



**James Budgett Sugars Ltd and
Napier Brown Foods PLC**

A report on the acquisition by Napier Brown Foods PLC
of James Budgett Sugars Ltd

March 2005

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Note by the Competition Commission

The Competition Commission has excluded from this report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002. The omissions are indicated by [✂].

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Acquisition of James Budgett Sugars Ltd by Napier Brown Foods PLC

Contents

	<i>Page</i>
Summary.....	3
Findings	6
1. The reference	6
2. The products and companies	6
The basic product: sugar.....	6
Napier Brown Foods	7
James Budgett Sugars.....	7
3. Backround to the merger and the relevant merger situation	7
The EU sugar regime	7
Sugar production in the UK	8
Effect of the sugar regime on NBF and JBS	8
Changes to the EU sugar regime	8
Implications of reform for our inquiry	9
The transaction and rationale for the merger	10
Jurisdiction	10
4. Market definition.....	11
Product market.....	12
Sweeteners	12
Industrial and retail.....	12
Types of sugar.....	13
Geographic market.....	13
Impact of EU sugar regime on imports.....	13
Pricing strategies of British Sugar and Tate & Lyle	14
Northern Ireland	14
Imports into Great Britain from other EU countries	14
Relative prices.....	15
Additional barriers to imports.....	15
Trends in the level of imports	16
Competitive constraints imposed by imports.....	16
Conclusions on market definition	17
5. Assessment of the competitive effects of the merger.....	17
Counterfactual and failing firm issues	17
Evidence from NBF	17
Evidence from JBS.....	17
Evidence from ED&F Man and Greencore.....	18
JBS financial performance, margins and customer gains and losses	18
Future of JBS	18
Conclusions on the counterfactual	19
Suppliers of sugar to industrial users	19
British Sugar and Tate & Lyle.....	19
NBF and JBS.....	20
Smaller resellers, overseas sugar producers and their agents	20
Factors affecting rivalry in the relevant markets prior to the merger	20
Concentration	20
Evidence from NBF	21
Evidence from third parties.....	21
Assessment of customer survey and bidding data.....	22
Conclusions on existing competition in the relevant market.....	23
Market entry, exit and expansion	24
Effects of the merger	25

Effect on concentration.....	25
Effect on prices.....	25
Effect on service, support, product choice and innovation	27
Conclusions on the effect of the merger on prices, service, product choice and innovation.....	27
Coordinated effects	27
Pre-merger conditions	28
Awareness of competitor behaviour	28
Incentives to conform	29
Competitive constraints.....	30
Additional evidence of coordinated effects prior to the acquisition.....	31
Effect of the merger on coordinated effects	31
Impact on awareness of competitor behaviour.....	32
Impact on incentives to conform.....	32
Impact on competitive constraints	32
Conclusion on impact of merger on coordinated effects	32
6. Findings.....	32

Appendices:

- A: Terms of reference
- B: Financial information on NBF
- C: Financial information on JBS
- D: The EU sugar regime
- E: Summary of decisions
- F: Sugar and Sweeteners
- G: Imports
- H: Market shares and concentration
- I: Negotiations and volumetric pricing
- J: Barriers to entry and expansion

