

EN

***Case No COMP/M.3130 –
ARLA FOODS/EXPRESS
DAIRIES***

Only the English text is available and authentic.

**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 9 (3)

Date: 10/06/2003



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 10/06/2003
C(2003) 1857 final

PUBLIC VERSION

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus [...]. Where possible the information omitted has been replaced by ranges of figures or a general description.

COMMISSION DECISION

of 10/06/2003

relating to a partial referral of

case No COMP/M.3130 – Arla Foods / Express Dairies

to the competent authorities of United Kingdom

pursuant to Article 9 of Regulation (EEC) No 4064/89

COMMISSION DECISION
10/06/2003
relating to a partial referral of
case No COMP/ M.3130 – Arla Foods / Express Dairies
to the competent authorities of United Kingdom,
pursuant to Article 9 of Regulation (EEC) No 4064/89

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) No. 4064/89 of 21 December 1989 on the control of concentrations between undertakings¹, as last amended by Council Regulation (EC) No 1310/97 of 30 June 1997² (hereinafter, ‘the Merger Regulation’), and in particular Article 9(3) thereof,

Having regard to the notification made by Arla Foods amba on 16 April 2003, pursuant to article 4 of the said Regulation,

Having regard to the request of the Office of Fair Trading in the United Kingdom of 15 May 2003,

WHEREAS:

1. On 16 April 2003 the Commission received notification of a proposed concentration by which the undertaking Arla Foods amba (“Arla”, Denmark) acquires within the meaning of Article 3(1)(a) of the Council Regulation sole control of the undertaking Express Dairies plc (“Express”, United Kingdom) by way of purchase of shares.
2. By letter dated 15 May 2003, The United Kingdom requested the referral to its competent authorities of the proposed concentration with a view to assessing it under UK national competition law, pursuant to Article 9(2)(a) and 9(2)(b) of the Merger Regulation (“the request”).

I THE PARTIES

3. **Arla** is a large dairy co-operative with production facilities mainly in Denmark, Sweden and the UK. Further, Arla has sales subsidiaries in most EU countries and a number of third countries. Arla is present in the supply of all standard dairy products.

¹ OJ L 395, 30.12.1989, p.1; corrected version OJ L 257, 21.9.1990, p.13

² OJ L 180, 9.7.1997, p.1; corrigendum OJ L 40, 13.12.1998, p.17

4. **Express** is an UK public listed dairy company. It is primarily active in the processing and supply of milk and cream products. Furthermore, Express has a distribution business.

II THE OPERATION AND CONCENTRATION

5. The proposed transaction is an acquisition by Arla (through Arla International A/S, a wholly owned subsidiary of Arla), and its wholly owned subsidiary Arla Foods UK Holding Limited, of sole control over Express. The proposed transaction is therefore a concentration within the meaning of Article 3(1)(b) of the Merger Regulation.

III. COMMUNITY DIMENSION

6. The undertakings concerned have a combined aggregate worldwide turnover of more than EUR 5 billion³ [Arla €5,308 million, Express €1,274.3 million]. Each of the parties have a Community-wide turnover in excess of EUR 250 million [Arla €4,387 million, Express €1,274.3 million], but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension.

VI. THE ARTICLE 9 REQUEST

7. The United Kingdom argues in its request that the proposed transaction:
 - (1) threatens to create or strengthen a dominant position in the market for (i) the procurement of raw milk in Great Britain, (ii) the supply of fresh processed milk in Great Britain or at the regional level, and (iii) the market for the supply of fresh potted cream in the UK, as a result of which competition will be significantly impeded, and
 - (2) may affect competition at the local level for the supply of bottled milk sourced from the parties' adjacent depots in London, Lancashire and Yorkshire;
 - (3) Preliminary information suggested possible joint dominance concerns that warrant further investigation in the market for the procurement of raw milk and also in the supply of fresh processed milk.
8. In the UK, these markets present all the characteristics of distinct national or sub-national markets. According to the OFT there are a number of competition concerns in the UK which would benefit from examination and enquiries with national customers and competitors. Since the parties are vertically integrated and a number of related markets are affected it is desirable for all these markets to be

³ Turnover calculated in accordance with Article 5(1) of the Merger Regulation and the Commission Notice on the calculation of turnover (OJ C66, 2.3.1998, p25). To the extent that figures include turnover for the period before 1.1.1999, they are calculated on the basis of average ECU exchange rates and translated into EUR on a one-for-one basis.

referred to the UK competition authorities. In particular since effective remedies, if required, might be complicated if not all the above-mentioned markets were to be referred.

V. RELEVANT MARKETS

Product Markets

A. Procurement of raw milk

9. Raw milk is collected from farms and delivered to dairies or creameries for processing. According to the Robert Wiseman Dairies plc and Scottish pride Holdings plc Milk Report, in the UK about half of the raw milk produced is processed for consumption as liquid milk and cream, mostly in fresh pasteurised form but a small proportion as UHT or long-life milk and cream. The remainder is manufactured into dairy products such as butter and cheeses or used in the production of other foods such as chocolate. The volume of raw milk produced in the UK is controlled by an EC quota regime under which excess production is subject to a punitive levy. The UK's current quota is equivalent to about 90% of its consumption of milk and dairy products. The shortfall is met by imports of dairy products such as butter, cheese, UHT milk and milk powder. The demand for fresh processed milk is satisfied almost entirely using raw milk from UK farms.
10. From an upstream perspective, the parties submit that a separate product market for the procurement of raw milk can be identified. The Commission's market investigation has confirmed the parties' view, which is in line with the view taken by the UK authorities previously. This is based both on supply and demand criteria, i.e. different level in the supply chain, different suppliers and different buyers, volume and value, no suitable substitutes in terms of product characteristics, price and intended use, etc..

B. Fresh processed milk

Introduction

11. Based on previous findings of the UK competition authorities, all liquid milk may be divided into a market for fresh liquid milk and the markets for long life UHT and sterilised liquid milk. This conclusion was based on the observation that consumers do not appear willing to switch between the two types of products in response to small price changes, and UHT sterilised milk requires a different processes and plant from fresh processed milk.⁴
12. Fresh processed milk is milk with standardised fat content and pasteurised at 72C for 15 seconds. Is it available as skimmed milk with a maximum milk fat content of

⁴ Competition Commission's Scottish Milk Report of December 2000.

