

Competitive effects

Introduction

1. In this appendix we assess the likely impact of the merger on the markets for shell eggs. In Appendix D we identified the following shell egg markets:
 - (a) organic shell eggs to retail customers;
 - (b) free-range shell eggs to retail customers;
 - (c) barn and cage shell eggs to retail customers; and
 - (d) shell eggs to wholesale and catering customers.

Market shares

2. A first step in assessing the likely effects of a merger is to assess the change in market structure as a result of the merger. One way to assess market structure is to look at market shares, and the increment to the parties' market share as a result of the merger. The parties' estimates of market shares by volume in the markets for free-range shell eggs (including organic eggs), barn eggs and cage eggs are shown in Tables 1A to 1C.¹

TABLE 1A Free-range shell eggs (including organic eggs)

Company	2002		2003		2004		2005	
	Cases	Volume share (%)	Cases	Volume share (%)	Cases	Volume share (%)	Cases	Volume share (%)
Stonegate								
Deans								
Combined								
Glenrath								
Total								

Source: The parties based on TNS, the parties' estimates and Defra data.

¹The parties were unable to provide market shares for organic eggs because Defra does not provide figures for free-range and organic eggs separately. Market shares by value are not available as Defra does not record the total size of the market by value.

TABLE 1B **Barn shell eggs**

Company	2002		2003		2004		2005	
	Cases	Volume share (%)	Cases	Volume share (%)	Cases	Volume share (%)	Cases	Volume share (%)
Stonegate								
Deans								
Combined								
Glenrath								
Total								

Source: The parties, based on TNS, the parties' estimates and Defra data.

TABLE 1C **Cage shell eggs**

Company	2002		2003		2004		2005	
	Cases	Volume share (%)	Cases	Volume share (%)	Cases	Volume share (%)	Cases	Volume share (%)
Stonegate								
Deans								
Combined								
Oaklands								
Fridays								
Total								

Source: The parties based on TNS data, the parties' estimates and Defra data.

3. However, the market shares listed in tables 1A to 1C are calculated using Defra totals from 18 May and 30 March 2006. Market shares calculated using Defra figures for November 2006 result in marginally higher estimates of the parties' shares of supply. Tables 2A to 2C below show 2005 shares of supply calculated using updated data from Defra.

TABLE 2A **Free-range shell eggs (including organic eggs) 2005**

Company	Cases	Volume share %
Stonegate		
Deans		
Combined		
Glenrath		
Total	8,069,068	100

Source: CC estimates based on the parties' data and Defra.

TABLE 2B **Barn Shell eggs 2005**

<i>Company</i>	<i>Cases</i>	<i>Volume share %</i>
Stonegate	()	()
Deans		
Combined		
Glenrath		
Total		

Source: CC estimates based on the parties' data and Defra.

TABLE 2C **Cage shell eggs 2005**

<i>Company</i>	<i>Cases</i>	<i>Volume share %</i>
Stonegate	()	()
Deans		
Combined		
Oaklands		
Fridays		
Total	16,825,246	100

Source: CC estimates based on the parties' data and Defra.

4. The parties' estimates of market shares also apportion imports to each type of egg in proportion to their relative volumes. Defra figures do not record the type of shell egg imported. We were told that the majority of imported eggs were either cage eggs or seconds for processing. Apportioning imports by volume may therefore present a distorted view, particularly in free-range eggs where, until recently, there was little evidence of imports having occurred on any scale. Revised market shares for 2005 excluding imports are therefore presented in Table 3 below.

TABLE 3 **Free range shell eggs (including organic eggs)**

<i>Company</i>	<i>Cases</i>	<i>Volume share %</i>
Stonegate	()	()
Deans		
Combined		
Glenrath		
Total		

Source: CC estimates based on the parties' data and Defra statistics for UK production.

5. The parties supply mainly to retailers. As a result their share of supply of shell eggs to retailers is higher than the figures outlined above. The parties estimate that their market shares for the supply of shell eggs to retailers are [X] per cent for Deans and [X] per cent for Stonegate respectively. Their combined share of supply post merger is therefore [X] per cent.
6. We therefore consider that, were shares of supply available for the markets defined in paragraphs 1(a) to 1(c) they would be higher than those outlined for each type of egg, to all customers, above.
7. Finally, the parties' market shares in the market outlined at 1(d) above, the supply of shell eggs to wholesale and catering customers in the UK, are relatively modest. The parties estimate their 2005 shares of supply at [X] per cent for Deans, [X] per cent for Stonegate and a combined share of supply of [X] per cent.
8. These shares of supply show that, the parties' post-merger market share is high in all markets and the increment to that share is significant in all of the markets defined in Appendix D except for the supply of shell eggs to wholesale customers in the UK. In addition, all of the remaining competitors are small in comparison with the merged entity.
9. We note that the parties' combined share of supply is greatest in the market for free-range eggs. As discussed below, this is the fastest-growing market and a market where barriers to entry and expansion appear higher.
10. In addition, the parties' shares of supply are relatively stable over time, with the major changes in share partly attributable to acquisitions rather than growth through

competition. Discounting changes in market share due to acquisitions, the parties' shares of supply have grown by no more than [REDACTED] per cent year on year.

11. The parties argued that the fact that their market shares were high and stable masked a high degree of churn within these shares of supply.
12. We would expect, all else being equal, the level of churn in contracts to be proportionate to the relative shares of supply of the market participants. However, notwithstanding this we assess the level of switching directly below. In addition, the geographic coverage of Deans and Stonegate appears to be greater than for their rivals. As a result, the direct geographic overlap between Deans and Stonegate is greater than the geographic overlap between either party and a smaller supplier such as Fridays, Glenrath or Skea.
13. In terms of customer switching, [REDACTED]. As a result there are some geographic aspects to competition.
14. The parties' customers may therefore have had more opportunities to switch between Deans and Stonegate pre-merger than between one of the parties and a smaller rival such as Glenrath, which is located in Scotland, because of their greater geographic coverage.
15. Some customers also sell eggs bearing a particular brand; a number of these brands are owned by the parties.² Several customers noted that product innovation and expertise of suppliers (for example, to assist in category management) were important factors, along with price, in their choice of supplier. This may inhibit their ability to switch to smaller suppliers.

²For example, the [REDACTED] which, the parties told us, is owned by Deans.

16. The parties argued that it was not necessary to ‘sack the category captain to discipline him on price or service levels’. This is presumably because customers can threaten to switch and may not therefore have to carry out that threat in order to secure a price reduction. However, the ability of customers to switch in practice cannot be ignored. If customers are unable to switch or if their ability to do so has been diminished by the merger then the credibility of any threat will be removed or diminished. As such, evidence of threats being made in the past and of successfully securing price reductions, will not be an accurate guide to customers’ ability to switch post-merger.
17. However, the parties argued that this was not the case; that the remaining competitors posed a substantially larger competitive constraint than their market shares would imply; and that in choosing to put the vast proportion of their requirements with either Deans or Stonegate, customers relied on the existence of smaller competitors as a competitive discipline.

Switching

18. The parties provided switching data which they said showed that the majority of switching in the past 5 years had not been between Deans and Stonegate. The parties also noted that there had been very little switching between them between October 2004 and the date of the merger. This evidence is discussed further in paragraph 6.8 of our provisional findings.
19. In addition to the parties’ estimates of switching we looked at two further sources of information. First, we looked at the parties’ sales data to try and identify evidence of large-scale switching between the parties. Second, we looked at the purchasing patterns of the parties’ customers to try and identify instances of switching between the parties or between the parties and their competitors.

20. Sales data provided to us by the parties is analysed in Annex 1. This analysis shows that there is evidence of customers switching volumes between the parties pre-merger, and also that there is evidence that there was some switching by customers to other competitors. There appears to have been switching between the parties for all types of eggs and all types of customer. In addition, switching appears to be relatively infrequent.

21. Purchasing data provided to us by customers has been analysed in Annex 2. This shows that for all customer groups there is evidence of large-scale switching between the parties. This pattern is particularly apparent for larger retailers. There is also evidence of relatively large-scale switching by customers to other suppliers. However, the use of smaller suppliers such as Oaklands and Fridays is more apparent among smaller customers and in particular wholesale and catering customers. As with the analysis in Annex 1, we find that significant changes in supplier are relatively infrequent.

22. In terms of the ease of switching supplier, the majority of customers were of the view that switching small volumes between suppliers was relatively easy. However, switching large volumes was more difficult.

23. Wholesale and catering customers appear to switch supplier more often and were generally more optimistic regarding the ease with which they could switch in the future. This would appear to be because they purchase smaller volumes and because their requirements are more heavily biased towards cage eggs, whereas retailers require a broader suite of egg products and are more heavily focused towards higher grade, and in particular free-range eggs. It also reflects the fact that the market for the supply of shell eggs to wholesale and catering customers is

considerably less concentrated than the markets for the supply of shell eggs to retailers.

24. In summary, the available evidence appears to indicate that the parties' smaller competitors can and do compete for all types of customer, subject to the availability of eggs. However there is no clear evidence that the relative constraint imposed by Glenrath, Oaklands, Fridays, Skea or any other competitor is substantially greater than would be suggested by their market share.

Capacity

25. The parties stated that there was abundant spare capacity and that smaller competitors could expand easily in the event of a price rise. With regard to packing capacity, this view was supported by the parties' competitors. [X] told us that they had significant spare packing capacity. However, a key constraint on their ability to expand was the availability of eggs to pack, and in particular the availability of free-range eggs to pack.
26. There are three main sources of shell eggs to pack. First, most egg packers produce a large proportion of their cage eggs on their own farms. Second, packers can arrange for third party farmers to supply eggs under contract. The parties told us that packers sourced the majority of their free-range eggs in this way. Finally, for small volumes of eggs, or to smooth short-term imbalances in supply and demand, packers can source eggs from the wholesale (spot) market.

The availability of eggs to pack

27. An important consideration when assessing the constraint imposed by competitors on the merged entity is the ability of competing suppliers to expand to accommodate new orders. Even if the parties' customers are price sensitive, and may be willing to

switch in the event of a price rise or any other anti-competitive effect, their ability to do so may be limited because the parties' competitors are unable to accommodate new orders. Evidence regarding the availability of eggs to pack from competing suppliers is limited. However, all the competitors that we spoke to indicated that they were constrained by the availability of eggs to pack, particularly in the markets for free-range and organic eggs.³

28. [X] said that it currently had no ability to accommodate new orders and that it had had problems fulfilling orders to its current customers [X]. It was a net buyer of free-range and organic eggs from the spot market.
29. The company also told us that for all egg types with the exception of barn eggs it was reliant, at least to a degree, on short-term spot market trades for some of its purchasing requirements. Its egg availability problems are most acute for free-range and organic eggs.
30. Oaklands said that currently it had capacity to pack [X] cases an hour. This equated to an achievable output of [X] cases a week. Currently it was producing 25,000 to 27,000 cases a week. The main limiting factor was the availability of eggs to pack. The company had been placing advertisements to try and recruit further contract producers; however, it had been unable to secure any new supplies.⁴
31. Fridays appears to have some availability to accommodate new orders for cage eggs. It was currently running with a surplus of approximately [X] per cent of its output, mostly of cage eggs. It said that it was selling more eggs than it would like to

³All the competitors that we spoke to indicated that they had substantial spare packing capacity. However, the limiting factor would appear to be the availability of eggs to pack.