Glossary

Summary

1. On 12 October 2004, the Office of Fair Trading (OFT) referred the completed acquisition by Napier Brown Foods PLC (NBF) of James Budgett Sugars Ltd (JBS) to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). We are required to publish our final report by 28 March 2005.
2. NBF is the largest distributor of sugar in the UK that is not also a sugar producer. It was incorporated on 18 July 2003 as a holding company, initially to acquire Napier Brown & Company Limited, a distributor of sugar in the UK, Garret Ingredients Ltd, a supplier of sugar, dairy products blends and associated ingredients to the food industry, and Sefcol Ingredients Ltd (Sefcol), a supplier of value-added sugar and nut products. JBS is the second largest non-producing distributor of sugar in the UK. On 7 July 2004 NBF acquired from ED&F Man Holdings Limited (ED&F Man) and Greencore Group plc (Greencore) the entire issued share capital of JBS.
3. As a result of the transaction, NBF and JBS ceased to be distinct. The UK turnover of JBS exceeded £70 million, so the turnover test set out in section 23(1)(b) of the Act was satisfied. We therefore conclude that a relevant merger situation had been created.
4. The supply of sugar within the UK takes place within the context of the EU sugar regime, established in 1968 as part of the Common Agricultural Policy. This involves a system of national quotas and price support that has been extensively criticized for a lack of competition, distortions in the market, high prices for the consumers and users, and its effect on the world market, particularly in relation to developing countries. British Sugar plc (British Sugar) holds the UK quota for production of sugar from beet, and Tate & Lyle PLC (Tate & Lyle) is the sole UK producer of preferential sugar from cane.
5. The current European Council Regulation¹ governing the sugar regime covers the period until 30 June 2006, and on 23 November 2004 the European Commission announced that it would bring forward proposals for future legislation in May or June 2005. These proposals are expected to incorporate significant reforms, although there remains uncertainty over the details of the new regime and its timetable for implementation, and considerable divergence of view on the eventual implications for different EU countries and companies within individual countries. We therefore assessed the implications of the merger under existing circumstances, whilst taking into account changes already occurring in anticipation of reform.
6. Sugar is sold in various forms which, for convenience, can be divided into three broad categories: white granulated sugar, liquid sugar and speciality sugars. Differences in packaging and branding for supply to industrial users and for retail appear to be sufficient to enable different prices to be charged to the two groups, and so constitute separate product markets. JBS supplies sugar to industrial users only. Supply-side substitutability led us to conclude that different types of sugar do not constitute separate product markets for industrial users. Problems with technical feasibility of substitution, economic viability of substitution and regulatory restrictions on substitution, led us to conclude that other sweeteners do not form part of the same product market.

¹Council Regulation (EC) No 1260/2001 of 19 June 2001. 32001R1260.

7. Imports of sugar sold into Great Britain by suppliers in other EU member states comprise around 5 per cent of sugar in the British industrial market and have shown no discernible trend over recent years. It appears that imports from other EU countries are subject to a variety of constraints, of which the most important is the strategy of British Sugar in pricing to ensure that no sustainable financial incentive exists for the import of material volumes of sugar into its domestic market. British Sugar is acknowledged as the price leader, and under this strategy the threat of imports essentially imposes an upper bound on sugar prices in Great Britain. It appears to us that sugar prices in Great Britain are higher than those prevailing on the Continent, and that this pricing position has been sustainable over a period of time without causing imports to grow beyond their observed low level. This led us to conclude that imports of sugar to Great Britain by other EU sugar producers have so far exerted an insufficient constraint on sugar suppliers in Great Britain for us to conclude that the geographic market is wider than Great Britain. We noted recent attempts by some Continental sugar producers to increase sales in Great Britain. But, in view of the success so far of British Sugar's pricing strategy, we decided that it is too soon to say whether such attempts will be successful in practice, and/or be sufficient to force prices in Great Britain down to those prevailing in neighbouring Continental countries.
8. We concur with the view in previous decisions by the European Commission that Northern Ireland is not part of the same geographic market as Great Britain, due to different supply conditions which reflect transport costs and the role of sugar imported from the Republic of Ireland.
9. These considerations on the product market and the geographic market lead us to the view that the relevant market is the supply of sugar products to industrial users in Great Britain.
10. Prior to the acquisition, NBF accounted for 17 per cent of the supply of sugar products to industrial users in Great Britain by volume and JBS accounted for 8 per cent. They compete with the only two UK sugar producers, British Sugar and Tate & Lyle, with some overseas producers of sugar and their agents, and with numerous smaller resellers of sugar. The market is highly concentrated with British Sugar, Tate & Lyle, NBF and JBS collectively having a market share of over 90 per cent by volume.
11. Competition in this market is significantly affected by the operation of the EU sugar regime, with the extent and nature of competition between the UK sugar producers and the resellers strongly influenced by the decisions of the producers, on whom the resellers are largely dependent for supplies. The market appears to be characterized by a high degree of price discrimination in which the UK sugar producers can, and do, target particular customers and exert considerable influence over the ability of NBF, JBS and the other resellers to compete both with the producers themselves and with each other. NBF, JBS and other resellers that are reliant, either directly or indirectly, upon the UK producers for supply are able to exercise little constraint on the prices to sugar users charged by the UK producers beyond the limited amount arising from their potential to sell imported sugar to industrial sugar users which otherwise would not be in a position to obtain imported sugar, or do so only at a higher price.
12. The market is characterized by extended and complex negotiation processes in which NBF, JBS and other resellers of sugar often negotiate with customers in competition with their suppliers and, around the same time, with those suppliers for the sugar they need. Analysis of data from our customer survey and information on negotiations supplied by British Sugar, NBF and JBS showed that annual contracts

account for the majority of transactions in terms of volume, with NBF bidding against JBS in a relatively small proportion of cases. It also revealed considerable differences in the price paid for sugar by different customers, which could not be explained by factors such as volume purchased, for which the relationship to price appeared weak. Our analysis indicated that the final price paid decreased as the number of bidders increased, but did not suggest that the outcome of the negotiation process is significantly affected by the presence of JBS as opposed to another supplier. Nor did it suggest that JBS is consistently more competitive on price than other suppliers.