0.5%, semi-skimmed milk with a milk fat content of 1.5-1.8% and whole milk with a minimum milk fat content of 3.5%.

13. Recent changes had increased the distances over which the milk could be transported, namely a) the growth in sales through supermarkets, which took large volumes of milk through individual sites and thus enable economies of scale in distribution to be achieved, b) an increase in the use of distribution depots which enable processors to expand the geographical area that can be reached by their customers and c) an increase in the shelf life of milk as a result of improved processing methods and better storage both by processors and retailers.
14. The various customer segments have different requirements concerning fresh liquid milk, i.e. delivery frequency and locations, product standards, customer support, new product development, etc.
15. The UK Competition Commission has previously distinguished between three categories of customers in the supply of fresh processed (liquid) milk:
 - (a) major supermarket chains (previously defined in the “Scottish Milk” report as Asda, Safeway, Marks & Spencer, Sainsburys, Somerfield, and Tesco⁵);
 - (b) middle-ground customers (including wholesalers, caterers, newsagents, smaller supermarkets, prisons, hospitals etc); and
 - (c) doorstep deliverers (“milkmen”)
16. In this regard it should be noted that the distinction between national multiples and middle ground customers is blurred and there are a number of competitive interactions between these sectors.
17. According to figures provided by the parties around 47% of fresh processed milk is supplied to the national multiples, 33% to middle-ground customers and the remaining 20% to doorstep deliverers. Based on a KPMG report about 65% of the sale of fresh liquid milk is made by supermarkets at the retail level.⁶
18. The distinction made previously by the UK authorities has been largely followed by the parties in their notification to the Commission.

Supply of milk to major supermarkets (“national multiples”)

19. The large multiples have particular requirements regarding the quality of their milk, they usually require daily deliveries direct to store up to three times a day, lead time of one or two days, full customer support, comprehensive forecasting and planning system, all products to be clearly date coded and fully traceable,

⁵ The parties also consider that Waitrose and Morrisons should be included in the list of national multiples. These two are however, even if they are large supermarkets, only active in England and Wales. Their demand is therefore distinct to the 6 major supermarkets in the United Kingdom.

⁶ Prices and profitability in the British dairy chain, Report to the Milk Development Council, KPMG LLP 2002, p 4.

promotions, packaging development etc. The national multiples purchase their milk almost exclusively from the 4 largest dairies since only these four dairies are able to meet the national multiples requirements. The only exception would be for regional or local produce which they may procure from local or regional dairies⁷. Given the large volumes required by national multiples transportation costs per unit are relatively small compared to the supply of milk to other customers. This justifies that the competitive impact of the merger may be particularly important for this group of customers that only have a limited number of alternative suppliers with the necessary size.

20. It may be difficult to exactly delineate the boundary between the national multiples and the large middle ground customers (such as e.g. Aldi, Budgens and Costcutter). These supermarket/grocery chains also tend to procure on a national basis. Though the market shares below are based on the eight largest multiples it can be left open at this stage whether the set of large multiples should be adjusted.

Supply of fresh processed milk to middle-ground customers

21. The Commission's market investigation has confirmed that there is a distinct product market for the supply of fresh processed milk to middle-ground customers. Middle-ground customers include supermarket chains such as Aldi, Budgens, Co-op, Costcutter, Iceland and Lidl, convenience stores, newsagents, corner shops and non-retailers such as the NHS, local authorities, Ministry of Defence, schools, caterers, hotels and restaurants etc. Express serves more than [...] middle ground customers.
22. Middle-ground customers have different supply requirements from that of the national multiples. The quantities supplied to each customer (drop size) are typically much smaller than those of the national multiples.⁸ Concerning the larger middle ground customers the picture becomes more blurred compared to the national multiples. Some of the larger middle ground customers buy fresh processed milk on a national basis like the national multiples do, but only few of the larger middle ground customers are active in whole of Great Britain. Instead, they tend to be active on a more regional level such as Wales, Northern part of England, Southern part of England etc. But still, they use the national distribution and infrastructure provided by the large dairies. It should be mentioned, that the logistic requirements of the middle ground segment especially those customers supplied on a local basis, seems to be highly dependent on the dairy distributing the milk to actual point of consumption/sale such as schools and local authorities.
23. The market investigation has in general confirmed that middle ground customers constitute a separate product market from that of national multiples and doorstep deliveries. Compared to supplying the national multiples, the smaller dairies are

⁷ E.g. in Scotland the consumers prefer milk of Scottish origin and many supermarkets therefore sell milk that is procured and labelled as such.

⁸ All the national multiples take delivery of fresh milk on roll containers, which are rolled onto the shop floor. The daily requirements are in sufficient volume that roll containers are not repacked from the production area with usually one product type and size per roll container. By contrast, deliveries to middle ground customers cover a very wide range of daily volumes and only high volume drops allow for the delivery to be made on roll containers.

better able to meet the requirements of the middle ground customers, i.e. supplying the required volumes and fulfil the quality requirements etc.