⁴Source: transcript of hearing with Oaklands.

the wholesale (spot) market and that it would like to see those eggs being sold to a higher-tier customer.

32. The company also said that it was currently quoting for volumes of around [redacted] to [redacted] cases a week of new business, mainly in cage eggs, where it had availability. This represents roughly [redacted] per cent of its current output.⁵ This level of volume, using existing capacity, could be brought on line relatively quickly, with approximately three months' notice. Larger volumes would require longer lead times to allow time to recruit contract producers.
33. Fridays had little free-range and organic egg availability and would have to source on the wholesale market in the interim. In the longer term it would have to recruit contract producers.
34. In summary, it appears that there is very little availability of eggs to pack among the parties' competitors in free-range and organic eggs.
35. There appears to be some evidence of availability for cage eggs. However, the available volumes are relatively small and may be insufficient to provide a viable alternative for a large retailer. Over time the cage sector is declining: further cage egg supplies may therefore become available over time as demand for cage eggs declines.
36. However, the parties submitted calculations which showed that the critical loss of business that would render a 5 per cent increase in price unprofitable was relatively large. This analysis is discussed further at Annex 3. The parties noted that the wholesale (spot) price, on which these estimates were based, was volatile, due to the

⁵[redacted]

illiquidity of the wholesale (spot) market, and that therefore in the event of a customer switching a large volume of eggs the critical losses would be smaller. However, even allowing for a fall in the wholesale price, the critical losses necessary to render a 5 per cent price rise unprofitable would appear large in relation to the available spare eggs amongst the parties' competitors and the difficulties in switching identified by the parties' retail customers discussed above. On either basis therefore, a post-merger increase in price would appear profitable.

Does customer switching induce the movement of eggs between suppliers?

37. The parties argued that, should a customer choose to switch a sizeable volume between suppliers, existing availability constraints would be relieved because the incumbent supplier would have an incentive to release its surplus eggs on to the wholesale (spot) market, where the new supplier would be able to purchase them. As a result of this, the constraints on their competitors, due to the availability of egg problems outlined above, would not, in their view, be binding.
38. However, a number of the parties' retail customers indicated that they would be unlikely to switch to a supplier unless that supplier could demonstrate that it had the capability of delivering the required volumes of eggs.⁶ In addition, some retailers noted that a lack of security of supply may be a reason to switch supplier.
39. The perception of the parties that competitors could compete on this basis to take business away from Noble was contrary to that of their competitors. As noted above, all of the competitors who responded to the CC said that they were constrained by the availability of eggs to pack. [X] all commented that this was not how the market worked and that they could not compete for new retailer contracts on the assumption that eggs would become available.

⁶Customers who held this view included [X].

40. Despite the fact that the parties' customers and competitors did not agree that suppliers could compete for new business without establishing that they had existing egg supplies in place we assess the parties' argument that eggs would become available below.

The cost of withholding eggs

41. There would appear to be a number of ways in which an incumbent supplier could dispose of surplus eggs. Not all of these would result in those eggs becoming available to the new supplier. The parties told us at the first main party hearing that they would try to avoid selling surplus eggs to the new supplier directly.⁷
42. They also told us that the options open to an incumbent supplier to dispose of surplus eggs were, as follows, to:
- (a) downgrade the eggs to another category;
 - (b) sell the eggs on to the wholesale market;
 - (c) sell directly to another packer;
 - (d) send for first quality processing;
 - (e) send for second quality processing;
 - (f) export; or
 - (g) destroy.
43. Options (b) and (c) would result in surplus eggs becoming available to a new supplier and would appear to facilitate switching between suppliers. The remaining options would not and the availability constraints outlined above would continue to apply.
44. The parties submitted a series of calculations which, they said, showed that there was a clear disincentive for Noble to withhold eggs as the losses associated with

⁷Source: transcript of first main party hearing.

exporting, processing or destroying eggs were considerably in excess of the losses that would result from selling eggs to the wholesale (spot) market.

45. However, the parties' calculations of the losses associated with each of the options outlined above were calculated using the current wholesale (spot) price for eggs. The parties themselves and a number of other third parties have noted that the wholesale market is relatively thin and as a result the wholesale price is volatile. The parties argue that the wholesale price would be likely to fall if a large volume of eggs were to be sold on to it at short notice. If this were the case, then the losses associated with selling eggs to the wholesale market would increase. We note in Annex 3 that there is some uncertainty as to the effect of customer switching on the wholesale (spot) price for eggs. As a result of this uncertainty over the wholesale price, we can only place limited weight on the parties' calculations.
46. A number of third parties confirmed the parties' view that the wholesale (spot) market was relatively shallow and illiquid. Fridays told us that the wholesale market would only need a small shortage to cause a large price increases and a small surplus to cause a large price drop.⁸ Fridays also said that it was possible for wholesale prices to fall by as much as 30 per cent within four or five weeks. This view was also confirmed by the Central Egg Agency.

The impact of the merger on the incentive to withholding eggs

47. It is also likely that the incentive to withhold eggs would be higher for Noble than would have been the case for each of the parties individually pre-merger. Then, Deans or Stonegate had less of an incentive to withhold eggs, as retailers appear to have been able to switch to another supplier without a transfer of eggs between them. As such, withholding eggs in order to thwart customer switching would have

⁸Source: transcript of hearing with Fridays.

been ineffective, as customers could switch without the release of surplus eggs in the way described by the parties. This is because Deans, and to a lesser extent Stonegate, ran with relatively large surpluses of eggs (by comparison with Glenrath, Oaklands and Fridays) and so could accommodate a significantly larger volume of new business using their existing surpluses than smaller rivals.⁹

48. The Central Egg Agency told us that egg packers tended to run with a surplus to accommodate short-term fluctuations in demand and supply.¹⁰

49. The parties told us that a key source of cost synergies as a result of the merger was that a larger combined entity would be able to operate with a smaller surplus of eggs. This would result in cost savings as fewer higher-grade eggs would be downgraded and fewer eggs sold on to the spot market.¹¹

50. [REDACTED] Figure 1 shows Deans' sales to the Central Egg Agency and the Central Egg Agency International over the past five years.

FIGURE 1



Source: Deans' monthly sales data.

51. Figure 1 shows that, [REDACTED]. The majority of these sales were cage eggs.¹²

52. This surplus of eggs has two important effects. First, it affords Deans capacity headroom which allows it to bid for new business, and second, the Central Egg Agency told us that Deans, and to a lesser extent Stonegate, were a net source of eggs for the wholesale (spot) market. Selling surpluses wholesale therefore helps

⁹Although smaller suppliers may run with relatively large surpluses in proportion to their overall volumes, in nominal terms these surpluses are likely to be much smaller because of the considerably smaller scale of the parties' remaining competitors.

¹⁰Source: transcript of hearing with Central Egg Agency.

¹¹Source: the parties' submission, 2.18.

¹²During the period shown in Figure 1, [REDACTED] per cent of sales to the Central Egg Agency were cage eggs. Sales to Central Egg International were more mixed with [REDACTED] per cent cage, [REDACTED] per cent seconds and [REDACTED] per cent free-range.

facilitate switching to rivals, who because of their smaller scale do not have capacity headroom. Smaller rivals use the wholesale (spot) market to smooth short-term imbalances in supply and demand and also help facilitate large changes in output, for example as would happen if they won a new customer supply contract.

Evidence of switching inducing the transfer of eggs between suppliers

53. Finally, it is not clear from the information provided by the parties whether the examples of switching in the past were accommodated out of existing surpluses of eggs or through the transfer of eggs between suppliers. Furthermore, there are no clear examples of this process taking place in the past.
54. The parties provided us with a number of examples which they said showed that the transfer of eggs from the incumbent supplier to the new supplier had happened in the past. We assess each of these examples in turn below.
55. The parties provided one example where a rival supplier was able to win a retailer contract, which was fulfilled using eggs from another supplier. The parties said that when [X] switched its [X] depot (representing [X] per cent of Deans' sales to [X]), from Deans to [X] in early 2005, [X] agreed to supply [X] with surplus eggs which it had available as a result of an earlier loss of sales to [X].
56. However we note that in this example, [X] sourced surplus eggs from [X], rather than the incumbent supplier [X]. [X] would have been more willing to supply [X] with surplus eggs as it would result in a loss of sales to a rival rather than to itself. Post-merger, the option to source surplus eggs from one or the other of Deans or Stonegate will be removed.

57. The parties submitted one further example of a loss of a retailer contract by Stonegate in 2004 which resulted in Stonegate selling surplus eggs on to the wholesale market. We note, however, that this contract was won by Deans, and that the parties have not claimed that Deans fulfilled this contract by sourcing eggs from the wholesale (spot) market.
58. Finally the parties submitted a further example of a supplier sourcing eggs by contracting with one of Stonegates' contracted suppliers. The mobility of the parties' contracted supply base is discussed in Appendix F.

Entry and expansion

59. The threat of entry and expansion can act as a constraint, preventing the merged enterprise from exercising market power. Alternatively, were prices to rise post-merger, subsequent entry may be sufficient to reduce prices to pre-merger levels or lower. Thus an SLC as a result of a merger would be unlikely where entry is easy, provided that such entry is sustainable and likely to have an impact on the potential for existing firms to exercise market power. The prospects for entry and expansion are discussed in paragraphs 6.29 to 6.43 in provisional findings.
60. The parties claimed that the existing competitors that they faced were a sufficient constraint on Noble to prevent any anti-competitive behaviour. They also claimed that recent and earlier history showed that entry and expansion was easy and could be rapid. The parties cited the example of Glenrath, Oaklands, Sunrise/Lakes and Skea, among others, as examples of firms growing rapidly. The parties also noted that there was a substantial amount of spare packing capacity (estimated by them at [X] cases per week).

