

# Deans Stonegate

## Remedies Working Paper

### Introduction and Summary

1. This paper considers the remedies options for addressing the SLC provisionally found for the merger of Clifford Kent Holdings (the parent of Stonegate Farmers Ltd) and Deans Food Group Ltd through Noble Foods Limited (the Parties). The paper takes account of submissions from the Parties and third parties made in response to the remedies notice published with the provisional findings.

### Conclusions

2. The paper concludes that:
  - o the divestiture of Clifford Kent Holdings Ltd and its subsidiaries (Stonegate) is likely to be the most effective and proportionate remedy for dealing with the provisional SLC and the resulting adverse effects of the merger;
  - o the behavioural remedy proposed by Noble is unlikely to be effective in remedying the SLC;
  - o We propose a phased process for divestiture, with:
    - [X];
    - [X].
    - [X].

### Remedy questions

3. If it is decided that the merger situation is expected to result in an SLC, the Group will need, under the Enterprise Act, to decide on three questions concerning remedial action, (section 35) namely:
  - a) Whether action should be taken by the CC for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effect which has resulted or may be expected to result from the SLC;
  - b) Whether the CC should recommend the taking of action by others (eg. regulators, government departments) to remedy, mitigate or prevent the SLC concerned;

- c) In either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.
4. In considering these questions the Group “shall, in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the substantial lessening of competition and any adverse effects resulting from it” (section 35(4)).
5. In deciding the questions mentioned above the CC shall, in particular have regard to the effect of any action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned (section 35(5)).
6. The CC’s guidance<sup>1</sup> states:
- 4.8 The remedial action that the Commission will decide should be taken will always depend on the facts and circumstances of the case. When deciding what is an appropriate remedy, the Commission will consider the effectiveness of different remedies and their associated costs and will have regard to the principle of proportionality.
- 4.9 The Commission must have regard to the reasonableness of any remedy and this will include consideration of the costs of any action it may decide is appropriate. The Commission will aim to ensure that no remedy is disproportionate in relation to the SLC or other adverse effect. If the Commission is choosing between two remedies which it considers would be equally effective, it will choose the remedy that imposes the least cost or that is least restrictive.
- 4.10 The Commission will generally include in its consideration of costs the costs of implementing a remedy. However, for completed mergers the Commission will not normally consider the costs of divestment to the Parties as it is open to the Parties to make merger proposals conditional on competition authorities’ approval. It is for the Parties concerned to assess whether there is a risk that a completed merger would be prohibited subsequently and the Commission will normally expect this risk to be reflected already in the acquisition price. Since the cost of divestment was, in essence, avoidable, the Commission will not, in the absence of exceptional circumstances, accept that the cost of divestment should be considered in the setting of remedies.

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<sup>1</sup> CC’s guidance: ‘Merger References’, CC2, paragraphs 4.8 to 4.10

7. Having identified the least cost, least intrusive effective remedy or package of remedies, the CC may decide to modify that remedy in order to take account of any Relevant Customer Benefits.
8. Section 30 of the Act describes relevant customer benefits as benefits to relevant customers in the form of lower prices, higher quality, greater choice or greater innovation in relation to goods or services in any market in the UK. A benefit is only a relevant customer benefit if it accrues (within a reasonable time period) as a result of the creation of the merger and if it was unlikely to accrue without the merger or a similar lessening of competition<sup>2</sup>. Relevant customers are customers at any point in the chain of production and distribution and are not limited to final consumers<sup>3</sup>. It can also include future customers.
9. It is open to the CC to reach an expectation that an SLC would result from a merger, but not to put in place a remedy. This might be the case if an inquiry group believed that the only effective remedy would entail relevant costs that are disproportionate to the scale of the SLC, but is only expected to occur in exceptional circumstances<sup>4</sup>.

### **Nature of the provisional SLC**

10. In its provisional findings<sup>5</sup> the Group reached the view that it expects the merger of Deans and Stonegate to result in an SLC in the:
  - (a) supply of cage and barn, of free range and of organic shell eggs to retailers;
  - (b) supply of free range liquid eggs and of cage liquid eggs to those customers in the UK for whom the use of imported liquid eggs provides a poor substitute; and
  - (c) procurement of shell eggs from producers in the UK.
11. As a result of the SLCs provisionally identified, the merger would also be expected to have the following adverse effects:
  - o the reduction in the number of suppliers and the absence of alternative suppliers of equivalent scale may be expected to lead to a loss of rivalry which

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<sup>2</sup> CC 2, paragraph 4.38.

<sup>3</sup> CC2, paragraph 4.39.

<sup>4</sup>CC 2, paragraph 4.6. The guidance states that it is unlikely that the CC will decide that there is no case for remedies where it has decided that a merger results or may be expected to result in an SLC.