Supply of fresh processed bottled milk to doorstep deliverers (“milkmen”)

24. In addition to the processing and sale of milk to major supermarkets and middle-ground customers both parties are active in the processing, bottling and supply of milk to milkmen (doorstep deliverers). In this regard, the parties are selling bottled milk to independent milkmen known as Bottled Milk Buyers (“BMBs”) and to either franchised or managed roundsmen from depots across Great Britain. The BMBs and the franchised/managed roundsmen deliver milk to the consumers’ doorstep within defined local areas. Franchised/managed roundsmen supply milk exclusively on behalf of one processor.
25. In the parties’ view the market should be defined as the (retail) supply of bottled milk, rather than the wholesale supply of bottled milk to milkmen (irrespective of whether independent, franchised or managed).
26. In the parties’ view the retail doorstep market does not represent a separate market from the national multiples and middle-ground retail segments as consumers have a choice of buying milk from all such places. Furthermore, branching out of supermarkets into home deliveries, as well as smaller outlets shows that the distinction between these market segments have become blurred.
27. The Commission’s market investigation has clearly indicated that given distinct supply and demand considerations the supply of bottled milk to milkmen could be considered as a distinct wholesale market from the supply of milk to other types of customers such as major supermarkets and middle-ground customers. From a demand side perspective bottled milk deliverers generally require milk to be supplied in glass bottles rather than NRCs (non-returnable containers) whereas this is not the case for major supermarkets and middle-ground customers (cf. above). From a supply side perspective bottled milk is typically processed either in specialist dairies or in a separate building adjacent to the filling for milk in NRCs. The reason mainly being that major supermarkets and middle-ground customers have concerns about the impact of milk in NRCs due to possible contamination of debris or dirt contained in glass bottles and glass fragments. The bottled milk is then delivered to depots where it is picked up by the independent BMB and the franchised and managed roundsmen.
28. The Commission therefore shares the view of the OFT that there is a distinct market for the supply of bottled milk from local depots to doorstep deliverers, BMBs as well as franchised and managed roundsmen.

C. Fresh cream

29. Cream is milk, which has been standardised to a fat content of 9 per cent or more. The cream is low pasteurised at 72 degrees for 15 seconds or a similar combination. Cream is essentially a commodity produced as a by-product of liquid milk processing and the production of various fresh dairy products. About 90% of cream are sold as fresh cream and the remaining proportion is sold as long life cream.

Supply of fresh cream (non-bulk)

30. The parties believe that an overall market for the supply of cream may be defined. The parties believe that there is substantial supply substitutability between different distribution channels for cream such as bulk for export customers or UK manufacturers of dairy products, UK food service customers such as caterers, hotels and restaurants and UK retailers. In addition, the parties submit that there is evidence of demand-side substitutability between e.g. fresh cream sold in pots and long life cream such as UHT cream, sterilised cream, frozen cream and cream alternatives.
31. The Commission's market investigation clearly shows that fresh cream constitutes a separate product market from that of UHT-cream and sterilised cream. This is reflected in the different levels of demand, taste, use and freshness⁹. Fresh cream is bought for its taste qualities while the others are bought for its convenience qualities. Only a small minority of the customers would expect the customers to switch to long-life cream or sterilised cream if the price for fresh cream were to increase with 5-10%. Likewise, the market investigation showed that the supply of cream should be subdivided into (i) the supply of bulk cream and (ii) the supply of non-bulk cream (pots, bottles, pallets). This separation is primarily based on different customer groups and intended use of the cream, where the bulk cream is sold in tanker loads to butter makers or large food processors. Non-bulk cream is sold in pallets, pergals, polybottles or pots to the catering trade or small food processors or national multiples.
32. On the supply side regarding non-bulk cream significant cost in investments in additional equipment (packaging equipment and production) is needed to enter the market. Some of the potential competitors estimate these cost to be around 1-1.5 million Euro. A third party estimates the cost of equipment around £5 million to service customers of 3 million litres and with the need to take into account the high Christmas demand. Additional costs would be incurred if civil expenditure were required for housing equipment for the associated fridge space and storage. The time horizon necessary to complete such investments would be 6-9 months. Furthermore, the market investigation showed that processors would need to invest in extra capacity to allow for the uplift in cream volumes during the Christmas period relative to regular weekly sales. This is due to a high increase in the consumption of fresh non-bulk cream during the Christmas period, which the customers will require the processor to supply. This uplift can be in the region of 1000%. As a result of this uplift processors have substantial "excess" capacity for 50 weeks each year.
33. On a possible sub-segmentation on customer groups i.e. for (i) national multiples, (ii) middle ground customers and (iii) the doorstep segment, the majority of customers agreed that the market should be segmented as mentioned above. This is partly based on the volumes bought where the national multiples account for the majority of non-bulk purchase. Some customers explained that cream is not generally direct-delivered to larger stores but instead to the national multiples RDC's and that doorstep delivery is less important on cream than on milk.

⁹ The shelf-life of fresh non-bulk cream will be in the range of 11-13 days.

However, the majority of the competitors agreed that the quantities and delivery channels are different from the different customer groups.

34. In conclusion, the supply of fresh non-bulk cream constitutes a separate product market from that of long life and sterilised cream. Furthermore, the market for the supply of fresh non-bulk cream can possibly be sub-divided into (i) supply to national multiples, (ii) supply to middle ground customers and maybe (iii) the supply to doorstep customers, even though this is a very small market. However, the precise definition of the possible customer groups needs further investigation.

Geographic markets

A. Procurement of raw milk

35. In relation to the geographic scope of the market, the parties submit that it is Great Britain (“GB”) given that there is considerable trade in raw milk between the various regions of GB but there are no imports or exports of raw milk between GB and the Island of Ireland or between GB and continental Europe. The Commission investigation largely supports the view of the parties and the UK authorities, which states a GB wide market. This is because of the perishable nature of the product and due to the fact that raw milk has a relatively high volume and weight in relation to its value and transport costs are therefore a significant factor influencing its distribution geographically. Therefore, it can be concluded that the geographic scope of the market for the procurement of raw milk is GB-wide.

B. Fresh processed milk

(i) Supply of fresh processed milk to major supermarkets (“national multiples”)

36. The parties have submitted that the geographic dimension of the market for supply of milk to major supermarkets is Great Britain. National multiples tend to make agreements with a supplier for delivery of fresh milk specifying at which outlets the milk should be delivered with a single price for all outlets from that supplier in Great Britain.
37. Not all suppliers have sufficient national coverage to deliver to all outlets of a given national multiple. One competitor, Wiseman who in recent years has expanded its activities from a very strong base in Scotland to England and Wales, does not presently supply any national multiples stores in London and the South East. Most of the national multiples (except Waitrose and Morrison) thus enter into delivery agreements with several suppliers in order to cover their needs in all different regions.
38. This shows that though the market is national in scope, there are regional aspects of competition that should not be ignored in the assessment. Transportation cost and time appear to be sufficiently important to make the geographic location of dairies have a non-trivial impact on the competitive process. In Scotland Wiseman has a very strong position (95% of the market) while Dairy Crest is very strong in Wales/Southwest England (78%).