13. Considerations such as volume of sugar purchased and transport costs are taken into account in these negotiations, but the terms of supply agreed with each customer are determined by a process of bilateral negotiation in which the relative strength and skill of the parties involved are important factors. There is considerable inertia in the market, with customers switching supplier infrequently but when they do so, price is the most significant factor.
14. JBS was not a failing firm. We accept that it would have been likely to continue to suffer from declining volumes in the absence of the merger, but we conclude that for the timescale relevant to our inquiry, this would not have threatened its ability to compete. We conclude that, in the absence of the merger, the relevant counterfactual is that JBS would have continued to compete in the supply of sugar to industrial users in Great Britain with its existing strategy and under the ownership of ED&F Man and Greencore.
15. The acquisition of JBS by NBF reduces the choice of supplier available to users of industrial sugar in Great Britain. Any adverse impact is most likely to occur in the small number of cases where JBS was the main competitor to NBF and suitable alternative suppliers are not brought into the negotiating process. However, where the merged company is in competition with British Sugar and Tate & Lyle, it will have limited unilateral ability to raise prices. In other cases, particularly in relation to customers requiring amounts of sugar below 100 tonnes a year and where sugar is purchased alongside other ingredients, its ability to raise prices will be constrained by competition from other resellers and importers. If it were to raise prices to particular types of customer, making those customers increasingly profitable to supply, British Sugar and Tate & Lyle would have an increased incentive to compete, strengthened by their desire to avoid prices becoming out of line with those elsewhere in the market, thereby creating an opportunity for imports. These considerations lead us to conclude that any impact from the acquisition of JBS by NBF will be limited in terms of the overall market, and we would not expect any general rise in prices. Accordingly, we do not expect that the acquisition of JBS by NBF will, in the absence of any impact on coordinated effects, lead to prices being higher than would otherwise have been the case. Nor do we expect that it will lead to a reduction in service, support, product choice or innovation.
16. We considered carefully the effect of the merger on coordinated effects. We conclude that it is likely that coordinated effects were present prior to the merger, but that the merger does not make coordinated effects significantly more sustainable or effective.
17. On this basis, we conclude that the acquisition of JBS by NBF has not resulted, and may not be expected to result, in a substantial lessening of competition (SLC).
18. At a late stage in the inquiry, on 8 March 2005 NBF announced that it was in discussions with a third party, which might or might not lead to an offer being made for its share capital. We are satisfied that these developments do not affect our conclusions or finding.

Findings

1. The reference

- 1.1 On 12 October 2004, the OFT referred the completed acquisition by NBF² of JBS to the CC for investigation and report. The reference was made under section 22 of the the Act. Our terms of reference are set out in Appendix A. We are required to publish our final report by 28 March 2005.
- 1.2 This document, together with the appendices, constitutes our findings. Further information, including non-commercially sensitive versions of main party and third party written submissions and details of a survey of industrial sugar users conducted on behalf of the CC by NOP (the customer survey) can be found on our web site.³ We cross-refer to these documents where appropriate.

2. The products and companies

The basic product: sugar

- 2.1 Sugar is the conventional name for sucrose, which is extracted from sugar beet or from sugar cane. It can be divided into three broad categories:
- (a) white granulated sugar, a solid crystallized product used primarily in the food and drinks industry and which constitutes around 80 per cent of sugar sales in the UK;
 - (b) liquid sugar, produced by dissolving granulated sugar in water or as a by-product of the sugar cane refining process and used mainly by the food processing industry; and
 - (c) speciality sugars, covering a wide variety of products, typically derived by processing granulated sugars (eg grinding granulated sugar to produce icing sugar) or by stopping the production process at a different stage (eg unrefined sugar).
- 2.2 Neither NBF nor JBS produce sugar themselves, but handle sugar from both the UK producers and from imports. In the past they acted primarily as nominal merchants, serving as *del credere* agents for the producers (processing orders, invoicing customers and collecting payments), which delivered the sugar to the customers and paid them a flat rate fee. Although both NBF and JBS still act as nominal merchants in some cases, they now function mainly as principals, buying and selling sugar on their own account. Commonly known as 'sugar merchants', NBF and JBS are the largest members of a group of resellers that buy sugar from the UK and overseas producers, and from others that have obtained sugar from the producers, for supply to industrial sugar users and retail outlets in the UK.
- 2.3 NBF and JBS overlap in the supply of sugar (granulated, liquid and speciality) to industrial users. NBF additionally supplies sugar for retail, and mills, sieves and packs brown and white sugars at its factory near Normanton in Leeds. JBS does not

