

**TO: PETER FREEMAN
CHAIRMAN
COMPETITION COMMISSION**

FROM: OFFICE OF FAIR TRADING

OCTOBER 2006

REVIEW OF UNDERTAKINGS FOLLOWING THE 1993 MMC MONOPOLY REPORT ON THE SUPPLY OF ANIMAL WASTE IN GREAT BRITAIN

1 ISSUE

- 1.1 Under Section 88 (4) of the Fair Trading Act 1973 (FTA)¹ the Office of Fair Trading (OFT) has a duty to keep under review undertakings given as a consequence of a monopoly report by the Monopolies and Mergers Commission (MMC).
- 1.2 Monopoly undertakings given under the FTA were given to the Secretary of State. In 2004, in the case of the majority of the undertakings, including the undertakings which are the subject of this advice, the power to vary or revoke was transferred to the Competition Commission (CC).² The OFT advises the CC if it considers that, by reason of any change of circumstances, the undertakings should be varied, revoked or superseded by a new undertaking.
- 1.3 This advice concerns undertakings given by Prosper de Mulder (PDM) and William Forrest and Son (Paisley) Limited (Forrest), relating to the supply of animal waste in Great Britain. These

¹ The relevant sections of the Fair Trading Act 1973 are still in force by virtue of Schedule 24 of the Enterprise Act 2002.

² As a result of the Enterprise Act 2002, Schedule 24, para.16 and SI 2004/2181, Schedule 1, Part 2, paragraph 6 the decision making power on these undertakings were transferred from the Secretary of State for Trade and Industry to the Competition Commission as of 4 October 2004.

undertakings were given as a consequence of a MMC report in 1993.³

2 RECOMMENDATION AND CONCLUSION

2.1 We recommend that the CC partially releases PDM from its undertakings (the specific undertakings are below). The OFT has determined that the remainder of the undertakings, relating to PDM's pricing, and undertakings given by Forrest are still necessary and should remain in place. We will therefore not be providing advice to the CC to revoke, vary or supersede these undertakings.

3 BACKGROUND AND ASSESSMENT

3.1 The OFT has reviewed the undertakings as part of its programme of reviews of Orders and undertakings under section 88 of the FTA. Our report of the review, setting out our findings and explaining our recommendations in more detail, is attached.

The MMC report and undertakings

3.2 Following the 1993 MMC report into the supply of animal waste in England and Wales, and Scotland, in 1995 PDM and Forrest gave undertakings to the Secretary of State for Trade and Industry. These undertakings were given to address the MMC's finding that aspects of PDM's and Forrest trading practices operated or may be expected to operate against the public interest.⁴

3.3 The main public interest concerns raised by the MMC, in both PDM and Forrest's case, related to their pricing policies, particularly the finding that both companies had engaged in discriminatory pricing which harmed smaller competitors and restricted competition.⁵ In addition to this the MMC found that PDM's financial reporting arrangements were not suitably transparent giving a distorted account of the true

³ MMC 1993, Animal waste: A report on the supply of animal waste in England and Wales and in Scotland. Report Cm 2340

⁴ The full text of the undertakings and a summary of the MMC findings are included in the annexes to the report.

⁵ MMC (1993), paragraphs 1.8-1.11, 1.15

profitability of its rendering business.⁶ Finally PDM was also found to have breached earlier undertakings relating to its gut room business⁷ and to acquisitions. The MMC concluded that these breaches were a 'serious matter' which led to competition being restricted.⁸

Summary of findings

- 3.4 The review has found that there have been several significant changes in the rendering industry since the MMC report. These have occurred primarily as a result of Government intervention to eliminate the risk of transmission of Bovine Spongiform Encephalopathy (BSE) to humans. Regulations have been introduced which have significantly restricted the uses to which outputs of the rendering process can be put, transforming the industry from one producing valuable outputs to one which is principally involved in the disposal of waste materials. In addition a number of government schemes were established to govern the disposal of animals that have a higher risk of transmitting BSE, notably the Over Thirty Months Scheme (OTMS). These schemes considerably increased the volume of material supplied to renderers but imposed restrictive rules on the handling of material.
- 3.5 The review has found that the range of methods to dispose of animal waste has broadened since 1993 to include composting and biogas. However OFT has not found evidence that they are available on a large enough scale to represent a real alternative to rendering and give enough customers a choice of disposal methods such that they act as an effective competitive constraint on the rendering industry at this time.
- 3.6. The structure of the rendering industry in both England and Wales, and Scotland has changed since the MMC report. In each market, the historical market leader (PDM in England and Wales and Forrest in Scotland) has lost overall market share to other companies. This change appears to be the result of the opportunities created by other renderers through their use of continuous processing technology (something that has historically been almost reserved to Forrest and PDM). This has significantly increased the smaller companies rendering capacity at a time when PDM's rendering capacity has declined. The structure of

⁶ MMC (1993), paragraph 1.13

⁷ See chapter 5 of the complete report for a definition of the gut room business.