39. The Commission's investigation clearly confirms that the markets are no larger than national, and tends to support that the market is GB-wide. Nevertheless the final conclusion on this can be left open, since it will not impact the assessment of the request by the UK authorities.

(ii) Supply of fresh processed milk to middle-ground customers

40. The parties consider, following the Scottish Milk report that the correct geographic scope of the middle-ground market is England and Wales. This is based on an increasing number of larger middle-ground customers procuring milk on a national basis. In relation to smaller middle-ground customers who tend to negotiate and procure on a more regional basis, the parties consider that irrespective of how regions are defined there is a chain of substitutability which links each region with its neighbouring regions throughout England and Wales. The parties submit that the reason for not extending the middle-ground market from England and Wales to GB as a whole is primarily that the nearest major dairies in England to Wiseman's Bellshill dairy in Scotland are around 150 miles away.
41. The Commission's market investigation has shown that the smaller middle ground customers such as schools and small regional supermarkets are supplied with fresh milk on a regional basis whereas some of the larger supermarket chains covering several regions in Great Britain, are supplied and procure their milk in several regions. Middle-ground customers are typically supplied on a daily basis directly to the shop or in some instance to an RDC. From the RDC the milk is distributed to the individual shop by the customer himself.
42. The market investigation has indicated that the geographic market for the supply of fresh processed milk to middle ground is likely to be at most regional in scope. This is based on the ability of the dairies to supply customers situated in the region and the cost of transporting fresh processed milk. From the supply side several factors delineate the geographic area which can be served by the typical middle ground dairy. This includes the size of the actual dairy, meaning, that operating a large effective dairy would reduce the processing cost per litre and thus enhance the distance over which the processed milk can be transported, compared to operating a smaller dairy which is situated close the customers supplied. In addition it is important with a distribution network covering the region and thus the ability to reach the customers.
43. A number of middle ground customers have raised concerns about the effects of proposed transaction on a regional level. Some of these customers are or have previously been served by either Arla and/or Express. After the merger these customers will only have one supplier i.e. the merging parties. The customers especially express concerns about the need for regional or in some instances local distribution facilities, which reduces the number of potential suppliers available in certain regions. In addition, the customers raise concerns about the limited number of large dairies such as Arla, Express, Wiseman and Dairy Crest, which are able to meet the requirements of larger middle ground customers.
44. Based on this it can be concluded that the geographic scope of market for the supply of fresh milk to middle ground is likely to be at most regional in Great Britain. However, as mentioned below, the precise delineation of each individual

region, based on the supply and demand characteristics, will need to be investigated further.

(iii) Supply of fresh processed bottled milk to doorstep deliverers (“milkmen”)

45. The geographical scope of the market for the supply of bottled milk from depots is determined by the area within which the customers are willing transport the bottled milk from the depot to their final consumers. Since this distance appear to be limited, the relevant geographic scope of the supply of bottled milk should be considered local.
46. None of the doorstep delivery rounds areas or the areas served by each depot can be considered as constituting a substantial part of the common market. Each area is confined to a very limited geographic area and represents a very small proportion of the total UK supply of fresh liquid milk.
47. Without determining the exact size of this local market, the Commission has concluded that it does not constitute a substantial part of the common market.
48. For the purpose of the current decision it is not necessary to conclude on the relevant geographic market since this does not change the Commission’s overall conclusion (see further below).

C. Fresh cream

Supply of fresh non-bulk cream

49. The parties contend that the relevant geographical market for the supply of all cream is EEA-wide due to the very considerable scope for trade. The parties further argue that if the geographic market were less than the EEA, it would at least be GB-wide and not regional in scope for the national multiples. The parties state that this is underlined by the fact that both Arla and Express supply the whole of GB from 2 cream facilities each.
50. The result of the market investigation does not support the parties’ view on an EEA-wide scope of the geographic market for fresh non-bulk cream. Instead the market investigation shows that the large majority of customers buy fresh non-bulk cream at a national or regional level. In relation to the supply of national multiples and middle ground customers, third parties argue that since the fresh cream generally is supplied to RDC’s, the market is likely to be national in scope. Furthermore, the transport costs and the relatively short shelf life of non-bulk cream limits the geographic area which it is viable to cover. Some retailers further more point to the fact that fresh cream is only purchased within the UK due to consumer pressures, which do not allow non-UK cream. Based on this it can be concluded, that the geographic scope of the market for the supply of fresh non-bulk cream is at most national in scope. However, at present it cannot be excluded that the geographic scope of the market could be less than national, but this warrants further investigation.

VI. COMPETITION ASSESSMENT

(i) Procurement of raw milk

51. Around half of all milk supplied to dairy processors goes through farmer co-operative groups of which there are now three major British players: First Milk, Dairy Farmers of Britain and Milk Link. The remaining 50% of raw milk is supplied to processors through direct supply contracts. The parties estimate the major raw milk suppliers market shares to be Dairy Farmers of Britain (18%), First Milk (21%), Milk Link (12%) and the remaining 51% are supplied by a number of smaller raw milk suppliers.
52. Arla has a milk intake in the UK of approximately [...] million litres of raw milk. Approximately [...] million litres per annum (mlpa) is bought from the successor coops to Milk Marque, including [...] mlpa from Dairy Framers of Britain, [...] mlpa from Milk Link and [...] mlpa from First Milk. The remainder is bought from four milk groups the members of which are all farmers. In addition to supplies from these groups, Arla also contracts directly with a small number of individual farmers.
53. Based on the above, the largest suppliers of raw milk to Arla can be identified as: Dairy Farmers of Britain ([35-45]%), Milk Link Ltd ([15-25]%), Premier Milk Producers ([10-20]%), First Milk ([5-15]%) and Norfolk & Waveney Group ([0-10]%).
54. Express current requirements for raw milk amount to approximately [...] million litres per annum (mlpa), taking into account all recent disposals. Express Milk Partnership, a joint venture between Express and its farmer suppliers would supply approximately [40-50]% of these requirements, with the remainder being provided by the various successor companies to Milk Marketing Boards (MMBs).
55. The largest suppliers of raw milk to Express can be identified as: Express Milk Partnership ([40-50]%), Dairy Farmers of Britain ([30-40]%), Milk Link Ltd ([15-25]%), Southern Milk Producers ([0-10]%) and Nestle ([0-10]%).
56. On the market for the procurement of raw milk, the largest buyers will be the parties ([15-25]%), Dairy Crest ([15-25]%), Wiseman ([5-15]%), ACC ([5-15]%) and a number of smaller dairies ([35-45]%). The market share of [15-25]% on the buyer side is unlikely to raise any concerns of single dominance.
57. One supplier of raw milk has raised concerns to the UK authorities as to whether the transaction is likely to create a situation of collective dominance on the buyer side. The UK authorities concluded that there were insufficient information to assess whether the criteria for sustained co-ordination through the ability to align prices and to detect and punish cheating. Consequently the risk cannot be assessed or dismissed without further investigation.
58. Collective dominance on the buyer side in a market would in itself be an unusual situation. A concern of collective dominance in such a situation would be one where the big purchasers jointly reduced demand in order to generate oversupply and trigger price decreases.