<sup>5</sup> Provisional Findings, published 11.1.07.

allows the merged entity to increase prices to retail customers unilaterally for cage and barn, free range and organic shell eggs;

- the loss of rivalry could also thereby allow the merged entity to act in a way that adversely affects the range, quality, innovation or service levels in the supply to retailers of cage and barn, free range or organic eggs, including to customers of different types;
- the merged entity would be in a position to refuse to supply certain retailers;
- the Parties are also in a position to increase prices to some customers for liquid eggs, by price discrimination in the supply of liquid eggs, in particular between those customers willing to source outside the UK or use powdered eggs and those for whom imported eggs or powdered eggs provide a poor substitute, and reduce the range, quality, innovation or service levels in the supply of liquid egg to such users;
- the merged entity could use its market power in the purchasing of eggs to buy from producers on less favourable terms, including, for example, reducing the prices paid to them, or making the purchase of other products (pullets, animal feed, spent hen processing etc) a condition of its supply contracts, reducing the number of eggs produced and raising prices to retailers; and
- by long term contracts with producers, the merged entity could jeopardize the position of other suppliers and/or limit the opportunities for entry thereby or in other ways, for example, by pricing policies, price discrimination or own branding of eggs.

12. The effect of the above would, in our view, be to increase final prices to consumers and to reduce the range, quality, innovation and service levels available to them.

13. We are still considering these provisional findings (in particular with regard to the supply of liquid egg referred to in paragraph 11(b) above) on the basis of submissions from the Parties and other parties to the provisional findings report and the remedies notice. In referring to the Group's assessment of an SLC in the rest of this paper, SLC is taken to include these provisional SLCs taken as a package. If we were to conclude that there was no SLC in the supply of liquid egg, we consider that the approach outlined in this paper would remain the same and our conclusions on remedies would still be effective and proportionate.

## Remedy Options

14. The purpose of remedies is to address the SLC and any adverse effects resulting or expected to result from it as required by section 35 of the Act. In general, this may be achievable in several different ways. It is possible to distinguish two broad categories of merger remedies:
- **Structural remedies:** which seek to address the competition problem through a direct (usually) one-off change in market structure, eg by reversing the transaction through divestiture;
  - **Behavioural remedies that facilitate competition or control outcomes:** which seek to change the behaviour of a firm or firms in the market so as to improve the process of competition, eg by lowering barriers to entry or reducing switching costs or which seek to address the adverse effects expected to result from the lessening of competition by directly controlling outcomes, eg by controlling prices, product range, and/or product quality.
15. In its guidance, the CC has said that: “structural remedies, such as divestiture or prohibition, are likely to be preferable to behavioural remedies, which seek to regulate the behaviour of firms, as structural remedies address the effects of a merger more directly and will usually require less monitoring or enforcement of compliance. However, behavioural remedies may be considered more suitable in some circumstances, for example, where the SLC is expected to be of limited duration or where the relevant customer benefits expected from a merger are substantial and behavioural remedies are likely to be more effective in preserving these than structural remedies. In certain circumstances, it may also be necessary to add behavioural remedies to a structural remedy in order to provide an effective and comprehensive solution”.<sup>6</sup>
16. The remedies notice, published on 5 January 2007, sought comments on the divestment of Deans or Stonegate, behavioural remedies and customers benefits. As expressed in this notice the Group considered that behavioural remedies are unlikely to be effective in addressing the SLC and its resulting adverse effects and in particular are likely to be difficult to monitor and enforce. Therefore the Group considered that structural remedies are likely to be preferable. Against this background the Group therefore needs to consider (i) structural remedies and (ii) Noble’s proposal on behavioural remedies.

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<sup>6</sup> CC’s guidance: ‘The Application of Divestiture Remedies in Merger Inquiries’, CC 8, paragraph 1.8.

## **Structural remedy (divestiture)**

17. The main issues in considering the possibility of a divestiture remedy in this case are:
- What should be divested that would, in principle, be effective in addressing the SLC?
  - What are the risks that may prevent effective implementation of such a divestiture?
18. In assessing these issues the CC's divestiture guidance<sup>7</sup> points to a number of risks that may impair the effectiveness of divestiture remedies:
- Composition risks—these are risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate effectively and viably in the market.
  - Purchaser risks—these are risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser.
  - Asset risks—these are risks that the competitive capability of a divestiture package will deteriorate prior to completion of divestment, for example through loss of customers or key members of staff.

### **What should be divested?**

19. Our divestiture guidance states that “In defining a divestiture package that will satisfactorily address the anticipated SLC, the CC will normally seek to identify the smallest operating unit of a business (eg a subsidiary or a division) that contains all the relevant operations pertinent to the area of competitive overlap and that can compete successfully on a stand-alone basis”<sup>8</sup>. The guidance also notes that “the CC will generally prefer divestiture of an existing business that can compete effectively on a stand-alone basis independently of the merger parties, to divestiture of part of an operating unit or a collection of assets. This is because divestiture of such a business is less likely to be subject to purchaser and composition risk.”<sup>9</sup>

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<sup>7</sup> CC8, paragraph 2.3.

