts for which they bid in the past three years. The Peters bid data showed that out of the [10-15] contracts for which they bid, [0-5] were contracts where Brakes was the incumbent; only [0-5] of these was won by Peters. The Brakes bidding data showed that out of [70-80] bids, only [0-5] were contracts where Peters was the incumbent. In addition, [0-5] of the [70-80] bids were for contracts for which both Brakes and Peters bid in direct competition with each other. In contrast, there were an estimated [45-50] contracts where both 3663 and Brakes bid.

27. In summary, it is clear from the above that, even when considering each segment of the industry separately, there remains sufficient competition after the merger to allay any potential competition concerns.

28. In addition, there is evidence that switching may occur, on both the demand side and the supply side, within the various segments. As a result of these constraints, the evidence available to the OFT suggests that the merged entity will not be able to raise prices or lower service levels following the merger. If this happened, customers would be likely to switch to another national wholesaler, contract supply or to local suppliers.

Barriers to entry and expansion

29. Barriers to entry in the foodservice supply sector depend upon the size of operation. The main costs involved are the cost of building or acquiring a depot with refrigeration facilities, the cost of a fleet of refrigerated delivery trucks and the costs associated with staff and the ordering infrastructure needed to operate a successful wholesale operation. The parties estimate the total cost of entry to be a minimum of £5 million to set up a small operation with a turnover of around £15 million.

30. Entry into foodservice supply is relatively easy for logistics companies via contract supply. These firms already have the infrastructure and often they already have the temperature controlled trucks necessary to operate in this sector. Exel and Wincanton are examples of logistics companies that have recently entered the contract supply segment.

31. The parties cited the major supermarket chains as potential entrants since they would already have in place the required infrastructure. However, while it is relatively common elsewhere in Europe for supermarkets to supply the catering industry, the incidence of this in the UK is low.

32. There appear to be no particular barriers to expansion for existing national operators, be they wholesalers or contract supply/logistics operators. These firms have existing depot networks and can expand by extending routes, increasing load factors in trucks, or by adding new trucks and routes to their existing networks.

33. There may be barriers to expansion for smaller regional operators when seeking to supply new customers outside their existing range. However regional firms have been able to extend their networks in the past[4] and they have the option of forming a network with other regional suppliers in order to compete for national contracts[5].

Buyer power

34. Third parties identified one possible area where competition concerns could arise, namely in the supply to national customers by national suppliers[6]. National customers tend to be relatively large catering groups and so, while their choices may be more limited because there are fewer national - as opposed to local - suppliers, they may have countervailing buyer power.

35. This power can be exercised in a number of ways. Firstly, large customers can make more use of contract supply, negotiating directly with manufacturers and using wholesalers or logistics companies to provide distribution services[7]. Secondly, smaller regional customers can use business from a large contract to extend their geographic coverage and so large buyers can to some extent sponsor entry to the national segment. Finally, customers are increasingly forming buying groups such as Beacon, Pelican and LSG. It is also possible for large chains to self-distribute. For example, Whitbread uses Brakes to deliver to one central depot from which it operates its own distribution system for the final stage.

VERTICAL ISSUES

36. This case raises no substantive vertical issues.

THIRD PARTY VIEWS

37. Third parties contacted by the OFT were unconcerned by this transaction.

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4 For example, Woodward Foodservice has developed from a regional into a national supplier and has expanded from the frozen into the chilled/fresh segment.

5 For example, Fairway Foodservice and Country Range are networks of independent regional suppliers.

6 It should be noted that third party concerns related to further consolidation in the sector and not to the merger of Brakes and Peters.

7 One of the national pub chains has recently switched from Brakes to Exel.

ASSESSMENT

38. The parties overlap in the wholesale supply of chilled food to national and local foodservice customers. The merged entity is constrained by competition from the other national players, including 3663, Woodward Foodservice and DBC.

39. It is also constrained by competition from logistics companies providing contract supply services, such as Exel and Wincanton. Like national wholesalers, these firms have the infrastructure and geographic coverage to compete for national customers.

40. In addition, national customers have the option of sourcing more of their requirements locally or from regional suppliers.

41. Third parties were unconcerned by this merger, and none regarded Brakes and Peters as particularly close competitors before the merger.

42. 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

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

NOTES

Note 1: This figure refers to the market for contract supply and wholesale delivery.

Note 2: Brakes is of the view that some of the educational and healthcare customers are regional rather than national.