61. However, third party responses from competitors consistently cited the limited availability of sufficient volumes of the appropriate type of egg to pack as the main factor inhibiting expansion.
62. In order to expand their output, the parties' competitors would need either to increase their own production of shell eggs, or to increase their purchasing from contracted farmers. It is possible for egg suppliers to source eggs in the short term from the spot market; however, the Central Egg Agency and a number of the parties' competitors told us that this was not a long-term option because of limited availability and problems with the security and consistency of supplies sourced in this way.¹³

Expanding existing production

63. The parties claimed that it was relatively easy to expand production of all types of shell eggs either by adding capacity to existing farms or by building new farms.
64. If planning constraints and pollution controls are disregarded, setting up new production appears to be relatively straightforward and can be achieved at relatively little cost.
65. However, the parties' competitors did not agree with this assessment. In particular, third parties cited the restrictions imposed by the planning system and other regulations such as pollution controls as a major barrier to entry and to expansion.
66. [REDACTED] noted that expansion in intensive (cage) eggs was relatively easy. However, expanding free-range output is practically impossible on a large scale. [REDACTED] it said that the planning process had seriously held up its expansion plans.

¹³Source: transcript of staff hearing with Central Egg Agency. [REDACTED].

67. It did not regard mobile sheds as a viable alternative due to problems with vermin. It also said that the issue over the need for planning permission with mobile sheds was something of a grey area.¹⁴
68. Oaklands produced only cage eggs. It bought in all its free-range and organic requirements from contracted farmers. It told us that to set up new egg production would take 18 months to two years. The main barriers would be planning, and other regulation such as environmental impact assessments. Modern free-range units were for 16,000 to 32,000 birds and were big units. As a result, there was often resistance from local residents to new units being set up.
69. As to intensive eggs, there has been little investment since 2002 because of EU proposals for enriched cages, due for implementation in 2012.
70. Fridays told us that over the past three years its total production had been largely static. The composition of its output had changed as some cage production had been taken out and free range production increased.
71. In terms of expanding its in-house production of eggs, it said that this would be difficult because of planning constraints. It had outstanding planning consent for additional cage egg units; however, the demand for cage eggs was declining and so it was likely to manage with its existing production facilities.
72. Fridays would be seeking to increase production of free-range eggs. However, it was particularly difficult to obtain planning permission for free-range units. Fridays had considered using mobile free-range units, which might not require planning

¹⁴ [redacted]

permission. However, it also said that its conclusion from experience of mobile units was that they were not commercially practical.

73. Entry and expansion in cage eggs may be limited by the fact that the cage egg market is declining over time. The parties noted that the cage egg market was declining by approximately [redacted] per cent a year.¹⁵ In addition, new entry in cage eggs is likely to be deterred by the uncertainty surrounding the introduction of enriched cages due for implementation in 2012.

Recruiting additional contracted farmers

74. In addition to expanding output from their own farms or farms already contracted to them, the parties' competitors could expand by recruiting additional contracted farmers.
75. The contracted supply base of the parties is relatively immobile. In the past, contracted farmers have not moved between packers on a large scale, despite some considerable switching at the level of supply to retailers.
76. In addition, in order to induce a farmer to move from one packer, with established customer contracts, to another, the parties' competitors are likely to have to offer an incentive to the farmer to do so. Competitors would have to offer better prices to farmers in order to induce them to switch or offer a lump sum, or some combination of the two. Oaklands told us that it was considering offering free-range producers a £[redacted] lump sum to induce them to switch. Glenrath noted that Noble had been signing up organic producers in Scotland by offering them significant financial inducements.

¹⁵[redacted] presentation to banks, December 2005.

77. Gaining new contract suppliers was therefore likely to be difficult and costly.

Sponsoring entry

78. It would also appear unlikely that a large retailer would sponsor entry or expansion on a large scale. Such a course of action would appear to be risky, and furthermore, there would be a free-rider problem, in that the retailer that incurs the cost of sponsoring entry is likely to have to share the benefits with its competitors. Customer responses indicate that retailers are reluctant to sponsor entry; few said that they would do so in the event of a 5 per cent increase in price.

Market outcomes

79. The parties cited the examples of Glenrath, Skea, Oaklands and others as evidence of growth in the past. However, all these competitors remain small, and have taken a number of years to reach a relatively modest market share.

80. Currently there appears to be an acute shortage of free-range eggs. The parties and at least one competitor are unable to supply all of their customers' requirements. This outcome is not what we would expect if there are few barriers to expansion, since any shortfall would induce suppliers to increase their output rapidly. However, the implication of current shortages may have arisen due to unforeseen circumstances and current shortages may be a temporary effect of unforeseen events coupled with the relatively long lead times associated with the life cycle of a laying flock.

Summary

81. In summary, the available evidence appears to indicate that there is little prospect that threat of entry by new firms or expansion by existing firms would impose a significant constraint on the merged entity. This is primarily because of the restrictions both for existing firms and new entrants as a result of the planning regime

and other regulatory constraints. These restrictions would appear to be particularly acute in the markets for free-range and organic shell eggs.

Buyer power

82. The parties argued that the merged entity would be constrained post-merger by the countervailing buyer power of its customers. Essentially the buyer power defence implies that vertical tension between buyer and seller can provide an adequate substitute for horizontal competition between suppliers.¹⁶
83. The parties argued that there were five main ways in which a customer might be able to exercise its bargaining power. These were as follows:
- (a) sourcing from outside the UK;
 - (b) sponsoring a new entrant to the market;
 - (c) switching from Noble to a number of smaller suppliers;
 - (d) sponsoring one of the smaller suppliers to enable it to grow to a sufficient size to provide a viable alternative (eg by offering a long-term supply contract); and
 - (e) delisting one or more product(s) and allocating shelf space to another product.
84. We asked customers how likely they were to use any of these options in the event of a small increase in price. In general, very few customers considered it likely that they would use any of the above options in the event of a 5 per cent increase in price by the merged entity.
85. As discussed in Appendix D, the majority of customers had not sourced from outside the UK in the past five years. They also said that they would not do so in the event of

¹⁶This argument has seen some criticism because whilst vertical tension may prevent the short-run effects of increased prices, it is not clear that buyer power can provide an adequate substitute for horizontal rivalry in the long run or for the other benefits of competition, such as innovation, service and quality.

a 5 per cent price rise, and furthermore none said that it had ever threatened to do so in previous negotiations.

86. Two wholesalers (DBC Foodservice Ltd (DBC) and [redacted]) responded that they might be willing to sponsor a new entrant into the market in the event of a 5 per cent price rise as did one smaller retailer ([redacted]). However, each of these customers purchased relatively small volumes. The remaining customers, including the large supermarkets, did not consider it likely that they would use this option in the event of a 5 per cent increase in price.
87. One large retailer, Asda, one smaller retailer, [redacted] and one wholesaler customer, DBC, indicated that they would be willing to switch to a range of smaller suppliers in the event of an increase in price: [redacted], another wholesaler customer, also indicated that it might be willing to switch to smaller suppliers in response to a price increase. In addition, a large retailer, [redacted] said that it might be able to switch a small volume to a range of smaller suppliers. Another large retailer ([redacted]) said that it already worked with small local suppliers ([redacted]) which were trying to expand. However, the other customers that responded did not consider this a viable option and furthermore they were of the opinion that in order to switch to a group of smaller suppliers they would have to accept less favourable terms.
88. One larger retailer ([redacted]) said that it would be willing to sponsor the growth of a smaller supplier, but that this was likely to take a long time. Another ([redacted]) said that it encouraged smaller suppliers [redacted]. Another (Asda) also said that it would be willing, but that it would take a longer-term view. The majority of the other retailers who responded said that sponsoring the growth of a smaller supplier was likely to take a considerable amount of time.

89. One small retailer and one wholesale customer, [REDACTED] indicated that they might consider delisting products and allocating shelf space to another product. However, the majority of customers indicated that this would not be a viable option. In addition, almost all customers indicated that eggs were a must-stock product and a KVI. Eggs were an important key basket item and helped to drive store footfall. As a result, delisting eggs was not a realistic option.
90. In addition to asking whether customers would use any of the above options, we also asked them whether they had used any of these strategies in the past. The majority of customers indicated that they had not. As a result, if customers did enjoy buyer power pre-merger, it appears that this was exercised by switching between existing suppliers rather than by sponsoring entry or any of the other options outlined above.
91. Finally, we also asked customers whether their answers to any of our questions on buyer power would be different for any particular type of egg. All respondents said that there was no difference by egg type.
92. The parties also submitted an analysis of their own margins and retailers' gross margins. The parties said that this analysis showed that their margins had not increased post-merger; that on some product lines to some customers the parties were not covering their fully allocated costs; and that on some product lines they were only just covering their variable costs.
93. We do not consider that the fact that the parties' margins have not increased post-merger to be a useful guide to what may happen in the future. Since the merger was completed, the parties have been under scrutiny by the competition authorities.

94. We also note that, although the parties are achieving slim margins and in some cases negative margins on the basis of total cost on some product lines, this is not true for all product lines. There may be a number of alternative explanations for these observations including:
- (a) Whilst some individual product lines may appear to be relatively unprofitable, the profitability of the account as a whole may be positive. The parties themselves acknowledge that they regard the profitability of a customer account as a whole as being the relevant measure to use. We note that for the majority of the examples given by the parties' of prices on a product line being below average total cost, typically on cage eggs, there was a positive margin on the sale of free-range eggs to that customer.
 - (b) As the parties' acknowledge in one of their examples, prices being below average total cost may reflect the particular cost allocation model chosen by them.
 - (c) Thin margins may simply reflect intense competition between the parties rather than the buyer power of the parties' customers.

Assessment

95. In this section we analyse the impact of the merger on the bargaining power of the parties' customers. The analysis presented here complements the analysis in paragraphs 6.48 to 6.57 of our provisional findings.
96. Effectively buyer power describes a possible outcome of bilateral bargaining between buyer and seller. In order to assess the impact of the merger on the buyer power, we looked at three key aspects of bargaining between buyer and seller.
- (a) The impact of the merger on buyers' outside option;
 - (b) The impact of the merger on sellers' outside option; and
 - (c) The impact of the merger on the relative bargaining power of buyers and sellers.

97. The buyers' and sellers' outside option is defined as their next best alternative, should they choose not to trade with each other. The difference between the buyers' and sellers' outside option is termed the incremental surplus. The share of the incremental surplus achieved by buyer and seller will be determined by their relative bargaining power. Buyer power may therefore result if a buyer has a valuable outside option (for example, the ability to switch) or has significant bargaining power.