<sup>8</sup> CC8, paragraph 3.1.

<sup>9</sup> CC8, paragraph 3.3.

20. In our notice of possible remedies the Group noted that it was of the view that the divestment of the Deans business or the Stonegate business, providing that constitutes a business capable of competing on a standalone basis, should be sufficient to address the SLC by restoring the pre merger situation. The Parties believed that divestment of either Deans or Stonegate would be disproportionate since they believed a behavioural remedy that they proposed would be more effective in addressing the SLC<sup>10</sup>. However the Parties also believed that the divestment of Deans would be particularly disproportionate since the SLC (if it existed) could be equally addressed by the divestment of Stonegate.
21. A number of retailers<sup>11</sup> agreed that the divestment of Deans or Stonegate would address the SLC equally well however some parties<sup>12</sup> suggested that Deans would be the better company to divest because Stonegate would not be as competitive as prior to the merger and, because there were more opportunities to add value at Deans, it would be a more attractive sales package.

## What are the risks?

### Composition risks

22. In considering divestment, a key consideration is whether the divested entity would be viable standalone.
23. [REDACTED]<sup>13</sup>. [REDACTED]<sup>14</sup> [REDACTED]<sup>15</sup> [REDACTED]<sup>16</sup> [REDACTED].
24. [REDACTED].
25. [REDACTED]<sup>17</sup>. [REDACTED]. We are also aware of producers owned by one of the Parties that supply the other Party and this will need to be dealt with on an individual basis to ensure that any divestment is viable.
26. We may also require some additional protections for the divestment which will include the arrangements set out in paragraphs 41 to 43 below].
27. The Parties have raised concerns [REDACTED]:

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<sup>10</sup> Note the parties also argued there was no SLC.

<sup>11</sup> [REDACTED], [REDACTED], [REDACTED], [REDACTED].

<sup>12</sup> [REDACTED], [REDACTED].

<sup>13</sup> Noble remedies hearing 31.1.07.

<sup>14</sup> [REDACTED]

<sup>15</sup> [REDACTED], [REDACTED], [REDACTED], [REDACTED].

<sup>16</sup> [REDACTED]

<sup>17</sup> [REDACTED]

- [REDACTED].
- [REDACTED].
- [REDACTED].

28. [REDACTED]. [REDACTED]<sup>18</sup>. [REDACTED] [REDACTED]<sup>19</sup>:

- [REDACTED];
- [REDACTED]
- [REDACTED].

29. [REDACTED] also confirmed that, [REDACTED].

30. [REDACTED]<sup>20</sup>. [REDACTED]<sup>21</sup>.

31. [REDACTED].

32. We note that both Deans and Stonegate were profitable before the merger. [REDACTED]. We see no reason why Stonegate would not be profitable and support a similar level of debt to the amount it had before the merger [REDACTED].

33. As a general point, we note the approach set out in CC guidance in relation to the cost of remedies<sup>22</sup> (see paragraph 6 above). In particular, we note that, since the merger was a completed merger, the Parties have exposed themselves to the risk of the CC finding that the merger has resulted in an SLC and therefore, in the absence of exceptional circumstances, we would not normally consider the costs of divestment in setting remedies. In principle therefore we do not consider that the structure of financing arrangements, and the cost to parties of restructuring in the event of a divestment, is an appropriate reason for not divesting a business. In this particular case we have considered carefully the reasons advanced by the parties for not divesting one of the businesses but for the reasons we have set out, we do not consider that these reasons are sufficient to change our view that the divestment of one of the businesses is an effective way to remedy the SLC.

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<sup>18</sup> [REDACTED].

<sup>19</sup> [REDACTED]

<sup>20</sup> [REDACTED].

<sup>21</sup> [REDACTED].

<sup>22</sup> CC2 paragraph 4.10.

34. We note that the amounts currently outstanding under the [X]. It is also open to Noble, if necessary and at some cost, to renegotiate or replace the [X].
35. We would therefore require that the financing of Deans and Stonegate should be separated and that Stonegate is sold with an appropriate level of debt to ensure that the business is viable and competitive. We consider that an appropriate level of debt [X].