²In this report we use NBF to refer to Napier Brown Foods PLC or its subsidiary Napier Brown & Company Ltd as the context requires. For details of the company structure see paragraph 2.4 and Appendix B.

³www.competition-commission.org.uk.

supply sugar for retail nor have any large-scale packaging or blending facility equivalent to NBF's Normanton plant.

Napier Brown Foods

- 2.4 NBF is the largest distributor of sugar in the UK that is not also a sugar producer. In the period from incorporation on 18 July 2003 to 28 March 2004 it generated turnover of £194 million.⁴ It was incorporated as a holding company, initially to acquire Napier Brown & Company Limited, a distributor of sugar in the UK, Garret Ingredients Limited, a supplier of sugar, dairy products blends and associated ingredients to the food industry, and Sefcol, a supplier of value-added sugar and nut products. In September 2004 it additionally acquired JF Renshaw Ltd and Renshaw Scott Ltd, a producer of products for use in baking including marzipans, ready to roll icings, baking chocolate and jam. The headquarters of NBF, which is listed on the Alternative Investment Market (AIM), are at St Katherine's Dock, London.
- 2.5 Appendix B provides further information on NBF, showing the current structure of the Napier Brown group of companies plus additional financial data.

James Budgett Sugars

- 2.6 JBS is the second largest non-producing distributor of sugar in the UK. In the period ending 24 October 2004, it generated turnover of £105 million. It describes itself as a sugar merchant, packing and processing company. Its headquarters are in Chelmsford, Essex. It operates a small processing plant at Ledbury, Gloucestershire, where it produces speciality sugars for the pharmaceutical industry and packs spray glucose and granulated sugar under contract. However, it began scaling back activities at Ledbury in April 2003 and the only continuing activity is now packing and storing of dried glucose for [X] and the production of caster, icing and powdered sugar for [X]. Prior to its acquisition by NBF it was owned by ED&F Man (67 per cent), a global merchant in agricultural products and Greencore (33 per cent), of which Irish Sugar Ltd (Irish Sugar) is a subsidiary.
- 2.7 Appendix C provides further information on JBS, including, in particular, more financial data.

3. Background to the merger and the relevant merger situation

The EU sugar regime

- 3.1 The European Union (EU) sugar regime, established in 1968 as part of the Common Agricultural Policy, involves a system of quotas and price support that severely limits the scope for, and extent of, competition between suppliers and has resulted in the price of sugar in the EU being three to four times the world price, with persistent production of surplus sugar that has typically exceeded 10 per cent of production under quota. The regime is described in Appendix D. The regime has been extensively criticized for limiting competition by blocking non-preferential imports from outside the EU, inhibiting the use of substitute products, assigning quotas to incumbent firms and preventing the entry of new firms, separating markets

⁴Source: NBF annual report and accounts for the period to 28 March 2004. As NBF acquired subsidiary companies on 18 December 2003 the profit and loss account includes the results for those companies from that date. The figure of £194 million quoted above is a pro forma figure which shows the adjusted result of NBF, had it owned the subsidiary companies for the full period to 28 March 2004.

geographically through the allocation of quotas at national level, subsidising excess production and exports and providing a retaliatory mechanism that enables firms to use the threat of shifting sugar from exports to sales within the EU.⁵

Sugar production in the UK

- 3.2 Within the UK, sugar produced from beet is supplemented by sugar refined from raw cane sugar imported from African, Caribbean and Pacific (ACP) countries under preferential agreements (preferential sugar). British Sugar plc (British Sugar) is the sole processor of domestically-produced sugar beet, with a sugar quota of slightly over 1.1 million tonnes. Tate & Lyle is the sole refiner of imported cane sugar, producing some 1.1 million tonnes of preferential sugar.⁶ A previous inquiry into the UK sugar market found that one consequence of the sugar regime was to provide Tate & Lyle with lower processing margins than those enjoyed by British Sugar, and that British Sugar is the price leader in the UK.⁷ This was not disputed by any contributor to our present inquiry, and we see no reason to dissent from these views.