59. The purchase of raw milk is fragmented. Furthermore, it should be noted that a large part of raw milk is not used for processing fresh milk and cream but for flavoured milk drinks and yellow fats. Buyers are thus very heterogeneous in their needs due to their different usage of the raw milk. In addition the large operators differ with respect to their vertical integration into the supply of raw milk. It is thus unlikely that the purchasers would be able to reach the terms of co-ordination. Furthermore, even if the large purchasers were to co-ordinate a decrease in their demand, it is unlikely that this would lead to a sustainable decrease in the price for raw milk. It is more likely that the other types of the demand would pick up due to the lower prices or the supply-capacity would adjust, thereby cancelling the oversupply that could generate the price decrease.
60. The Commission's assessment is thus that these concerns in the present case are unfounded. On this basis the Commission has concluded that the proposed transaction will not threaten to create or strengthen a dominant position as a result of which effective competition will be significantly impeded in the market for procurement of raw milk.

(ii) Supply of fresh processed milk to major supermarkets (“national multiples”)

Single dominance:

61. The parties have provided the following market shares for supply of fresh processed liquid milk to national multiples in Great Britain:

	1999/2000	2000/2001	2001/2002
Arla	[20-30]	[20-30]	[15-25]
Express	[25-35]	[25-35]	[25-35]
Arla-Express combined	[50-60]	[50-60]	[45-55]
Wiseman	[15-25]	[15-25]	[20-30]
Unigate	[10-20]		
Dairy Crest	[5-15]	[20-30]	[20-30]
ACC	-	[0-10]	-
Others	[0-5]	[0-5]	0
HHI post merger			[>3500]
Change in HHI			[>1200]

62. The market shares are based on the set of eight large multiples: Asda, Marks and Spencer, Morrisons, Safeway, Sainsbury, Somerfield, Tesco and Waitrose.
63. The concentration will lead to a market situation with only three operators left: Arla/Express, Wiseman and Dairy Crest. This is in contrast with the situation in 1999/2000 where there were five independent operators. This evolution has led to an increase in the HHI from [<2500] in 1999/2000 to [>3500] after the merger. The merger itself constitutes an increase in the HHI of [>1200].
64. A market share in excess of 50% may in some circumstances in itself be an indication of single dominance. During the course of the Commission's

investigation the parties have provided more recent data indicating that the market shares of the merging parties is now lower than indicated above. In particular, they provide estimates for February 2003 in which the market shares appear to be only [40-50]%. It would require further investigation to verify which numbers give the most adequate picture. In general the Commission considers it most appropriate to base an assessment on annual averages. These data are not disturbed by short-term fluctuations and shifts in supplies, but give a more robust picture of the market situation. The most recent data should be included though to the extent that they reflect important recent changes that are likely to be of a permanent nature.

65. Furthermore, it should be noted that the exact market shares would be somewhat sensitive to the exact delineation of the market. As mentioned above it is not clear-cut where the distinction between national multiples and the large middle-ground customers should be. Among the eight national multiples that the parties proposed to include, one of them, Waitrose questioned whether they should be considered a national multiple due to their lack of presence in certain regions. Waitrose is currently supplied uniquely by Dairy Crest. Excluding Waitrose from the relevant market would lead to an increase in the merging parties' market share by [<5]%.
66. In markets where products are homogeneous and market prices are decided by the output decisions by the producers, the incentive to compete is closely linked to the market share of the company. Aggressive pursuit of an increased market share is likely to depress margins generally in the market. In particular firms with large volumes will lose from a decrease in margins. The merged entity is thus likely to have weaker incentives to compete aggressively to win or defend their market share than Arla and Express had individually before the merger.
67. In this context the likely effect of competition will depend on whether the competitive pressure by the remaining two competitors in the market will be sufficient to prevent prices from increasing post merger.
68. The parties have argued that the threat of entry and the presence of excess capacity make it unlikely that the merger would have any unilateral effects. Based on the information available to the Commission there appear to be examples in which suppliers have declined customer's request to participate in milk tenders referring to internal capacity restraints. The Commission thus questions whether the excess capacity as claimed by the parties will be sufficient to prevent the concentration from generating price increases.
69. Some of the customers have expressed concern that the merger may lead to a level of concentration in which there would be no incentive to improve supply chain efficiencies or to engage in price competition. In particular there are concerns that in some regions (e.g. Southeast) there would only be two credible suppliers.
70. The reduction of competitors in the market may also provide the basis for the removal of excess capacity and thereby generate the conditions for the reduction in output and increase in prices.

Collective dominance:

71. The past shift in market shares, the modest margins in the industry and the expansion in geographical reach by Wiseman does not in itself point towards a market situation that historically has been characterised by co-ordinated behaviour

by the members of the oligopoly. Nevertheless, based on the information available the Commission believes that the market in principle has a number of characteristics that could lead to the emergence of tacit co-ordination provided a sufficient level of concentration is reached.