### Purchaser risks

36. The Parties suggest that[X]<sup>23</sup> [X].
37. [X][X]<sup>24</sup> [X]<sup>25</sup>. [X]<sup>26</sup>and a number of parties<sup>27</sup> have suggested that there would be buyers at the right price. [X]<sup>28</sup>. Other parties<sup>29</sup> however have suggested that a sale may face obstacles. [X]<sup>30</sup>. [X]<sup>31</sup>.
38. The Parties have also suggested that their main competitors such as [X]. A party<sup>32</sup> has suggested to us that it may be interested in purchasing a smaller set of assets but we note that:-
- o Fragmentation of operations through disposal to a number of operators is unlikely to be effective in restoring the degree of rivalry that would have been present between Deans and Stonegate in the absence of the merger. In particular there would not be a strong second competitor in the market.
  - o Achieving a satisfactory set of partial sales of the Deans or Stonegate business is highly uncertain.
39. We therefore consider that a partial divestiture and/or divestiture of assets and contracts is unlikely to be as effective a remedy as divestiture of Stonegate.
40. It will be important to a purchaser to retain key staff, customers and suppliers to maintain the competitive capability of the business which has been divested. In this context, we note the following important facts:

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<sup>23</sup> [X]  
<sup>24</sup> [X].  
<sup>25</sup> [X].  
<sup>26</sup> [X].  
<sup>27</sup> [X], [X], [X], [X],[X].  
<sup>28</sup> [X].  
<sup>29</sup> [X], [X], [X].  
<sup>30</sup> [X].  
<sup>31</sup> [X], [X], [X], [X], [X].  
<sup>32</sup> [X].

o [REDACTED].<sup>33</sup>

o [REDACTED].<sup>34</sup>

o [REDACTED].

41. As a general principle, any sale of a business may involve the vendor giving non-compete and non-solicitation covenants provided these are reasonable in terms of scope and duration in relation to the nature of the business sold. [REDACTED]:

o [REDACTED].

o [REDACTED]<sup>35</sup> [REDACTED]<sup>36</sup>

o [REDACTED]

42. [REDACTED]<sup>37</sup>.

43. We would also expect that in order to ensure the attractiveness of Stonegate to potential purchasers, the Parties would provide undertakings that they will use their best endeavours to ensure that Stonegate will be divested with its [REDACTED].

44. Taking account of the above factors we believe that it is likely that a suitable purchaser would be found given a suitable sale process and a degree of flexibility in the sale price.

## Asset Risks

45. The CC's guidance on divestiture remedies<sup>38</sup> states:

5.2 The parties to a merger may have significant incentives to run down or neglect the business or assets of a divestment package in order to reduce future competitive impact. The resulting asset risk may also be influenced by such factors as the length and complexity of the divestiture process and the pace at which customer goodwill and employee relations may erode.

5.4 Where hold-separate undertakings are in place, the CC will usually require the appointment of an independent monitoring trustee to oversee the performance

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<sup>33</sup> Remedies hearing with Noble.

<sup>34</sup> [REDACTED].

<sup>35</sup> [REDACTED], [REDACTED], [REDACTED], [REDACTED].

<sup>36</sup> [REDACTED], [REDACTED].

<sup>37</sup> For example [REDACTED].

<sup>38</sup> CC8 – Competition Commission: Application of divestiture remedies in merger inquiries December 2004.

of the hold-separate manager and the parties' compliance with the undertakings. The need for a trustee may be avoided if the CC can be satisfied that the hold-separate management will be appropriately independent. The trustee will have an overall duty to act in the best interests of the divestiture package. The trustee will oversee the ongoing management of the divestiture package and will have the right to propose and direct measures necessary to ensure compliance with the hold-separate undertakings. The trustee will report to the CC at regular intervals.

46. We have interim undertakings in place which operate to hold separate the Deans and Stonegate businesses and to prevent any action being taken with respect to those businesses which might prejudice our scope to impose remedies. We have also appointed a monitoring trustee. We anticipate maintaining, and in some respects enhancing, the protection provided by these interim undertakings when final undertakings are accepted, with regard to protection against running down/neglecting the business during the divestiture process. The enhanced protections would include the need to ensure during this process that the existing relationships with retail customers are maintained and ensuring that both parties compete effectively for new customer contracts.
47. We would also propose that the role of the monitoring trustee is expanded to include monitoring the divestiture process. The trustee would oversee the ongoing management of the divestiture package and would have the right to propose and direct measures necessary to ensure compliance with the hold-separate undertakings. The trustee would continue to report to the CC at regular intervals. We will also consider appointing a hold separate manager if it proves necessary.

### **Divestiture process**

48. CC guidelines suggest a maximum of six months for the initial divestiture period, in which the Parties should complete the disposal of a divestiture package<sup>39</sup>. Noble told us [REDACTED]. Others<sup>40</sup> agreed that the process should be as quick as possible although one<sup>41</sup> party commented that longer than [REDACTED] should be allowed. [REDACTED]:
- [REDACTED].
  - [REDACTED].

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<sup>39</sup> CC8, 5.5.

<sup>40</sup> [REDACTED], [REDACTED].

<sup>41</sup> [REDACTED].

- [X].
- All of the above transactions will be subject to prior approval by the CC of the purchaser and the divestiture arrangements.

49. The CC will wish to ensure, before providing its approval at the end of the divestiture process, that the divestiture agreement and relevant supporting documentation convey all the assets required to be divested and contain no provisions that are inconsistent with the objectives of the divestiture to remedy the SLC identified.