The impact of the merger on buyers' outside option

98. Responses from customers indicate that the merger has reduced the value of their outside option. The available evidence on customer switching indicates that the parties were vigorous competitors pre-merger. Therefore, prior to the merger it is likely that the next best option for any customer of Deans was likely to have been Stonegate and vice versa.
99. Post-merger, the customer responses discussed above indicate that the next best (outside) option to dealing with Noble would be for a customer to attempt to switch to a number of smaller suppliers and attempt to grow them over time. Customer responses indicate that customers would expect this to be relatively costly, that they would have to accept worse terms, and that switching a sizeable volume would take a considerable amount of time. It therefore seems likely that the outside option of buyers has been reduced in value by the merger.

The impact of the merger on sellers' outside option

100. The merger has not changed the structure of the buyers' side of the market. The alternative options open to sellers are therefore unaltered by the merger. The sellers' outside option is therefore no less valuable than pre-merger.

The impact of the merger on buyers' and sellers' bargaining power

101. We would expect that, all else being equal, a reduction in the value of the buyers' outside option would result in an increase in price. There are two possible circumstances whereby the negotiated price would not increase. These are if buyers have absolute bargaining power, such that they appropriate the entire incremental surplus, or if there is a concurrent increase in the buyers' bargaining power, sufficient to offset the loss in the value of the buyers' outside option.
102. The parties argued that customers had bargaining power with their suppliers because they could impose considerable costs on suppliers by switching away and leaving the supplier with excess eggs.
103. However, as discussed above, Noble may have the ability and incentive to thwart the switching process by withholding eggs. In addition, retailers' ability to switch suppliers is limited by the lack of available eggs to pack, and modest scale among the remaining competitors.
104. In addition, customers told us that eggs were a must-stock item. It is very damaging to a customer to have shortages of eggs as this may induce consumers to go to a rival store. It seems that Noble could also impose costs on its customers by creating shortages of eggs to individual retailers.

The breadth of buyer power

105. A key criticism of the countervailing buyer power defence is that some of the parties' customers may not enjoy buyer power and therefore would be vulnerable to an increase in price, quality reduction or other anti-competitive effect. There is no generally convincing reason that buyer power held by some customers would directly impact upon other customers.

106. As a result of recent shortages, there are indications that the parties have not treated all their customers in the same way and have ceased supplying some of them.
107. There are a number of circumstances in which buyer power may prevent price rises for all customers. These include the following:
- (a) if there is one market price so that the buyer power of large firms drives down the price for all firms;
 - (b) large buyers sponsor a new entrant;
 - (c) large buyers are able to disrupt collusion by switching or credibly threatening to switch large volumes between suppliers; and
 - (d) all buyers in the market enjoy buyer power.
108. In the case of shell eggs, it is clear that prices are negotiated individually with each customer. As such, there is no market price, and the bargaining power of any one customer is therefore likely to affect that customer's price only.
109. From the discussion above, it is clear that customers are reluctant to assume responsibility for market structure and sponsor an entrant, and in any event this is likely to take a considerable amount of time. It also appears that it is difficult for customers to switch large volumes between suppliers.
110. It therefore seems that for the countervailing buyer power defence to apply in this case the parties would need to demonstrate that all customers enjoy buyer power. In this context it is interesting to note that Annex 2 appears to indicate that foodservice and wholesaler customers have a greater ability to switch between suppliers, although these customers purchase predominantly cage eggs.

111. The CC carried out its own analysis of the relative profitability of different customers based on Deans' price and cost data. This analysis is included at Annex 4. [✂]

Summary of the impact of the merger on retailers' countervailing buyer power

112. It appears that the parties' customers enjoy at least some bargaining power *vis-à-vis* their suppliers. It does not seem likely that large retailers, for example, are simply price takers. Large retailers in particular are large and sophisticated buyers. However, the available evidence shows that the relative bargaining positions of the parties and retailers are more balanced than the parties suggest. Furthermore the merger has weakened the bargaining position of retailers. We do not consider, therefore, that the buyer power of retailer is sufficient to enable them to resist a price rise and thereby offset an SLC.

Upstream buyer power of Noble

113. A large number of farmers have raised concerns with the CC regarding the upstream bargaining power of the merged entity. Farmers noted that, particularly in the south west of England, where there were few alternative packers, Noble represented the only available 'route to market' for farmers.
114. Analysis of the parties' supply base shows that there is relatively little switching by farmers of their route to market, at least between Deans and Stonegate. However, the threat to switch may have provided a constraint on Deans and Stonegate pre-merger. In this context it is interesting to note that Noble and other suppliers are currently actively trying to recruit contract producers, particularly free-range and organic egg producers.
115. A reduction in rivalry between Deans and Stonegate upstream for the purchasing of shell eggs from producers raises the prospect that Noble's increased bargaining

power *vis-à-vis* its contracted suppliers would result in lower prices paid to producers, or other adverse effects such as bundling feed, pullet or spent hen contracts with supply contracts or a reduction the quantity of eggs produced at the farm level.

116. The effect of an increase in upstream buyer power on final consumers can be ambiguous. Lower prices to producers, ignoring any changes in competitive conditions downstream, may lead to lower output, reduced investment, innovation and lower quality of eggs from producers.
117. However, it will also result in reduced costs to Noble, which, all else being equal, would result in at least a degree of pass-through in terms of lower prices to retailers and possibly consumers.¹⁷
118. Given the discussion above, it would appear that the merger also results in a concurrent increase in the parties' market power downstream. As a result, it would appear unlikely that Noble would pass on the benefits of lower input costs. As a result the adverse effects of upstream buyer power outlined above are likely to dominate leading to an increase in prices to final consumers.
119. Farmers themselves had mixed views as to the effect of the merger on final consumers. Farmers said that the merger might benefit them as the merged entity would provide a stronger counterweight to the power of large retailers. However, the loss of an alternative route to market may result in depressed producer prices.¹⁸

¹⁷Although the degree of pass-through will depend on elasticities of demand.

¹⁸Source: transcript of hearing with BFREPA. Farmer Questionnaire responses.

Unilateral effects

120. In summary, the market share data and evidence of customer switching in Annexes 1 and 2 to this appendix appears to indicate that the merger between Deans and Stonegate has resulted in a significant loss in rivalry in the markets for the supply of:
- (a) organic shell eggs to retail customers;
 - (b) free-range shell eggs to retail customers; and
 - (c) barn and cage shell eggs to retail customers.
121. The parties' competitors in all of these markets appear to be capacity constrained, although there appears to be a limited amount of spare capacity in the market for the supply of cage shell eggs to retail customers. Competing firms would therefore be unable to increase supply substantially in the event of a rise in price initiated by the merger. In the presence of these capacity constraints, the parties' smaller competitors may have an incentive to increase their own prices resulting in a multilateral increase in price.
122. The remaining constraints on the merged entity, including the threat of new entry, expansion or the constraint imposed by buyers' bargaining power, would appear to be insufficient to prevent an increase in price or any other adverse effects that may occur as a result of the loss in rivalry between Deans and Stonegate.

Coordinated effects

123. CC guidelines state that there are three conditions which are necessary in order for coordinated effects to arise and be sustainable over time. These are that, first, the market must be sufficiently concentrated that firms recognize their interdependence, and sufficiently concentrated that firms can observe their competitors' behaviour, and any significant deviation from prevailing behaviour; second, it must be clear that it will be costly for firms to deviate from the prevailing behaviour; and third, the competitive

constraints acting on the market must be sufficiently weak that collusive behaviour is not disrupted.

124. In the case of shell eggs, there are a number of factors which may lead to the conclusion that these three conditions are not met. First, shell egg suppliers negotiate individual supply contracts with customers. The price that individual customers pay is not directly observable by rivals. This, in addition to the limited capacity of the parties' rivals, may indicate that the second condition, namely that it would be costly to deviate from prevailing behaviour, may not be met.

125. However, there are a number of factors in the market for shell eggs, including the concentrated nature of the market, repeated interaction between market participants and the strong role of trade associations which may raise the prospect of coordinated behaviour. Given our provisional findings about unilateral and multilateral effects we have not had to reach a final view on the likelihood of coordinated effects.

Evidence of switching from the parties' sales data

1. In this annex we examine the parties' sales data for evidence of customer switching between Deans and Stonegate. The parties provided monthly sales data for Deans and Stonegate respectively as part of their response to the market questionnaire. The CC used this data to construct a number of charts. The charts show the number of cases of eggs sold in each month: in every chart Deans is represented by blue bars, Stonegate by orange bars. We consider that the charts show that there has been customer switching between Deans and Stonegate in the last three years. We note that the charts also suggest that there may have been switching from Deans and Stonegate to other, third party, egg suppliers.
2. The purpose of the analysis was to find evidence of switching rather than to analyse the average extent of switching. Therefore, the charts contained in this annex are a selection in which there is evidence of switching and should not be taken to be representative of the average level of switching in the market(s) for eggs.
3. In summary, the charts suggest [redacted] switched supply between Deans and Stonegate during the time period analysed.
4. Deans and Stonegate record their sales data using different time periods. Deans supplied sales data in four-weekly periods, whereas Stonegate provided sales data in calendar months. In order to match the dates which sales volumes relate to, it was necessary to generate a variable 'period' against which to plot sales. As a result, every 12 periods there is a gap in the Stonegate data in order to ensure that the time periods are comparable. Period 1 relates to 3 March 2001, period 65 to 31 December 2005.

5. Figure 1 shows free-range eggs sold to [redacted]. The chart suggests that [redacted].¹⁹ We consider that this is evidence of customer switching between Deans and Stonegate.

FIGURE 1

[redacted]

Source: CC study from information supplied by the parties.

6. Figure 2 shows a similar pattern in late 2003 for [redacted] purchases of cage eggs. Again there appears to be a third supplier(s). However, this is less apparent for cage eggs compared with free-range eggs.

FIGURE 2

[redacted]

Source: CC study from information supplied by the parties.

7. Figure 3 shows free-range eggs sold to [redacted]. The chart suggests [redacted]. There may also be evidence of a third supplier prior to period 37.

FIGURE 3

[redacted]

Source: CC study from information supplied by the parties.

8. Figure 4 shows cage eggs sold to [redacted]. The chart suggests that over most of the period [redacted].

FIGURE 4

[redacted]

Source: CC study from information supplied by the parties.

9. Figure 5 shows cage eggs sold to [redacted]. The chart suggests that [redacted].

¹⁹See Annex 2. The third party which supplied [redacted].

FIGURE 5

[REDACTED]

Source: CC study from information supplied by the parties.

10. Figure 6 shows cage eggs sold to [REDACTED]. The chart suggests that [REDACTED]. There would appear to be evidence of a third supplier prior to November 2004 (period 37).

FIGURE 6

[REDACTED]

Source: CC study from information supplied by the parties.

11. Figure 7 shows free-range eggs sold to [REDACTED]. The chart suggests that [REDACTED].

FIGURE 7

[REDACTED]

Source: CC study from information supplied by the parties.