72. The concern of the Commission is thus whether the process of concentration that the industry has undergone will eventually lead to a market environment in which a situation of collective dominance will be created.
73. A final conclusion on this matter would require further investigation, but the Commission seriously questions whether the market after the transaction will continue to be sufficiently fragmented to prevent co-ordination from taking place.
74. The reason for the concerns of the Commission is that it believes that the market conditions are such that it would be possible to establish the terms of co-ordination; that transparency in the market is sufficient to verify whether firms are deviating; and if deviation occurs, precise punishment mechanisms are available. Finally, the Commission is at this stage not convinced that customers and potential entrants would be in position to destabilise the co-ordinated outcome.

Establishing terms of co-ordination

75. Fresh milk is a relatively homogeneous product, which is, inter alia, illustrated by the national multiples' ability and willingness to switch supplier at relatively short notice. It is not a market where innovation is important.
76. The production process that is undertaken by the dairies also appear to be fairly standardised and each dairy can thus be expected to have cost structures that are fairly symmetric and with reasonably good estimates of the costs of productions of the other dairies.
77. The main part of the cost for the dairy is the procurement of raw milk (more than two thirds of the variable cost) which are publicly available. Another large share of the cost is transportation costs. Due to the detailed knowledge of both production locations and sites of delivery it would be possible for each producer to get a good estimate of the transportation cost of each of the others.
78. It could be expected that the most recently built production sites would allow for a somewhat lower production cost but it would require further investigation to verify whether these differences are sufficiently important to generate important asymmetries among the firms.
79. The parties argue that the aggressive expansion of Wiseman and its investment in new capacity proves that suppliers have incompatible market share aspirations. In principle this argument could be valid, but it must also be recognised that the envisaged expansion of Wiseman to cover the parts of the country that it does not already cover would increase the symmetry between the suppliers in terms of geographical coverage.
80. Market studies indicate that demand for dairy products in general and milk in particular is very inelastic. A study referred to in a report by KPMG to the Milk Development Council, the elasticity of demand for end-customers is estimated to be -0.36. If overall prices of milk rose by 10% this would thus lead to an overall

decrease in demand of less than 4%. If mutual co-ordination would generate an increase in prices to national multiples only and this price increase is passed on to consumers, the resulting decrease in demand from this group of customers is likely to be larger than 4% because some end-customers would buy the milk from other suppliers than national multiples. The fact that milk is purchased as part of general grocery shopping is likely to mitigate the incentive to switch. Given that currently margins are relatively low, the benefit from the increase in margins is likely to far outweigh the loss in volumes even if this is significantly larger than 4%. It thus appears likely that the parties would have an incentive to co-ordinate.

81. In this context, where the firms have a lot to gain from tacitly co-ordinating it could be conceived that the terms of co-ordination could be established in a way where each customer or part of customers requirements belong to a given supplier, and that the suppliers refrain from soliciting each-others customers.

Transparency

82. The parties have confirmed that there is a high degree of transparency in the sense that each producer knows which competitor is supplying which customer. In particular, they have produced maps depicting the actual supply of each of the dairies of its competitors. The final prices to consumers that the national multiples charge are also publicly available whereas the prices that are paid to the dairies are confidential and presumably only available to the supplier and seller in question.
83. For the purpose of establishing the risk of co-ordination it is necessary to investigate whether the information that is available to the parties will be sufficient to allow each dairy with reasonable certainty to establish whether the behaviour of the other dairies are compatible with the co-ordination. This must be seen in the context of the type of co-ordination that is likely to occur.
84. Based on the information available to the Commission, it appears that suppliers are unlikely to be able to verify the price offers of the competitors. Co-ordination based on prices is thus unlikely to be sustainable¹⁰.
85. On the other hand the Commission believes that the information available would be sufficient for a type of co-ordination in which the dairies tacitly co-ordinate on splitting the customers between them. Each dairy would be able to verify whether one supplier is "stealing business" from the others.

Enforcement

86. The parties argue that there appears to be ample excess capacity in the market. In this context each member of the oligopoly would thus be able to expand its output if needed in order to punish a deviator. Furthermore, if a competitor deviates from the co-ordinated outcome by stealing business from somebody else, targeted retaliation would be fairly easy. This could be done by "stealing back" the lost market share through targeted submissions of low price offers to the deviator's

¹⁰ A national multiples has expressed the view that the four major dairies have a very good idea of what their competitors are likely to offer, unless unexpectedly any particular supplier is willing to sacrifice margin to gain significant volume. Others have expressed similar views.

customers. In principle this type of punishment mechanism would remove the incentive to deviate without causing a large general price war that would be detrimental to all suppliers.

Reaction from outsiders

87. The parties have argued that the national multiples have strong buyer power and would thus be able to counter any attempt to co-ordinate.
88. The alleged buyer power by the multiples is based on a number of claims, including that they buy very large amounts, have complete control over the procurement procedure and since the product is so-called own-label they can switch supplier without their own customers detecting it.
89. The precondition for the national multiples' ability to exercise market power is that the suppliers are competing aggressively as they have done historically. It is not obvious that national multiples would be able to maintain their buyer power in the context of sustainable co-ordination in which the dairies would behave as one entity. In this context it should be noticed that the supply side is significantly more concentrated than the buyers with only three dairies and eight national multiples. In a market situation of co-ordination the national multiples will only be able to exercise market power to the extent that they have alternative sources of supply available outside the members of the oligopoly. The market investigation has shown that the large multiples would incur financial costs if they were to deviate from their current practice of procuring only from the members of the oligopoly.
90. For the assessment of the risk of co-ordination, the main question is thus whether the national multiples would have means available to disturb the stability of the co-ordination. This issue would require a further investigation.
91. The parties also argue that the national multiples could sponsor entry should the prices rise as a result of co-ordination. The view expressed by some of the customers is that they would not consider placing orders with any of the smaller dairies because only the three large ones have good enough facilities and sufficient capabilities to match their needs.

Conclusion

92. As a result of the above the Commission finds that the transaction threatens to create a position of either single or collective dominance in the market for supply of fresh processed milk to national multiples.