### **Behavioural remedies**

50. The Group has also considered whether behavioural remedies are more suitable than divestment in the circumstances of this case. Our guidance<sup>42</sup> suggests that behavioural remedies may be considered more suitable in some circumstances, for example where the SLC is expected to be of limited duration or where the relevant customer benefits expected from a merger are substantial and behavioural remedies are likely to be more effective in preserving these than structural remedies. However, in this case, these conditions do not appear to apply since the SLC is not expected to be of limited duration and the relevant customer benefits expected from the merger are not substantial (see para 66-71 below).

51. Our guidance also suggests that it may be necessary to add behavioural remedies to the divestment remedy in order to provide an effective and comprehensive solution.

### **The Noble behavioural remedies proposal**

52. Noble have submitted a behavioural remedy proposal which they suggest would address directly the concerns identified about switching and barriers to expansion as a result of the perceived limited availability of egg, in particular free-range egg, and also the concerns about barriers to switching by producers.

53. Noble is willing to commit to release any current Stonegate producer from its contract with Stonegate so as to permit it to supply another packer/processor. This will involve Stonegate amending its contracts with its producers. This would be up to the volumes which a retailer currently supplied by the parties had notified it intended to switch. Noble suggest that this would make it easier for other packers to supply retailers at short notice and, more generally, would allow any retailer concerned

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<sup>42</sup> CC8, para 1.8.

about the size/significance of the merged firm as a supplier of eggs to reallocate a substantial proportion of its business to other packers within a short period of time. Therefore if retailers were concerned about the behaviour of the merged firm, they would rapidly be able to switch to and orchestrate the expansion of a smaller player(s) (Noble believe potentially to the size of Stonegate plus the smaller player) and the consequent reduction in share of the merged firm, in principle to the level represented by Deans prior to the merger.

54. Noble believe that this remedy i) provides assurance that retailers and/or processed egg customers can rapidly and effectively discipline the merged firm by switching business to other packers/processors and ii) avoids the uncertainties and risks associated with divestment.

55. Noble envisage that the remedy would operate as follows:

- It would apply to all producers which supplied Stonegate at the date of the undertaking;
- Any of these producers could switch all or part of their business with Stonegate to another packer or processor on written notice. The aggregate switched would not exceed the amount which the retailer concerned has notified it intends to switch;
- The notice period should be three months, to tie in with the three months' notice which the major supermarkets are required to give to their suppliers under the Supermarkets Code of Practice<sup>43</sup> (a retailer<sup>44</sup> told us that the requirement under the Code of Practice is to give a reasonable period of notice, not necessarily three months);
- When giving written notice, the producers should provide confirmation from the packer or processor to whom they are switching that the eggs are required to supply a particular retailer and/or processed egg customer and documentary evidence from the customer in question should be included specifying the egg types and volumes required. This is to ensure that the business is switching to

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<sup>43</sup> Clause 2 of the Code states: "Reasonable Notice of variation of a Supermarket's terms of business shall be given to the affected Supplier(s)."

Clause 16 of the Code states: "A Supermarket shall not directly or indirectly require a Supplier to change the specification (including the quantity of products required) of any agreed order **unless** that Supermarket either:

(a) gives Reasonable Notice of such change to that Supplier in writing; or

(b) fully compensates that Supplier for any net resulting costs incurred as a direct result of the failure to give Reasonable Notice."

<sup>44</sup> [redacted]

end customers and that other packers/processors are not simply poaching Stonegate's producers to supply the wholesale market or simply to undermine the merged firm. The packer would forward this data to the Parties to enable them to verify that the aggregate volume does not exceed the amount the retailer has notified it intends to switch;

- The Parties believe that it is unlikely that disputes will arise as there will be a straightforward check to be made of the aggregate volumes set out in the producer notices and the volume notified by the retailer. Should there be disputes, however, the Parties would undertake to submit them to binding and speedy arbitration (e.g. by the current Monitoring Trustee or other independent third party approved by the CC).
- The Parties envisage that this undertaking would remain in place until varied or lifted by the CC.

56. Noble also submitted a worked example to illustrate the process:

- Draw up list of Stonegate producers at the date of the undertaking specifying average weekly production volumes by egg type. Arbitrator or Monitoring Trustee validates volumes. Deans agrees not to seek to contract existing Stonegate producers.
- Retailer A wishes to switch 4,000 cpw at Newtown depot to Packer X (2,000 cage, 1,500 free-range, 300 organic, 200 barn) and agrees terms subject to Packer X securing supply of eggs.
- Packer X has 2,000 cpw of spare cage but needs 1,500 cpw free-range, 300 cpw organic and 200 cpw barn.
- Packer X contacts known Stonegate producers (or advertises).
- Packer X successfully agrees with a number of producers with the required volumes to give notice under their contracts (copied to Stonegate) and confirms this to Retailer A. In the case of large producers, notice is given in respect of specific flocks.
- Retailer A gives Noble 3 months' notice of intention to switch 4,000 cases.