12. Figure 8 shows organic eggs sold to [REDACTED]. The chart suggests that [REDACTED]. It also suggests that in [REDACTED].

FIGURE 8

[REDACTED]

Source: CC study from information supplied by the parties.

Summary

13. In summary, the parties' sales data appears to indicate that there is switching between the parties and that therefore the parties are important competitors at least for those customers analysed here. It appears that there is competition between the parties for all types of egg and all types of customer. There is also some evidence of switching to third party suppliers in these data. However, as the data contain only Deans and Stonegate sales data we are unable to determine either whether each instance was a switch to a third party, or who that third party was.

Key to time periods

<i>Period</i>	<i>Date*</i>	<i>Period</i>	<i>Date*</i>	<i>Period</i>	<i>Date*</i>
1	Feb-01	26	Jan-03	51	Dec-04
2	Mar-01	27	Feb-03	52	Jan-05
3	Mar-01	28	Mar-03	53	Jan-05
4	Apr-01	29	Mar-03	54	Feb-05
5	May-01	30	Apr-03	55	Mar-05
6	Jun-01	31	May-03	56	Apr-05
7	Jul-01	32	Jun-03	57	May-05
8	Aug-01	33	Jul-03	58	Jun-05
9	Sep-01	34	Aug-03	59	Jul-05
10	Oct-01	35	Sep-03	60	Aug-05
11	Nov-01	36	Oct-03	61	Sep-05
12	Dec-01	37	Nov-03	62	Oct-05
13	Jan-02	38	Dec-03	63	Nov-05
14	Feb-02	39	Jan-04	64	Dec-05
15	Mar-02	40	Jan-04	65	Dec-05
16	Mar-02	41	Feb-04	66	Feb-06
17	Apr-02	42	Mar-04	67	Mar-06
18	May-02	43	Apr-04	68	Apr-06
19	Jun-02	44	May-04	69	May-06
20	Jul-02	45	Jun-04	70	Jun-06
21	Aug-02	46	Jul-04	71	Jul-06
22	Sep-02	47	Aug-04	72	Aug-06
23	Oct-02	48	Sep-04	73	Sep-06
24	Nov-02	49	Oct-04		
25	Dec-02	50	Nov-04		

Source: CC study from information supplied by the parties.

*This represents the end of the period. Periods are not aligned perfectly to actual dates in the raw data.

Evidence of switching from customer responses

Introduction

1. In this annex, we examine data from the responses to our shell egg customer questionnaire regarding switching. In particular, we examine the history of switching and the ease with which customers could switch to alternative suppliers in the future. We assess separately responses from the three major customer groups: large retailers, the smaller retailers and finally wholesale and catering customers.²⁰

Large retail customers

Asda

2. Asda provided data for its procurement of eggs over the past two years. It told us that data prior to this were not available, as its internal retail system only captured data up to two years previously. The data are presented in Figure 1.

FIGURE 1

Supply of eggs to Asda

[✂]

Source: Asda.

3. Data for period 10 of 2005 were provided twice and do not match exactly in both periods. Hence, both values have been summed in the chart presented in Figure 1. The raw data confirm that Asda did not source eggs from [✂] prior to period 10 of 2005.
4. Asda also sources from a number of smaller suppliers, including [✂]. However, volumes sourced from these suppliers are too small to be included in Figure 1.

²⁰In this annex we refer to wholesaler customers as the 'wholesale segment'. We do not refer to the traded wholesale or spot market for shell eggs.

5. Asda told us that there were options to switch to smaller suppliers, but not necessarily on the scale required. In order to meet the required volume, a number of smaller suppliers would have to be introduced. According to Asda, there would be a cost in switching to smaller, less efficient suppliers. However, Asda also stated that it would work with the suppliers to grow their capacity (and therefore cost efficiencies) over time.

6. In particular, Asda told us that, in its opinion, it could purchase from the following: [redacted] (on worse terms and it might not have the capacity), [redacted] (which had some additional capacity but they may not have enough to cover all required) and local/regional suppliers, such as [redacted] (which could supply only on a local/regional basis and would offer worse contract terms).

[redacted]

7. [redacted] provided data on its egg supply from February 2002 to October 2006, shown in Figure 2.

FIGURE 2
Egg supply to [redacted]

[redacted]

Source: CC analysis of data from [redacted].

8. [redacted]

9. [redacted] told us that it was supplied by several other smaller suppliers. Information on supply history is presented in Table 1.

TABLE 1 Background of supply to [REDACTED]



10. According to [REDACTED], small volume changes between suppliers could be done relatively quickly and at little cost. [REDACTED]

11. [REDACTED]

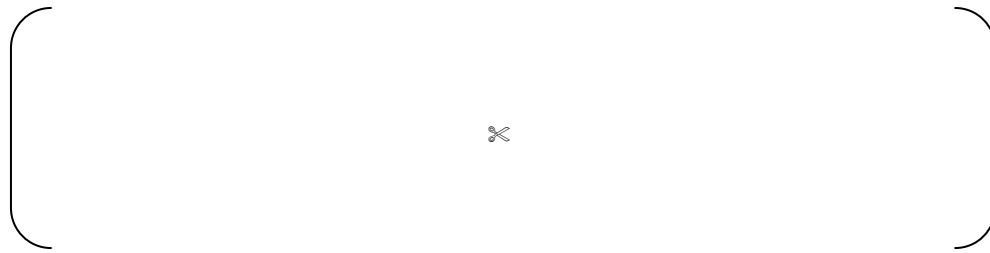
12. [REDACTED]

[REDACTED]

13. [REDACTED] told us that it would be difficult to switch supplier as the scale required to meet its volume demands would require long lead times. A minimum of six months would be required, with a gradual increase of volumes following as production became available. Any change would therefore need long-term planning, according to [REDACTED].

14. The last time [REDACTED] changed its supply base was in [REDACTED], following a tender which took place in [REDACTED]. The results of the tender are illustrated in Table 2.

TABLE 2 [REDACTED]



Source: [REDACTED].

-
15. The volume sourced from [REDACTED] increased, at the expense of volume sourced from [REDACTED]. Volumes with [REDACTED] changed little. This is confirmed by data from the parties.
 16. [REDACTED] only provided time series data on egg supplies after this tender (commencing [REDACTED]). This is illustrated in Figure 3, and shows that the proportions sourced from [REDACTED] have remained relatively stable over the period.

FIGURE 3

Egg supply to [REDACTED]

[REDACTED]

Source: CC analysis of data provided by [REDACTED].

Tesco

17. Tesco told us that it would be rare to delist a supplier. The costs involved in switching would include the cost of audits to ensure that any new supplier would meet the quality and technical requirements. This might take several months, according to Tesco. The process would be much longer for organic eggs, where land had to be left fallow for up to two years.
18. The last significant switch by Tesco occurred early in 2003, when a review of its supply base took place. This led to Tesco delisting Stonegate and Freshlay, which had [REDACTED] per cent of Tesco's egg business between them. The volumes were replaced by Deans and Glenrath.

19. Four-weekly data provided by Tesco do not cover the period prior to 2004. A chart of [redacted] volumes [redacted] is presented below (Figure 4).

FIGURE 4

Egg supply to [redacted]

[redacted]

Source: [redacted]

20. Tesco told us that suppliers such as [redacted] would be alternatives, but that switching large volumes would be more difficult. Tesco noted that, at times, production capacity could limit its ability to switch volumes. Tesco also stated that in the short term, it would be difficult to find any single supplier to cover the Deans' volume, but that it might be possible to meet demand by spreading volumes among a number of suppliers.
21. Figure 5 shows volumes supplied to Tesco from January 2004 to the present. This data was provided by Tesco. The chart confirms that Tesco is mainly supplied by [redacted].

FIGURE 5

Egg supply to Tesco (data from Tesco)

[redacted]

Source: Tesco.

[redacted] retailers

22. [redacted] and Somerfield are the only [redacted] retailers that have switched supplier in the past five years to have provided useful supply data that can be charted over time. Other [redacted] (such as [redacted]) have not provided supply data over time.

Waitrose Ltd

23. Waitrose Ltd (Waitrose) told us that it had set up a dedicated and unique supply situation with Stonegate, which involved the use of a specific breed of hen. Switching would therefore not be easy as this arrangement would be difficult to duplicate with another supplier. Whilst changing system requirements to facilitate the introduction of a new supplier would be straightforward, the volume and quality required by Waitrose would make changing supplier difficult, costly and time consuming.
24. Waitrose told us that Stonegate had been used for the last five years. This business was consolidated by adding the Deans business in January 2002. Waitrose also told us that it had reduced the number of suppliers supplying eggs to local branches and added two more local suppliers.

[REDACTED]

25. [REDACTED]

26. [REDACTED]

27. [REDACTED] told us that there was capacity within alternative suppliers to meet its demand.

[REDACTED]

28. [REDACTED] provided daily data for egg cases purchased between 1 February 2005 and 8 October 2006. [REDACTED] In order to present a clearer picture of supply, data was summed over [REDACTED] periods. This analysis is presented in Figure 6.

FIGURE 6

Supply of eggs to [REDACTED]

[REDACTED]

Source: CC analysis of data provided by [REDACTED].

29. [X] told us that it ceased trading with [X] in 2006, and Figure 6 confirms this. The additional volumes were moved to [X]. According to [X], the reason for the switch was that [X] informed [X] that it would stop a pre-agreed price promotion [X].²¹ Figure 6 indicates that there has been a limited increase in eggs sourced from [X].
30. According to [X], it was extremely difficult to switch suppliers. This was because capacity was limited and suppliers must have the ability to deliver nationally. Scotland could not be supplied economically from England. Contract lengths also hindered switching (most own-label suppliers would normally sought to work with at least a 13-week contract and notice period). It was also necessary to complete a full audit of a new supplier before switching, in order to ensure that appropriate food standards were adhered to, again delaying switching. Finally, [X] told us that the control exercised by the major players on the overall supply switching (including the possibility that large players were deliberately manipulating the overall supply situation) acted to hinder switching.
31. It is interesting to note that Figure 6 indicates that the switch from [X] took some time to implement.

[X]

32. [X] provided data for the number of egg cases to be purchased between October 2005 and September 2006, on a four-weekly basis. Negative values and months where the data had been duplicated were removed.²²
33. [X] told us that it ([X]) was supplied by [X]. In addition, a number of smaller suppliers were used, including [X].

²¹Response to shell egg customer questionnaire.

²²[X]

TABLE 3 Proportion of purchases [redacted] by volume)

Time period	per cent
2004/05	[redacted]
2005/06	[redacted]
2006/07 (pre-merger)	[redacted]
2006/07 (post-merger)	[redacted]

Source: [redacted].