(iii) Supply of fresh processed milk to middle-ground customers

93. Both Arla and Express are active in the supply of fresh milk to the middle ground segment. None of the parties are active in Wales and only Express is active in Scotland. The parties have been asked by the Commission to submit the relevant market share information on a regional level, which has proven to be difficult. This is due to the fact that middle ground customers are supplied by a number of smaller competitors in each region. For the purpose of defining regions the parties have

provided ACNielsen¹¹ regions of population separating Great Britain into 9 regions. Taking into consideration the scope of this division in regions and the possible drawback of such a split into regions, when considering the dairy industry, the parties have identified three regions where the transaction will give rise to overlaps between the parties' activities in the middle ground segment. The areas concerned are London, Lancashire and Yorkshire. Based on the Commission request the parties have estimated their combined market shares in these regions. The market shares include the parties' own sale to middle ground customers and the parties' sales to independent wholesalers supplying middle ground customers. In the London region, the parties combined market share will be approximately [25-35]% (Arla [10-20]%, Express [15-25]%), Lancashire approximately [55-65]% (Arla [20-30]%, Express [35-45]%) approximately [10-20]% in Yorkshire (Arla [5-15]%, Express [5-15]%). These figures have not been verified during the market investigation and they are provided on the basis of the ACNielsen regions.

94. As regards the Lancashire area further investigation needs to be conducted in order to establish the impact of the proposed transaction including a precise delineation of the above-mentioned regions. However it cannot be excluded that the proposed transaction will create significant competition concerns in other regions given that the Nielsen data provided by the parties do not necessarily correspond to the actual geographic areas in which competition is taking place. A detailed analysis of the competitive structure in the regions needs to be undertaken to identify the competitive impact of the transaction and determine the exact scope of the relevant geographic market.

(vi) Supply of bottled milk to doorstep deliverers ("milkmen")

95. The UK authorities have submitted that in case the Commission's investigation indicates that the relevant geographic market for the supply of bottled milk to doorstep deliverers constitutes local markets, and in particular markets which do not constitute a substantial part of the common market, and the merger removes an actual or potential competitor in such markets, the Commission shall, pursuant to Article 9(3) refer the concentration to the UK.
96. As stated above the Commission's investigation has shown that there is a market for the supply of bottled milk from local depots (to BMBs or franchised/managed roundsmen). It has proved difficult to have any exact data on such a market given that some BMBs also act as wholesalers.
97. From the information provided by the parties, there are three regions of GB in which the parties have adjoining depots from which they both supply bottled milk. These are the London, Yorkshire and Lancashire regions.
98. As regards the London region, the information provided by the parties indicates that the areas served by the parties' managed and franchised rounds directly adjoin one another in parts of northern London. These relate to rounds operated from Arla's depots in Holloway, Edmonton and Walthamstow and the rounds operated

¹¹ The ACNielsen regions approximate ITV areas or combination of ITV areas.

from Express' depots in Kingsbury and Bloomsbury. From these depots the parties also supply BMBs.

99. In the Lancashire region both parties are active in the supply of bottled milk to milkmen in the area north of Manchester. Even though the parties argue that none of the managed or franchised rounds served by each of them directly adjoin an area served by the other party the maps provided by the parties show that if sales to BMBs are included the area currently served by Express' depot in Leigh and Tyldesley directly adjoin to a larger or lesser extent the area currently served by Arla's depots in Atherton and Bolton. Further the Express depot in Rochdale is in close proximity to Arla's depot in Bury. It should be noted that the Bury depot is directly adjoining the area served by Arla's depot in Bolton.
100. As regards the Yorkshire region the maps provided by the parties show a similar picture, in particular as regards the Leeds/Wakefield area. Even though none of the managed or franchised rounds served by either party directly adjoin an area served by the other party the area supply from Arla's depot in Barnsley directly adjoin a large area served by Express (which includes the depots in Wakefield, Castleford, Pontefract, South Elmsall and Conisbrough).
101. According to the parties the proposed transaction does not lead to any horizontal overlaps or competition concerns in the supply of doorstep milk in any of these areas given that there is no actual competition between the parties' franchised and managed doorstep delivery businesses since they do not both serve any overlapping local areas. Moreover, the geographic areas where the managed and franchised rounds operated by the parties adjoin each other only to a very small degree. The parties acknowledge however that the parties compete to supply BMBs from their adjoining depots. In their view such competition is however very limited and there are a number of alternative suppliers for these BMBs.
102. Even though the proposed transaction does not lead to any direct overlaps in the retail supply of bottled milk the Commission's investigation has shown that as regards the wholesale supply of bottled milk the parties are actual and potential competitors in a number of areas in the London, Yorkshire and Lancashire regions, in particular for BMBs. Accurate market shares are not available to the Commission as regards the wholesale market but figures provided by the parties showing the areas served from each depot indicate that the parties have significant market shares in all areas that they cover with market shares ranging from around [20-30]% up to [90-100]% depending on the area in question. Very often the parties are the largest suppliers in the depot area covered. Further investigation is warranted to determine the exact size of the parties' market shares given that some sales to BMBs should either be excluded or added. It is further necessary to assess the potential competitive constraints the parties face in these areas from other suppliers of bottled milk.
103. None of the doorstep delivery round areas or the areas served by each depot can be considered as constituting a substantial part of the common market. Each area is confined to a very limited geographic area and represents a very small proportion of the total UK supply of fresh liquid milk. This is evident from the fact that sale of bottled milk represents less than 20% of the total supply of fresh processed milk in United Kingdom.

104. Given the above, the Commission concludes that the proposed transaction affects competition in markets within the United Kingdom which do not constitute a substantial part of the common market. The assessment of the impact on such markets should therefore be referred to the United Kingdom.