- Packer X consolidates the producer notices and sends them to Noble to verify volumes against Retailer A's notice. Volumes appear to exceed Retailer A's requirements very slightly.
- Noble refers it to the arbitrator.
- Arbitrator decides within one week that the excess volumes are negligible. Notices become effective and producers are removed from the list and transferred to Packer X to coincide with start of supply to Newtown depot.
- Noble agrees not to solicit producers who have switched for two years. If producers who have switched start supplying Stonegate again subsequently, Noble reinstates them on the list of Stonegate producers.

57. Noble says that the remedy would provide the following benefits:

**Customers**

- Customers are assured that they can rapidly switch large volumes to alternative suppliers, whereas that guarantee is not provided by a divestment unless the divested entity has spare eggs.
- The mere threat of switching large volumes will become much stronger.
- The shorter notice period for producers may act as a stimulus to more frequent switching.

**Producers**

- Stonegate producers can take advantage of the remedy to ensure that they obtain prices which provide a fair return on their investment, by offering to supply competitors at short notice.
- They retain the assurance of a secure outlet for production because current notice periods for Noble would remain unchanged.
- Deans' producers will know that the second largest producer base in the UK, Stonegate's, has to be paid competitive rates by Noble and that they in turn will have to be paid competitive rates.

**Competitors**

- All competitors would have the opportunity to expand their business by as much as Stonegate's volumes.

- They acquire much easier and faster access to additional supplies of eggs, particularly free-range, which enhances their credibility with customers in competing for new business.
- They are able to plan substantial switches of business with customers and producers in advance.

**Other**

- [§<].
- This remedy allows all the merger-specific efficiencies (which have resulted in customer benefits) to be retained rather than seeing the majority[§<]lost.
- This remedy could probably be implemented much faster than a divestment, in as little as two weeks.
- The need for monitoring is likely to be very limited and simple. The remedy is not likely to “degrade” over time, but may well result in structural changes which obviate the need for its continuance.

58. We have considered Noble’s proposal carefully, discussed it with Noble, and consulted on it.

59. Most retailers that commented to us<sup>45</sup> did not feel that Noble’s proposal would be effective in addressing the SLC, since it would not restore the competitive situation to that that existed before the merger with a large second competitor.

60. Of the egg suppliers to the Parties two<sup>46</sup> small producers felt the merger should proceed and did not need remedying, emphasising the value of stability and continuity. Another<sup>47</sup> believed that the proposed mechanism would be attractive to producers (but also suggested that only a low amount of volume would transfer in practice). A number<sup>48</sup> expressed concern that the proposed remedy only applied to Stonegate’s producers, of which most felt that if the remedy included Deans’ suppliers it would be more effective in addressing the SLC. One<sup>49</sup> believed that the mechanism would not restore the pre merger situation by giving producers all over

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<sup>45</sup> [§<], [§<], [§<], [§<] ([§<] had no comment). Note we received a brief verbal comment from [§<] that it was happy with Noble’s proposed remedy but did not have any comments on a divestment remedy, however we did not feel that it had extensively considered the proposal.

<sup>46</sup> [§<] (who said “I believe that producers are a loyal bunch who prefer stability and continuity compared to the promise of an unknown alternative where any perceived benefit could be whittled away in any manner of hidden overheads”) and [§<].

<sup>47</sup> [§<].

<sup>48</sup> [§<], [§<], [§<].

<sup>49</sup> [§<].

the country the same access to the choice of market that they had before and another<sup>50</sup> expressed doubt that retailers would wish to deal with a large number of smaller competitors (and suggested that smaller competitors would not be able to grow rapidly because of a lack of Lion quality packing capacity).

61. Two competitors<sup>51</sup> also felt the remedy as proposed would not remedy the SLC but, if extended to Deans production, would be more effective. One other party<sup>52</sup> felt the behavioural remedy proposal “would help”.
62. We have noted that not all of those third parties who responded to the consultation on Noble’s behavioural remedy were critical of the proposal (see paragraphs 59 to 61 above). As a result of our own analysis and our assessment of the consultation responses as a whole however, we consider that there are a number of significant concerns about whether the proposal is effective and practical:
- o The mechanism would only apply to Stonegate’s external producers, not its own in-house production. In total [X]. Therefore even if all of Stonegate’s suppliers switched the pre merger situation would not be recreated<sup>53</sup> and the SLC would not be remedied. The producer volume is split between [X]<sup>54</sup>, which two parties<sup>55</sup> suggested leaves only a small amount of the Stonegate free range volume available to compete for (one said this was only 15%).
  - o A party<sup>56</sup> thought that the restriction to Stonegate’s external producers would result in a competitor experiencing difficulty in sourcing sufficient intensive egg<sup>57</sup> to enable retail customers to switch any large volumes to the competitor [X].
  - o Even if a significant amount of Stonegate’s suppliers were dispersed around the other competitors, then the pre merger situation would still not exist (i.e. a second large player to provide a strong alternative supplier for retailers’ business). There would be one large player and a number of fringe competitors slightly larger than now<sup>58</sup>. Some competition may be created but

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<sup>50</sup> [X].