34. The proportion of egg purchases from individual suppliers is presented in Figure 7.

FIGURE 7

Supply of eggs to [redacted]

[redacted]

Source: [redacted].

35. Figure 7 indicates that [redacted] reduced its purchases from [redacted] to nearly zero in April 2006. Purchases from [redacted] have also declined. It also appears that volumes from [redacted] have increased dramatically from month [redacted] of the current financial year. This is confirmed by data from the parties, which indicate that supply from [redacted] has increased sharply, as supply from [redacted] has fallen.²³

36. [redacted]

The Co-op

37. The Co-op told us that its major shell egg suppliers were Deans for the mainland UK and [redacted] in Northern Ireland. [redacted] only supplied Co-op branded products. The Co-op had dealt with Deans for at least ten years and [redacted] for over five years. It also dealt with regional suppliers which accounted for approximately [redacted] per cent of its business.

²³Evidence of no SLC from the creation of Noble Foods, RBB Economics, 24 August 2001.

38. Agreements with shell egg suppliers were on a three-month rolling basis. The notice period was three months and negotiations took place on an annual basis.

39. According to the Co-op, it would be fairly difficult to move 100 per cent of its egg volumes quickly due to both its strategy of focusing on free-range and organic eggs and the fact that it took about nine months to arrange the planning and management of flocks. Moving cage egg supplier would be easier, as the Co-op's volumes were lower. The last major switch was at the Oxford depot in 2002 and was to Freshlay (which was acquired by Deans in 2003).

[REDACTED]

40. [REDACTED] told us that it sourced eggs from both [REDACTED] and [REDACTED]. [REDACTED] had been dealing with [REDACTED] for five years and [REDACTED] for two years.

41. According to [REDACTED], it was relatively easy to switch supplier. However, it told us that there had been no significant changes in its suppliers over the past five years.

[REDACTED]

42. [REDACTED] told us that [REDACTED] had been its only egg supplier for the past five years. Despite this, [REDACTED] submitted that there would be no significant issue with switching suppliers. The costs would depend on the number of own-label products involved for packaging and marketing. If [REDACTED] was not available, [REDACTED] told us that it would switch to [REDACTED] or [REDACTED].

Wholesale and catering customers

DBC

43. According to DBC, it was not difficult to switch supplier. The process would normally take 28 days. The costs incurred would include management time and other factors such as packing costs.
44. DBC told us that there was only one alternative supplier to Deans and Stonegate on a national basis, which was Oaklands. If, prior to the merger, DBC were no longer able to purchase eggs from its existing supplier, its plan would have been to purchase eggs on a regional basis.
45. DBC supplied bidding data for cage eggs. It appears to hold an annual tender for its shell egg supplies and to change its supplier regularly. A summary of the last three DBC tenders is provided in Table 4.

TABLE 4 **DBC bidding data**

Year	Bidder	Volume and type of egg	Successful bidder
2003/04	[Redacted]	✂	[Redacted]
2004/05			
2005/06			

Source: DBC.

McDonald's

46. McDonald's told us that due to the scale and high quality it demanded, changing suppliers required considerable time, careful planning and consultation together with a policy decision. McDonald's only used free-range eggs.

47. McDonald's had made several changes to its shell egg supply over the past five years. In June 2003, [redacted] was introduced as a third party supplier of free-range shell eggs into McDonald's third distribution centre in Manchester. In October 2004, a tender was issued to the three incumbent suppliers [redacted] for four different supply splits. In December 2005, [redacted].
48. Figure 8 illustrates the number of cases supplied to McDonald's over time. The phasing-out of [redacted] and introduction of [redacted] are clearly shown.

FIGURE 8

Supply of eggs to McDonald's

[redacted]

Source: McDonald's.

49. McDonald's told us that it might switch to other suppliers in the event of a 5 per cent increase in price; however, this would only be done after a full supply chain review. It considered that alternative suppliers had sufficient capacity to meet its requirements.

[redacted]

50. [redacted] was supplied by both Deans and Stonegate. They had supplied [redacted] for the past three years and off and on for the past four/five years. [redacted] purchased mainly cage eggs; however, it also sourced a modest amount of free-range eggs. Table 5 shows [redacted] current purchasing of shell eggs.

TABLE 5 [redacted] shell egg purchases, 2006

	Cage		Free-range	
	Volume (cases/week)	%	Volume (cases/week)	%
[redacted] Total				

Source: [redacted].

51. [redacted] told us that switching egg supplier could be managed easily, providing the new supplier was equipped to deal with [redacted] (ie it had the ability to offer electronic ordering/invoicing and the ability to deliver six days a week using its own haulier or [redacted] backhaul). It would also have to guarantee strong availability. [redacted] did not believe that switching costs would be high.

52. If both existing suppliers were unavailable, [redacted] would switch to another big producer as a short-term measure, whilst investigating local supply as a long-term option.

[redacted]

53. [redacted] told us that it would be fairly easy for it to switch supplier and that it would take four to six weeks. It also stated that there would be an alternative supplier/group of suppliers capable of meeting its requirements. However, it had not changed supplier over the past five years.

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54. 3663 purchased mainly medium-sized cage eggs, although it did sell some free-range lines. It currently sourced from [redacted]; however, in the past it had also used [redacted], Deans and Stonegate. 3663 was unable to provide detailed purchasing data by supplier as some of its product codes were shared between suppliers. 3663 selected suppliers through a tendering system and it said that it was easy to switch between

suppliers who had supplied the business before on a product that was generally a similar specification across the supply base.

55. 3663 noted that had its current suppliers been unavailable, it would have sought to switch those volumes to one of its other existing suppliers or one with which it had previously had a supply relationship. However, there would have been difficulties with some suppliers such as [X], who are located in [X] because of logistical limitations.

Summary

56. From the evidence provided by customers, it appears that there is some large-scale switching between Deans and Stonegate. In particular, this appears to be the case for the larger retailers. There is clear evidence of large-scale switches in supply between the parties for Asda, [X] and Tesco.²⁴ There is also evidence of smaller-scale switching between Deans and Stonegate for Somerfield.
57. There are also some examples of relatively large-scale switching to other suppliers; however, the use of smaller suppliers such as Fridays and Oaklands is more apparent for smaller customers. We have one clear example of a customer switching a substantial volume to a smaller supplier, when [X]. In addition, DBC appears to have switched its entire shell egg purchasing requirements between Deans and [X] in 2005.
58. The majority of respondents in the large retailer and middle-ground customer groups indicated that switching, other than between Deans and Stonegate, was relatively

²⁴Tesco switched away from Stonegate to a combination of Deans and Glenrath.

difficult, took time to implement and would require careful planning. This was particularly the case when attempting to switch large volumes between suppliers.²⁵

59. Customers in the foodservice and wholesale segment appear more optimistic about their ability to switch and a number of them responded that switching supplier would be relatively easy. This would appear to be because foodservice and wholesale customers buy in much smaller quantities, and so their requirements are more easily accommodated by smaller suppliers. In addition, foodservice and wholesale customers, with the exception of McDonald's, purchase mainly cage eggs.²⁶

²⁵Some [REDACTED] customers, [REDACTED] and [REDACTED], said that it would be relatively easy to switch to an alternative supplier. However, neither had been through the process of switching egg supplier in the past five years.

²⁶In this context, it is interesting to note that McDonald's indicated that switching supplier would be relatively difficult as they would need to carry out a full supply chain review.

Critical loss estimates

1. The parties provided us with estimates regarding (i) the critical loss of volume that would render a 5 per cent increase in price unprofitable and (ii) the financial implications of a loss of a retailer contract.
2. The parties argue that the second part of their paper in particular shows that the capacity constraints acting on their competitors are not binding, because in the event that a retailer decided to switch to another supplier, Noble would have no option but to release those surplus eggs to the wholesale (spot) market, where the new supplier would be able to buy them.
3. We find that if the response of retailers to a 5 per cent increase in price was to switch a small volume, the parties' critical loss estimates would appear to be relatively accurate, and a price rise would be profitable because this small actual loss would be insufficient to render a price rise unprofitable.²⁷
4. We also find that if the retailers' response to a 5 per cent increase in price was to try to switch a large volume to other suppliers, the parties' incentives to thwart that switching, by withholding eggs, would be greater than for a small shift in volume, and so the retailers would not be able to switch sufficient volumes to other suppliers because of their binding capacity constraints as a result of problems of egg availability.²⁸

²⁷This is discussed further below, the impact of customer switching on the wholesale price for eggs is difficult to determine. For the purposes of discussion a small volume shift is defined as a shift in volume that would not cause the wholesale price of egg to change significantly, whereas a large volume shift is defined as a volume shift large enough to induce a change in the wholesale price.

²⁸The parties argue that the threat of switching could be sufficient to constrain prices, however any such threat would need to be credible. As such the issue of capacity is fundamental to the parties' argument.

5. In either case, the actual loss would be smaller than the critical loss and the parties would find it profitable to raise prices post merger.
6. However, as there is necessarily a degree of uncertainty regarding the reliability of the parties' critical loss estimates, because of the uncertainty over the level of the wholesale (spot) price on which they depend, we can only place a limited weight on the precise calculation of the critical loss. However it would seem that even taking different assumptions as to the wholesale price into account, the critical loss necessary to render a price rise unprofitable would be larger than the likely actual loss that would result, (given the limited availability of eggs and retailers' evidence that switching large volumes between suppliers would be difficult) making such actions profitable.
7. Regarding the parties' calculations of the financial implications of the loss of a retailer contract, we can only place limited weight on the parties' analysis, when determining whether Noble would have an incentive to release or withhold eggs in the event of an attempt by a customer to switch, since it assumes a fixed wholesale (spot) price. However, even on the basis of a fixed wholesale price, using different assumptions which are arguably more realistic than those used by the parties, we show that the parties have overestimated the length of time to recover the incurred loss.

(i) Critical loss estimates

8. The first section of the parties' analysis provides a critical loss calculation which estimates the loss of sales in each type of egg that would render a 5 per cent increase in prices for all types of egg unprofitable.
9. This shows that, on the parties' estimates using current prices and margins, an egg supplier (and by inference Noble) would find it unprofitable to raise prices by 5 per

cent for all egg types if as a result of the price rise it lost [X] per cent of its cage egg sales, or [X] per cent of both its cage and barn egg sales.

10. This supplements an earlier analysis which showed the loss of sales in each type of egg that would render unprofitable a 5 per cent increase in the price of that type of egg. These estimates are shown below for convenience.