(v) Supply of fresh non-bulk cream

105. The total market for the supply of non-bulk fresh cream is estimated by the parties to be 127.2 mlpa in the UK in 2001/2002. The market can be sub-divided into the supply of non-bulk fresh cream to national multiples in the UK 43.9 mlpa or 35% of the total market. Middle ground customers in UK account for 80 mlpa or 63% of the total market. The doorstep segment in GB is 3.3 mlpa, which constitutes approximately 3% of the total market. On the overall market for the supply of fresh cream non-bulk in the UK the parties' market share will be [30-40]% (Arla [5-15]%, Express [20-30]%) in 2001/2002. Their major competitors are Dairy Crest [5-15]%, Wiseman [5-15]%, ACC [0-10]% and other competitors with a combined market share of [35-45]%.

National multiples

106. The parties submit, that the suppliers of non-bulk fresh cream are wholly dependent on a few customers who account for approximately 90% of all fresh non-bulk cream sales to retailers in GB. The national multiples enjoy substantial buyer power, which is enhanced by the use of own-label sales. According to the parties 98% of the national multiples retail sales of fresh potted cream in the UK were own-label. Neither party is present in Northern Ireland, but the parties submit, that if a GB wide market were to be defined this would not materially affect the size of the market shares of the parties or the market shares of the competitors. The parties have not been able to provide information on market shares to the national multiples on a more regional level.
107. Most of the cream bought by consumers is sold as fresh potted cream by the major supermarkets. Six of out of the eight national multiples have cream delivered through RDCs. The two remaining national multiples have their cream distributed directly to the individual store. The market investigation has indicated that the supply of fresh cream to the major supermarkets is very much linked to the supply of fresh processed milk and that major supermarkets basically only procure fresh cream from the parties, Wiseman and Dairy Crest.
108. The parties' market share¹² on the supply of fresh non-bulk cream to national multiples was [65-75]% in 1999/2000, [75-85]% in 2000/2001 and [70-88]% in 2001/2002. Wiseman and Dairy Crest each has a market share of approximately [5-15]%. From the market investigation there are indications that there are barriers to entry into the supply of potted cream to national multiples. This is based on the necessary investment in quality, capacity, logistics etc. that the supply of these supermarkets requires. Further, the investigation has shown that major supermarkets prefer to limit their suppliers of fresh non-bulk cream to their fresh

¹² It should be mentioned that neither party is present in Northern Ireland. However, the parties submit that if a GB market were to be identified this would not materially affect the size of the market shares of the parties or market shares of the competitors.

milk suppliers, i.e. the four major dairies. Asked about the possibility of middle ground dairies' ability to start supplying the national multiples, several national multiples only identified Wiseman and Dairy Crest as potential suppliers based on the national multiples national requirements in relation to quantities, quality levels and the associated financial implications (costs).

109. Some national multiples raised concerns that the use of middle ground dairies on a small scale would dilute the volumes through the main four dairy companies and could potentially increase the costs and therefore the prices to the consumers. Likewise interest in sponsoring entry from the national multiples side seems very limited. On the supply side only few larger middle ground dairies could have any expectations of supplying large supermarkets at a short notice on a regional level. Several middle ground competitors argued that they do not have the national distribution infrastructure or economies of scale to meet the national multiples' very demanding requirements on price and delivery. In addition the financial implications of entering the supply to national multiples including the investments necessary could pose a major risk if the national multiples would terminate a new contract.

Middle ground customers

110. As mentioned above, middle ground customers consists of both larger supermarkets, retail sale from petrol stations, caterers and public authorities. On the supply of fresh non-bulk cream to middle ground customers the parties' combined market share will be [10-20]% (Arla [0-10]%, Express [5-15]%). The major competitors are Dairy Crest [5-15]%, Wiseman [5-15]%, ACC [0-10]%. The remaining [55-65]% are accounted by smaller middle ground dairies.

Doorstep deliveries

111. In comparison the parties' estimate the supply of fresh cream to doorstep customers in GB only accounted for a total of [...] mlpa in 2001/02 and the middle ground segment to be [...] mlpa in 2001/2002. The parties' supply to the doorstep segment only accounted for a total of [...] mlpa, which amounts to around [10-20]% of the total market.
112. It can be concluded, that the transaction will at least create or strengthen a dominant position on the possible market for the supply of fresh non-bulk cream for national multiples. However, further investigation needs to be undertaken concerning the competitive interaction between the different possible sub-markets. In this respect it needs to be investigated to what extent the supply to doorstep customers and the supply to middle ground customers will in fact be able to constrain the parties' behaviour on the market for the supply of non-bulk fresh cream to national multiples.

VII. CONCLUSION

113. From the above follows that the Commission has found that the proposed transaction does not threaten to create or strengthen a dominant position as a result of which effective competition will be significantly impeded in the market for procurement of raw milk. On this basis the request of referral of this market by the UK authorities is not granted under Article 9(2)(a).

114. It also follows from the above that the conditions to request a referral under Article 9(2)(a) in the case of fresh processed milk and fresh non-bulk cream are met. The Commission also considers that, given the national or sub-national scope of the markets affected by the transaction, the competent authorities of The United Kingdom are better placed to carry out a thorough investigation of these markets, and that it is therefore appropriate for the Commission to exercise its discretion under article 9(3)(b) so as to grant the referral.
115. Furthermore, it also follows that the conditions to request a referral under Article 9(2)(b) in the case of supply of bottled milk to doorstep deliverers are met.
116. On the same date as this decision, the Commission has also adopted a decision on the basis of Article 6(1)(b) of the Merger Regulation clearing the operation with regard other affected markets not covered by the UK request.

HAS ADOPTED THIS DECISION:

Article 1

The notified concentration resulting in the acquisition of control of Express Dairies by Arla Foods amba is referred to the competent authorities of the United Kingdom, pursuant to Article 9(3)(b) of Council Regulation (EEC) No 4064/89 as regards the markets for supply of fresh processed milk and fresh non-bulk cream.

Article 2

The notified concentration resulting in the acquisition of control of Express Dairies by Arla Foods amba is not referred to the competent authorities of the United Kingdom, pursuant to Article 9(3)(b) of Council Regulation (EEC) No 4064/89 as regards the market for the procurement of raw milk.

Article 3

This decision is addressed to the United Kingdom.

Done at Brussels,

For the Commission

Mario MONTI
Member of the Commission