⁸ MMC (1993), paragraph 1.12

each geographical market has changed from having one company in it with a very high market share and a large number of smaller players, with only small market shares, to one where PDM and Forrest each face competitors with higher market shares than in 1993 and the potential capacity to expand.

- 3.7 The OFT has been informed that the increased capacity amongst smaller parties in the industry has led to more vigorous competition for sources of animal waste. It has been suggested that this competition led to a significant reduction in rendering charges in 2001, although since 2004 charges have been generally increasing.
- 3.8 As the OFT conducted its review the Government replaced the OTMS with the Older Cattle Disposal Scheme (OCDS), The OCDS reduces the volumes of material supplied to renderers. Renderers have expressed different views as to the likely effects of the termination of OTMS, some claiming they will lose important sources of raw material, whereas others consider the effect is limited. It is not possible, within the confines of this review, to come to a firm view about the mid term effect the termination of this scheme will have on competition between renderers. Indeed as the amount of material made available through the OCDS progressively reduces we would expect the impact to change over time.

The undertakings

- 3.9 The undertakings have been reviewed against the background of the changes in the market set out above.

Price undertakings (PDM and Forrest)

- 3.10 Both PDM and Forrest gave undertakings not to engage in price discrimination. In addition both companies undertook to improve the transparency of pricing by publishing pricing information in the Meat Trades Journal. The MMC intended that increased transparency of information would be of use to customers and competing renderers enabling more effective competition.⁹
- 3.11 The OFT has found no evidence that PDM and Forrest are not complying with the discrimination/price information undertakings. Also,

⁹ MMC (1993), paragraph 10.128

larger market players, which have historically expressed concerns about price discrimination, have indicated that changes in industry capacity have reduced their concerns about price discrimination by PDM/Forrest. However, we have noted the ongoing concerns from smaller parties in the industry which emphasise that PDM and Forrest, as the largest renderers in their respective geographic markets and still have market power which could be used to the detriment of competitors. In addition the complexity of pricing, supplemented by the changes to the regulatory structure, and general lack of transparency means that it is not possible to come to a final view on the extent, if any, of price discrimination in this market with certainty. This uncertainty has been heightened through the failure of several renderers to provide requested information during the course of the review.¹⁰

- 3.12 Some renderers have informed the OFT that the published pricing information is not used by customers in negotiating prices, whereas other renderers (most notably Forrest) have told us published prices are routinely used by customers during price negotiations. We have also received mixed views from customers, some claiming published prices are not generally useful, as they are considered unreliable or not appropriate to those companies. However, others claim the information is useful in identifying trends in prices, which can provide information for the purposes of negotiation. One customer indicated that published pricing information made customers aware of the decreases in prices in the industry after 2001 thereby spreading the benefits of lower prices further throughout the market than would otherwise have been the case. The OFT has also noted the complexity of pricing arrangements throughout animal waste rendering, the prevalence of negotiated prices and the limited sources of pricing information, other than that available in the Meat Trades Journal (and tariffs available to butchers).
- 3.13 Given these findings the OFT believes that the undertakings on price discrimination and price information should remain in place for the present and will not be recommending the variation, revocation or supersession of these undertakings. Their continued presence provides an increased degree of transparency of pricing. The OFT will continue to

¹⁰ Information was requested of renderers under section 5 of the Enterprise Act 2002. The section gives the OFT with the function of 'obtaining, compiling, and keeping under review information about matters relating to the carrying out of its functions'. However, the Act does not give the OFT power to compel parties requested to provide information for this purpose.

monitor these undertakings to ensure that they do not have a distortionary effect on the market and will review these undertakings further after a period of stability in the industry.