TABLE 1 Critical loss estimates by type of egg²⁹

Egg type	Volume (cases)*	Selling price (p/doz)	Packing and packaging cost (p/doz)	Wholesale price (p/doz)	Gross margin (p/doz)	Gross margin (p-c/p)	Critical loss (%)	Critical elasticity†
Organic Free-range Barn Cage	[X]

Source: The parties and CC calculations.

*Stonegate weekly average.

†CC estimate based on constant elasticity assumption.

11. The estimates in Table 1 imply that a price rise of 5 per cent in, for example, free-range eggs, would be unprofitable if that volume fell by [X] per cent or more.
12. Customer switching on this scale would appear unlikely given that customers have told us that it is difficult to switch large volumes between suppliers and given the capacity constraints outlined in the competitive effects working paper.
13. The parties argue that it would be perfectly credible for any retailer to threaten to switch, for example, [X] per cent of its cage egg purchases to another supplier particularly as there is spare capacity in cage egg and because it is also easy to import cage eggs.³⁰ Alternatively, if there was a 5 per cent increase in the price of free-range eggs, the parties argue that it would be perfectly credible for a retailer to

²⁹Note that the price and cost assumptions used by the parties in their critical loss estimates are different to the assumptions they use in their analysis in part (ii), where they calculate the financial impact of losing a customer account. For example, in their critical loss estimates they use a sale price of £[X] per dozen for organic eggs, but in their assessment of financial impact in part (ii) they use £[X] for their organic egg sale price assumption.

³⁰Note however for this threat to be credible, the retailer would need to be able to switch this volume of egg easily in practice. Given the evidence in Annex 2 of Appendix E it would seem unlikely that such a threat would be credible in practice post merger. Customers, in particular retailer customers, have told us that it is difficult to switch large volumes of egg between suppliers.

threaten to switch [X] per cent or more of its free-range purchases to another supplier.

14. In addition, the parties claim that, in practice, the critical loss that would render a price rise unprofitable would be lower than these estimates. They argue that if a large volume of surplus eggs were to be placed on the wholesale market at short notice, the wholesale price would fall.³¹ As a result, the avoidable cost that would face Noble would be lower, and so their price cost margin would be larger. The critical loss is simply a function of the price cost margin. Larger margins lead to smaller critical loss.³²

15. It is difficult to predict, with any degree of precision, the effect of an increase in volume on the wholesale price. We have received evidence which confirms that the wholesale market is relatively shallow and illiquid. All else being equal we would expect an increase in supply to result in a sharp drop in prices. However, the scenario the parties seek to assess is one of a large volume of egg being switched between suppliers. In this scenario there would also be a concurrent increase in demand, as the new supplier would need to source eggs from the wholesale market in order to fulfil the contract. However, if the new supplier was able to delay its purchases from the spot market, perhaps by using existing surplus eggs, the wholesale price would still be likely to fall.

16. If we accept the parties' argument that the wholesale price would fall in the event of customer switching, there would still appear to be a limit to which the avoidable cost would fall. Once the wholesale price falls below the price that could be achieved by processing, exporting or destroying eggs, the avoidable cost facing a supplier would

³¹Note: the term wholesale (spot) market is used in this note to denote the spot market for shell eggs; this consists primarily of the Central Egg Agency.

³²This is because each individual unit is more profitable.

change as selling wholesale would no longer be the suppliers' next best option. These other alternatives would not appear to be as affected by volumes as the wholesale price. For example, eggs for processing can be stored for longer periods and export prices are less likely to be volatile. These alternatives therefore provide a floor for avoidable cost. Tables 2 and 3 below show revised critical loss estimates based on the information provided by the parties in response to part (ii). These could be considered lower bounds to the critical loss facing a shell egg supplier.

TABLE 2 Revised critical loss estimates for a large volume switch

Critical loss, Large volume case 1

Egg type	Assumptions		Packing and Packaging cost (p/doz)	Avoidable cost (p/doz)	Gross margin (p/doz)	Gross margin (p-c/p)	Critical loss (%)	Critical Elasticity (2)
	Volume (cases) (1)	Selling price (p/doz)						
Organic	[✂]
Free-range								
Barn								
Cage								

Source: CC estimates based in information provided by the parties.

- (1) Stonegate weekly average.
- (2) Constant elasticity assumption.
- (3) Avoidable cost based on higher of 1st/2nd quality processing price or export price.

TABLE 3 Revised critical loss estimates for a large volume switch

Critical loss, Large volume case 2

Egg type	Assumptions		Packing and Packaging cost (p/doz)	Avoidable cost (p/doz)	Gross margin (p/doz)	Gross margin (p-c/p)	Critical loss (%)	Critical Elasticity (2)
	Volume (cases) (1)	Selling price (p/doz)						
Organic	[✂]
Free-range								
Barn								
Cage								

Source: CC study from information supplied by the parties.

- (1) Stonegate weekly average.
- (2) Constant elasticity assumption.
- (3) Avoidable cost based on lower of 1st/2nd quality processing price or export price.

17. It is important to note however, that these lower estimates of critical loss would still appear to be in excess of the available capacity, in terms of available eggs to pack, amongst the parties competitors.

18. The parties cited three examples which they suggested show that ‘critical loss’ can be and has been achieved in the past. They noted that the percentages that would need to be switched to achieve a critical loss and render a 5 per cent price rise unprofitable are “very much in the ball park of those that have been switched”. The examples they give are:
- (a) [X] switched [X] per cent of their total business to [X].
 - (b) [X] switched its [X] depot to [X] in [X] accounting for [X] per cent of Deans’ sales to [X], and another example on the [X] when [X] switched volumes in its [X].
 - (c) [X] moved its [X] depot from [X] to [X] in [X], this accounted for around [X] per cent of the parties sales to [X].
19. However, when we assess these movements in terms of volume, it is clear that these examples fall far short of the volumes necessary for a critical loss to Noble. For example, to render unprofitable a 5 per cent increase in the price of its cage eggs, Noble would need to lose in excess of [X] cases per week of cage eggs.
20. The [X] example concerned only [X] cases per week (according to the parties’ competitor activity paper). According to the parties’ internal documents, Deans’ sales to [X] are approximately [X] cases per week. [X] per cent of this volume is equal to [X] cases per week and [X] per cent is equal to [X] cases per week. Finally, [X] is a very small customer for Deans and so [X] per cent of Deans’ sales to [X] is likely to represent a very small nominal volume.
21. It is therefore clear that, even on the lowest possible estimates of the critical loss necessary to render a 5 per cent increase in price unprofitable, the actual loss that would occur would be lower and consequently an increase in price would be profitable. There is no evidence of switching on this scale having occurred in the

past, and given the limited ability of Noble's competitors to expand due to the limited availability of eggs to pack, such a volume loss would not be likely in the event of a 5 per cent increase in price either.

22. The parties argued that capacity constraints, as a result of the limited availability of eggs to pack, would not in practice be binding because Noble foods would have an incentive to sell their now surplus eggs into the wholesale (spot) market. In support of this they supplied a detailed set of calculations of the financial implications of a loss of a retailer contract.

(ii) Financial implications of a loss of a retailer contract

23. The second part of the parties' response provides an estimate of the financial impact of a loss of a customer contract to a shell egg supplier. The parties outline the following options available to a shell egg supplier to dispose of surplus eggs:

- (a) downgrade the eggs to another category;
- (b) sell the eggs onto the wholesale market;
- (c) sell directly to another packer;
- (d) send for first quality processing;
- (e) send for second quality processing;
- (f) export; or
- (g) destroy.

24. We note in the main text of Appendix E that only options (b) and (c) would result in eggs becoming available to a rival supplier. For each of the remaining options the availability constraints outlined in Appendix E would still apply.

25. The parties then go on to calculate the costs of each of these options for various losses of volume by calculating the difference in revenue achieved by using each

option, compared with the revenue achieved by selling to a retailer. They then use these costs to estimate the number of weeks that it would be necessary to maintain a 5 per cent increase in the retail price to recoup the losses that they would have to bear from withholding egg from retailers for one week.

26. The first problem with the parties' calculations is that they ignore the parties own arguments with respect to critical loss in that they assume a fixed wholesale price. Were this assumption to be relaxed, the parties' critical loss estimates would diminish as outlined above. However, the relative cost of withholding eggs would be reduced, making it more likely that the supplier would seek to thwart the customer switching process by for example processing surplus eggs.
27. Second, the parties' calculation of the relative cost of withholding eggs from the market measures the cost by comparing the revenue achieved under each of the scenarios above compared with the revenue achieved by selling to a retailer.
28. However, in order to assess the parties' argument that they could not prevent customer switching by withholding the supply of eggs, it is arguably more informative to assess the difference in the revenue achieved by selling eggs wholesale (which according to the parties would not thwart customer switching) with the revenue achieved by processing or exporting surplus egg (which would inhibit customer switching).
29. On this basis, the parties' calculations of the time required to recoup a loss of sales as a result of withholding eggs would appear to be overestimates. Table 4 shows a worked example for free range-egg.

TABLE 4 CC and RBB calculations of the time taken to recoup losses that would accrue from a 2 week withholding of surplus free-range egg

Destination of eggs	Prices (pence/doz)*	Parties estimates of relative cost of withholding eggs (pence/doz)*	Alternative estimates of relative cost of withholding eggs (pence/doz)†
Retail + 5%	(✂)
Retail			
Wholesale			
2 nd quality processing			

*Source: The parties. The numbers for wholesale and 2nd quality processing are calculated by taking account of the revenue loss by selling at a lower price (eg the lower wholesale price compared to the retail price) and the cost savings from supplying the different level (for example lower packing and packaging costs).

†Source: CC alternative calculations see paragraph 31 below.

Note: The above estimates assume constant wholesale prices. Relative cost of withholding egg based on parties' estimate of revenue loss.

30. The parties calculate the benefit of successfully withholding egg as [✂] pence per dozen (ppd). This is the difference between the retail price and the (assumed) increased retail price as a result of withholding eggs. Using this estimate they estimate that it would take [✂] to recoup the losses incurred by selling eggs wholesale ([✂]) and it would take [✂] weeks of inflated prices to recoup the losses incurred by processing eggs ([✂]).