<sup>51</sup> [X],[X]. [X] did not specifically comment on the Parties’ remedies proposal but, in their remedies hearing, suggested that freeing up producer contracts would be beneficial.

<sup>52</sup> [X].

<sup>53</sup> [X].

<sup>54</sup> [X].

<sup>55</sup> [X], [X].

<sup>56</sup> [X].

<sup>57</sup> We assumed this meant cage egg.

<sup>58</sup> [X].

this does not effectively restore the situation of rivalry that was present prior to the merger. Retailer comments (see paragraph 59) emphasised this point.

- The mechanism, as set out in Noble's worked example, is complex.<sup>59</sup> This, and its lack of transparency to retailers, producers and competitors would allow Noble significant ability to frustrate the mechanism to prevent either retailers or producers switching.
  - For example, although Noble did not include it in the worked example for consultation, Noble has since confirmed that it would have the right to persuade a producer to stay. Noble could selectively improve producer or retailer terms to prevent the transfer occurring. This could impact on a competitor's credibility. Noble however claims it would have limited ability to change a producer's terms because of the impact on its agreements with other producers.
  - One producer<sup>60</sup> was concerned that the restrictions contained in the remedy, which impose on producers an obligation to disclose to Noble what competitor they are moving to, and which contract between the competitor and retailer the notice relates to, look extremely onerous. The producer suggested that there are few examples in business where a company can demand information about contracts held between a former supplier or customer and a competitor.
- Given the possibility of a failed transfer, producers may not wish to be associated with a proposed transfer for fear of reprisals from Noble. A competitor to Noble would find it difficult to be sure that enough producers could be assembled at a suitable price to allow the transfer, and retailers would be wary of dealing with competitors to Noble when it was unclear that the competitor may not be able to amass the eggs.
- One party<sup>61</sup> has suggested that Noble may be tempted to improve terms to Stonegate's producers and fund this by maintaining captive Deans producers on less attractive terms.
- Due to producers exiting the industry from time to time, the available supply base to which the remedy applies will decline over time because new

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<sup>59</sup> [X].

<sup>60</sup> [X].

<sup>61</sup> [X].

producers, including new producers within the [X], would be outside the arrangement.

- There is some potential, given the market information that could be transmitted between parties in the mechanism proposed by the parties, for some co-ordinated effects to result.<sup>62</sup>
- The highly concentrated nature of Stonegate's producer base for free range eggs ([X]) means that switching supplies for a retailer would require those producers to agree to part switch their volume to a competitor, with the balance remaining with Stonegate. It is unclear that a producer would agree to do this, since it would complicate its operation, and could make the mechanism unattractive for a large proportion of Stonegate's producer base. [X]. It is unclear how the mechanism would work for those producers to be transferred.
- Noble has an incentive to allow their least attractive producers to transfer, either because of location, quality of eggs or other factors. These would be less economic to Noble's competitors and it may be that the competitor is unable to attract a retailer with those producers.
- Once a producer had switched it would be unlikely that the new packer would agree to shorten that producer's notice period because of the impact on its own producer contracts. Therefore the mechanism would have limited impact on producer mobility compared with a divestment.
- The proposal therefore provides for what we consider to be a complex, opaque and bureaucratic exercise in managing the production base which we do not consequently regard as a practicable remedy.

63. In light of the issues and concerns set out above, we do not consider that Noble's behavioural remedy proposal will address the SLC effectively.

64. We note that the remedy proposed does not include Deans production. We considered that even if it did so, it would still be ineffective in addressing the SLC because it would not recreate a large second competitor. In addition, the

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<sup>62</sup> We note that similar undertakings covering Dean's as well as Stonegate's egg suppliers were offered to the OFT in 2006 and were not felt by the OFT to be acceptable. The OFT, in its decision document, said :  
"In this case, the proposed remedies raise the following serious questions: first, whether a rival could actually negotiate terms with the merged firm so as to represent an effective alternative source of supply; second, the possibility that such negotiations may facilitate supplier coordination; third, there is a requirement on the potential competitor to bid to supply eggs prior to having an assured source of supply; fourth, the parties propose that the remedy be in force for a limited period of two years.

bureaucracy of the process noted above would make it an impractical proposal. We also note the likely ability of the Parties to frustrate the transfer of producers as set out in paragraph 62 above.]

### **Measures supporting a divestment**

65. It will be important to ensure that the divestment package is viable such that a divested Stonegate may operate in such a way as to remedy the SLC identified.. We will therefore require various undertakings to be given by the Parties in relation to ensuring the maintenance and continuation of Stonegate’s existing producer and customer base. The nature and scope of the undertakings are set out in paragraphs 41-43 above.