Remaining PDM undertakings

- 3.14 PDM also undertook not to make the collecting of low grade wastes conditional upon a customer also supplying higher grade material to PDM. The reduction in value of raw materials in the wake of BSE reduces the incentives for PDM to engage in this practice. In accordance with section 88 (4) of the FTA the OFT considers that this constitutes a change in circumstances since the undertakings were given and that by reason of that change the undertakings are no longer appropriate. It therefore recommends that PDM should be released from this undertaking.
- 3.15 PDM undertook not to directly or indirectly acquire an animal waste enterprise unless the OFT has first been notified and informed PDM of its opinion that any such acquisition is in the public interest. The OFT has reviewed PDM's acquisitions over the last decade and can find no evidence that it has made any acquisitions of the type regulated by the undertakings. The OFT notes that the number of smaller rendering companies, which have historically been likely acquisition targets for PDM, has greatly decreased since 1993 due to the increasing concentration across the industry. The OFT believes that the changes in the structure of the market constitutes a change in circumstances since the undertakings were given and that by reason of the change the undertakings are no longer appropriate. In addition, PDM's current share of supply means that any future acquisitions are most likely to qualify for OFT consideration under the merger provisions of the Enterprise Act 2002 (EA02). The OFT therefore recommends that PDM should be released from this undertaking.
- 3.16 PDM also undertook to provide its complete consolidated accounts to the OFT and anyone who requests them so that market participants would have a greater idea about PDM's profitability to challenge them on pricing. PDM has wound up the unlimited companies (PDM Transport and PDM Services) which the MMC noted distorted PDM's accounts and has incorporated its operations into a single company, the accounts of which are made available. The OFT believes that this change in PDM's accounting policies has resulted in a greater degree of

transparency in PDM's accounts, that this constitutes a change of circumstance since the undertakings were given and that by reason of the change they are no longer appropriate. The OFT therefore recommends that PDM should be released from these undertakings.

- 3.17 PDM further undertook to carry on gut room activities (for the segregation of high value products from abattoirs) separately from the remainder of the business, ensuring no cross subsidies, and to provide various pieces of accountancy information to the OFT. PDM ceased its gut room operations in 2001 and subsequently dissolved the company which was responsible for operating gut rooms, PDM Abattoir Services Limited. These two changes constitute a change in circumstance since the undertakings were given and that by reason of those changes that they are no longer appropriate. The OFT recommends that PDM be released from this undertaking.
- 3.18 Finally, PDM undertook that it would not hold any interest in the rendering plant at Market Harborough or influence the running of it. Since the undertakings were given the plant has been sold to J. G. Pears, a significant renderer, which operates a major rendering facility from the site. The OFT has received no evidence that PDM has any interest in the running of the facility or has an influence upon J G Pears of the type prohibited by the undertakings. The OFT believes that the sale of the Market Harborough plant to a competing renderer constitutes a change in circumstances since the undertakings were given and that by reason of the change that the undertaking is no longer appropriate.

4 CONCLUSIONS AND RECOMMENDATIONS

England and Wales (PDM)

- 4.1 For the reasons outlined above the OFT will not be recommending the variation, supersession or revocation of the undertakings 1 (1) a, 1 (2) and 2, which relate to PDM's pricing practices. The OFT believes that they should be retained in place subject to review in due course once changes in the industry have stabilised. In the mean time the OFT will continue actively to monitor the remaining undertakings alongside further developments in the market.
- 4.2 As outlined above, a number of changes have occurred in the market since the MMC reported. These changes represent a

change in the circumstances of supply of animal waste and the OFT considers that as a result of the changes the undertakings are no longer appropriate. Using its powers under section 88(4) of the FTA the OFT recommends that the release of PDM from the following sections of its undertakings.

Undertaking 1 (1) b (conditional purchasing).

Undertaking 3 (acquisitions).

Undertaking 4 (accounting information).

Undertakings 5-8 (gut rooms).

Undertaking 9 (Market Harborough plant).

Undertaking 10 (consequential amendments to remove references to issues in removed undertakings).

Undertaking 11b (PDM auditors to provide information to the OFT).

Undertaking 12 (appointment of auditors).

Undertaking 13 (replacement of the 1986 undertakings).

Scotland (Forrest)

- 4.3 For the reasons outlined above the OFT has concluded that Forrest's undertakings should remain in place, subject to monitoring and further review in due course, as set out above in paragraph 4.1.
- 4.4 The OFT will publish this advice and our report on our website, having excised commercial information, once the CC has announced its provisional decision.