31. However, when assessing the parties' incentives to thwart customer switching, the calculation may be different. In the following calculation we use the parties' estimates. We agree with the parties that the 5 per cent price rise provides a gain of [✂] ppd. However in the following scenario this price rise underestimates the gain to the supplier. In this scenario the retailer informs the supplier that it no longer wants its eggs as it is going to source them from elsewhere. The supplier is then faced with a choice—does it sell at the wholesale price (the highest price it can achieve) which will enable the retailer to obtain the eggs, or does it sell at the processing price (which is lower than the wholesale price) which will prevent the retailer obtaining the eggs. If it sells at the processing price it will lose the difference between sales at the wholesale price (which is the most that it could achieve having lost the retailer contract) and sales at the processing price (the price it actually achieves) which is [✂]. This is the cost of withholding eggs from the retailer. However, if the supplier

regains the retail contract, because the retailer cannot obtain the eggs, the supplier gains the benefit of the 5 per cent increase in price plus the loss from selling at the wholesale price (the price it was getting when it lost the retail contract, which is [X]). On this revised basis the cost of withholding egg by sending it for processing could be recouped in [X] rather than [X].

32. It is therefore by no means clear that the parties would have a strong incentive to release surplus eggs to the new supplier in the event of a customer attempting to switch. The parties would appear to be able to recoup the cost of withholding eggs relatively quickly even on the assumption that the wholesale price remains unaltered.
33. Also, as discussed in Appendix E, it would appear likely that the merger has improved the bargaining position of the merging parties by making the threat of withholding eggs more credible.
34. Finally, the parties' analysis seeks to quantify the financial impact on a supplier of an impasse in negotiations with a retailer. However, in order to assess the relative bargaining power of buyer and seller, it is also important to assess the financial impact of an impasse in negotiations on the buyer.

Summary

35. In summary, the parties' critical loss estimates show that at current prices retailers would need to switch a substantial volume of sales to alternative suppliers in order to render a 5 per cent increase in price unprofitable. This would appear to be highly unlikely given the availability constraints outlined in Appendix E. The parties argue however that their estimates would be unreliable for large changes in volume due to uncertainties over the impact of large scale switching on the wholesale price for egg.

36. However, even when these estimates are adjusted to take account of the potential impact of switching on the wholesale price (see Tables 2 and 3), and hence on the parties' avoidable costs, the critical loss would still appear large given the limited available capacity (in terms of available egg supplies) amongst the parties' competitors, particularly with respect to non-cage eggs.
37. The parties seek, in part (ii) of their paper, to demonstrate that the capacity constraints of their rivals are not binding. They argue that there would be a clear incentive, in the event of a customer deciding to switch, for Noble to release its surplus eggs. The parties' calculations of the financial implications of a loss of sales do not appear to demonstrate that they would have a clear incentive to release eggs.
38. In addition there is no indication how the merger may have affected these incentives.
39. The parties' calculations are also based upon a fixed wholesale price. If we were to believe the parties argument that the wholesale price would fall in the event of large scale customer switching, the cost of withholding eggs (and thereby thwarting customer switching) evaporates.
40. It would seem that, for larger volume shifts, the critical loss necessary to render a price rise unprofitable may be smaller. However this will also impact upon the parties' incentives to withhold eggs as the relative cost of thwarting customer attempts to switch by withholding eggs would be much reduced—or in the case of Tables 2 and 3 above, the cost of processing eggs and thereby thwarting customer switching would be equal to the cost of releasing those eggs to a rival.

Analysis of contributions

1. As part of our assessment of the buyer power defence advanced by the parties, we need to assess the breadth of buyer power. One way to assess this is to look at the relative profitability of customers to Deans. We may expect profitability to be lower for contracts with customers who have stronger bargaining power.
2. Price and cost data from Deans were used to calculate the gross contribution to overheads, which was calculated as the net price less a measure of variable cost,³³ as a percentage of net price. This figure gave us a relative measure of profitability.
3. We use this measure to examine whether Deans' profitability differs significantly by customer (possibly due to negotiating strength). Section A looks at average profitability for a number of Deans' customers. Section B examines the profitability over time of the most popular, comparable SKUs at the major retailers, whilst section C looks at the most popular SKUs, regardless of whether they are of the same egg and pack size. Finally, section D looks at the weighted average contribution of SKUs by egg type across various customer groups.
4. The evidence appears to suggest that [✂].

A. Average monthly sales and contributions

5. The following charts present the average monthly sales (number of cases) and contributions for selected customers for all egg types, and separately for cage and free range eggs. Error Bars representing two standard deviations above and below the average percentage monthly contribution are shown, to give an impression of the

³³[✂]

degree of variability of the contribution over time. The period covered is January 2001 until September 2006, although it should be noted that not all suppliers were contracted with Deans for the duration of this period.

FIGURE 1

Average monthly sales and contributions for selected customers (all eggs)

[✂]

Source: CC analysis of data provided by Deans.

FIGURE 2

Average monthly sales and contributions—cage eggs

[✂]

Source: CC analysis of data provided by Deans.

FIGURE 3

Average monthly sales and contributions—free range eggs³⁴

[✂]

Source: CC analysis of data provided by Deans.

6. In each of Figures 1 to 3 above, contributions do not appear to increase as customers become smaller (ie smaller customers do not appear to be making a lower percentage contribution to Deans' overheads). Deans' sales of cage eggs to [✂] appear to be slightly less profitable on average. However, the same is not true for free range sales and without reviewing time series data it is difficult to assess how consistent an effect this is.

B. Contribution of highest selling comparable SKUs across customers

7. Figure 4 presents the percentage contributions over time for the most popular, comparable³⁵ cage egg SKUs (ie those where the egg type and size and pack size are the same). The highest volume cage SKU at most of Deans' large retail

³⁴[✂]

³⁵Popular SKUs have been chosen which are of the same egg and pack size at each retailer, and of the same egg type.

customers was the [redacted].³⁶ Details of the individual SKUs used in Figure 4 appear in Table 1.

TABLE 1 **Cage SKUs selected**

Retailer	Code	Description	Cases	% of total of	
				retailer's cage cases	Retailer's cage SKU rank by volume
[redacted]					

Source: CC study.

FIGURE 4

Contribution – large retailers (MWT cage eggs, most popular 15 pack)

[redacted]

Source: CC analysis of data provided by Deans.

8. Figure 4 indicates that profitability across retailers appears to follow a broadly similar pattern over time. It appears that [redacted] is a less profitable customer for Deans, and there appears to be some evidence, though less obvious, of systematic differences for the other retailers. However it is important to remember that this is only one of many SKUs.
9. Figure 5 shows how the contribution over time varies for large free range egg six packs, [redacted]. Table 2 details the exact SKUs used.

³⁶[redacted]

TABLE 2 Free range SKUs selected

<i>Retailer</i>	<i>Code</i>	<i>Description</i>	<i>Cases</i>	<i>% of total of retailer's cage cases</i>	<i>Retailer's cage SKU rank</i>

FIGURE 5

Contribution – large retailers (large free range eggs, most popular six pack)

[✂]

Source: CC analysis of data provided by Deans.

10. Again, profitability across retailers appears to follow a broadly similar pattern over time. However, given the variation in the data it is not clear that any one of these customers is making a consistently better contribution on free range eggs, other than [✂] since [✂].

11. In summary, section B has not found strong evidence that any one of the selected customers is less profitable for Deans when popular, comparable SKUs are examined over time ([✂]). This is consistent with the findings in section A.

C. Contribution of the top selling SKU across customers

12. Next, the contribution of the highest selling SKU for each retailer—regardless of pack size—was plotted.

13. Table 3 lists the highest selling cage egg SKU for each major retailer and Figure 6 illustrates their profitability over time. Again, there does not appear to be evidence to suggest that any one customer is obtaining a better deal, although variation in the data makes this more difficult to assess. Deans' sales of cage eggs to [✂] are consistently less profitable for Deans than sales to the other retailers shown.

TABLE 3 Cage SKUs selected

<i>Retailer</i>	<i>Code</i>	<i>Description</i>	<i>Cases</i>	<i>% of total of retailer's cage cases</i>	<i>Retailer's cage SKU rank</i>
()					



FIGURE 6

Contribution of the most popular cage SKU for the main retailers

[✂]

Source: CC analysis of data provided by Deans.

14. Table 4 details the most popular free range SKUs for each retailer, whilst Figure 7 illustrates their contributions over time. As found in Figure 5 in section B, the only retailer consistently making a smaller percentage contribution to Deans' overheads appears to be [✂] since [✂].

TABLE 4 Free range SKUs used

<i>Retailer</i>	<i>Code</i>	<i>Description</i>	<i>Cases</i>	<i>% of total of retailer's free range cases</i>	<i>Retailer's free range SKU rank</i>
[✂]					

FIGURE 7

Contribution of the most popular free range SKU for the main retailers

[✂]

Source: CC analysis of data provided by Deans.

D. Weighted average contribution across customer groups³⁷

15. In this section, we look at weighted average contributions and examine whether any particular customer group is less profitable for Deans.³⁸ Initially, we look at the relative profitability of the large retailers. Then we assess whether the weighted average contribution of smaller retail customers and food service customers is significantly different, using the weighted average contribution of the [X] account as a comparator.
16. The following figures present weighted average contributions over time across the full range of SKUs sold to various customers.

Cage eggs

17. Figure 8 does not appear to indicate [X].

FIGURE 8

Major retailer contributions—cage eggs

[X]

Source: CC analysis of data provided by Deans.

18. Figure 9 suggests that there is no clear evidence that smaller retailers are more profitable for Deans than [X].

FIGURE 9

Smaller retailer contributions—cage eggs

[X]

Source: CC analysis of data provided by Deans.

19. Figure 10 suggests that there is no clear evidence to suggest that food service customers are more profitable for Deans than [X].

³⁷The analysis carried out in this section is of volume weighted averages.

³⁸A weighted average is used in this section because when comparing a larger set of customers it is more difficult to find individual SKUs that are comparable across all customers.

FIGURE 10

Food service contributions—cage eggs



Source: CC analysis of data provided by Deans.

Free range

20. Again, Figures 11 and 12 do not appear to suggest substantial, systematic differences in the profitability of Deans' customer accounts. Figure 12 does not appear to suggest that smaller retailers are systematically less profitable for Deans than [✂].

21. As few catering and wholesale customers supply free range eggs, Figure 13 provides limited information. Data problems mean that [✂] cannot be included in the chart. It is therefore difficult to draw conclusions about the relative profitability of catering and wholesale customers for free-range eggs.

FIGURE 11

Major retailer contributions—free range eggs



Source: CC analysis of data provided by Deans.

FIGURE 12

Smaller retailer contributions—free range eggs



Source: CC analysis of data provided by Deans.

FIGURE 13

Catering and wholesale contributions—free range eggs



Source: CC analysis of data provided by Deans.

Summary

22. In summary, there is no evidence that the size of a customer negatively affects the relative profitability for Deans. There is also no clear evidence to suggest that large retailers are relatively less profitable for Deans. Deans may be making lower profits on its cage egg sales to [redacted], but this does not apply consistently to free range eggs. As noted, variation in the data over time makes it difficult to draw definitive conclusions.