### **Relevant Customer Benefits**

66. Our guidance states in paragraph 4.34<sup>63</sup> that the CC may, in deciding the question of remedies have regard to the effects of any action on any relevant customer benefits in relation to the creation of the relevant merger situation concerned.

67. Relevant customer benefits are defined by section 4.37 of our guidance<sup>64</sup> as benefits that arise from a merger that are “limited to benefits to relevant customers in the form of:

- (a) lower prices, higher quality or greater choice of goods or services in any market in the United Kingdom (whether or not the market or markets in which the substantial lessening of competition has, or may have occurred or (as the case may be) may occur); or
- (b) greater innovation in relation to such goods or services”.

68. The Parties state that some, though by no means all, of the cost savings from the merger would be lost as a result of a divestment of Stonegate from Deans.

- o [REDACTED];
- o [REDACTED]
- o [REDACTED]

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<sup>63</sup> CC2 – Merger References: Competition Commission Guidelines.

<sup>64</sup> and section 35(5) of the Enterprise Act (2002) which limits relevant customer benefits to lower prices, higher quality, greater choice and greater innovation.

o [redacted].

69. We note these savings [redacted]. However, we consider that it is unlikely that the savings arising from the merger that are discussed by the Parties will result in significant relevant customer benefits. The benefits listed would only be relevant if they resulted in lower prices, better quality etc to customers [redacted]<sup>65</sup>. From our analysis of the SLC it appears likely that the merged entity will have sufficient market power to ensure that it retains most of the efficiencies resulting from the merger without passing them on to customers.
70. Retailer comments<sup>66</sup> suggest that they do not believe that any merger benefits have been passed on to customers to date.
71. As we do not consider that remedies other than divestiture are likely to be effective, we do not consider that the likely scale of relevant customer benefits is sufficient to modify our choice of remedy.

### Proportionality

72. As noted in paragraph 6 above, the CC's guidance<sup>67</sup> states that in deciding what is an appropriate remedy, the CC will have regard to the principle of proportionality as well as considering the effectiveness of different remedies and their associated costs. The guidelines state in paragraph 4.10:

*"The Commission will aim to ensure that no remedy is disproportionate in relation to the SLC or other adverse effect. If the Commission is choosing between two remedies which it considers would be equally effective, it will choose the remedy that imposes the least cost or that is least restrictive."*<sup>68</sup>

73. As noted in paragraph 20 above, the parties have suggested that the behavioural remedy they proposed would address the SLC. However, as we set out in detail above (see paragraphs 62 to 64), we do not believe that Noble's proposed behavioural remedy would on its own effectively address the SLC. We also do not consider that there are any other appropriate behavioural remedies which would be effective to address the SLC.

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<sup>65</sup> [redacted] (check date)

<sup>66</sup> [redacted],[redacted], [redacted]

<sup>67</sup> CC2, paragraphs 4.6 to 4.10

<sup>68</sup> CC2, paragraph 4.9

74. The Group considers that in order to effectively address the SLC and its adverse effects in this case, a divestment of one of the businesses of Noble would be required in order to restore as far as possible the pre-merger situation. This could mean the divestment of either Stonegate or Deans or a package based on either Stonegate or Deans. In line with our guidance, in choosing between two remedies which would be equally effective, the CC has generally chosen the remedy which imposes the lower cost or which is the least restrictive. We consider that the divestment of Stonegate, being the smaller of the two companies, is the least intrusive, least costly and therefore most proportionate remedy. We have taken account of the parties' arguments on proportionality and in particular, their view that divesting Deans would be disproportionate when it would be possible to divest Stonegate.

75. [X].

76. The CC's guidelines note that the CC will generally include in its consideration of costs the costs to the parties of implementing the remedy. However in relation to completed mergers the guidelines go on to say that the CC:

*“will not normally consider the costs of divestment to the parties as it is open to the parties to make merger proposals conditional on competition authorities' approval. It is for the parties concerned to assess whether there is a risk that a completed merger would be prohibited subsequently and the Commission will normally expect this risk to be reflected already in the acquisition price. Since the cost of divestment was, in essence, avoidable, the Commission will not, in the absence of exceptional circumstances, accept that the cost of divestment should be considered in the setting of remedies.”*

77. We have considered carefully the issue relating to costs and in particular the points raised by the Parties in this respect. We do not believe that the costs associated with divesting Stonegate changes our view that the divestment of Stonegate is the most effective and proportionate remedy.

## **Conclusions**

78. Key conclusions are therefore:

- the divestiture of Stonegate is likely to be the most effective and proportionate remedy for dealing with the provisional SLC and the resulting adverse effects of the merger;

- we will require the monitoring trustee to monitor the Parties' actions during the sales process to ensure the divestiture package is protected and will if necessary consider the appointment of a hold separate manager;
- we consider the behavioural remedy proposed by Noble is neither effective nor practicable in remedying the SLC;
- We propose a process and scope for divestiture as set out in paragraph 48 above.