Effect of the sugar regime on NBF and JBS

- 3.3 A previous inquiry⁸ noted that one effect of the introduction of the EU sugar regime in the UK was to change the role of NBF and JBS, reducing their ability to profit from skilful trading against movements in the world sugar price and hedging of purchases on the London Sugar Market. It found that following the accession to the EU of the UK they became heavily dependent upon supplies of sugar from British Sugar and Tate & Lyle and provided competition mainly by restraining the ability of those companies to charge excessively for distribution, and by importing sugar from Continental Europe. In undertakings to the European Commission in 1986, British Sugar accepted the need for sugar merchants and stated that it believed that they had a useful function to perform in the UK market. British Sugar further stated that it had no intention then or in the future of undertaking any pricing practice which might in any way damage the continued existence of the merchants. In 1988 the European Commission found that British Sugar had abused its dominant position by refusing to supply industrial granulated sugar to NBF, by reducing its prices for retail sugar to the extent that an insufficient margin existed between its prices for retail and industrial sugar, by refusing to sell sugar unless it was on a delivered-price basis, by discriminating against NBF in refusing to supply exclusively beet-origin sugar to NBF whereas it supplied exclusively beet-origin sugar to other purchasers at their request, and through other practices.⁹

Changes to the EU sugar regime

- 3.4 The sugar regime is renegotiated every five years and is currently governed by Council Regulation (EC) No 1260/2001 of 19 June 2001, which is applicable until 30 June 2006, at which point agreement on a new regime is necessary if it is to continue. Pressures for reform have arisen both from within the EU, and from outside. Pressures for reform from within the EU include:

⁵For a list of relevant previous investigations by UK competition bodies and decisions of the European Commission see Appendix E.

⁶For the purpose of this report, the limit on Tate & Lyle's production of sugar from raw cane sugar for sale within the EU is referred to as a quota. Quotas apply to the UK as a whole, and British Sugar and Tate & Lyle are therefore referred to in this report as the UK sugar producers, but no sugar is produced in Northern Ireland.

⁷Tate & Lyle PLC and British Sugar plc. MMC 1991.

⁸See footnote 8.

⁹EC Case No. IV/30.178. Napier Brown/British Sugar. Decision of 18/07/1988.

- a desire to bring the sugar regime more in line with other sectors of the Common Agricultural Policy which have moved away from price support towards direct support for farmers;
- the effects of EU sugar prices being substantially higher than world prices; and
- concerns over the regime's impact on competition in the sugar industry.

Pressures for reform from outside the EU arise from:

- international trade negotiations;
- World Trade Organisation (WTO) rulings, most recently the WTO panel decision on 15 October 2004 upholding a complaint from Brazil, Thailand and Australia over subsidies on EU exports; and
- the so-called 'Everything but Arms' (EBA) unilateral arrangement under which the EU is committed progressively to decrease import tariffs and increase import quotas of cane sugar from 46 Least Developed Countries (LDCs) between 2006 and 2009, at which point quotas and tariffs are scheduled to disappear completely for these countries.

3.5 In July 2004 the European Commission published suggestions for reform of the EU sugar regime including a reduction in the support price for sugar and in production quotas, introduction of direct income support to farmers, subsidisation of closure of inefficient factories and transferability of quotas between member states. However, many of the practical aspects of the reform have yet to be determined, including the length of the replacement regime, how the proposed quota transfer system would work in practice, the method for allocating quota cuts, and future arrangements governing refining of cane sugar within the EU. On 23 November 2004 the European Commission announced that it would bring forward proposals for future legislation in May or June 2005 following the expected ruling on its appeal against the WTO's panel decision on 15 October 2004. It hoped that political agreement could be reached in time for the WTO ministerial meeting in Hong Kong in December 2005. However, we were told by Defra that agreement between the Member States may prove difficult to reach and that the Council may decide to defer the implementation of certain aspects of its decision to allow the supply chain to adjust to changes.

Implications of reform for our inquiry

3.6 Reform of the EU sugar regime could have significant implications for the UK sugar market and we considered carefully its implications for our inquiry. There was general agreement among those who provided evidence to us that any changes were unlikely to be introduced before July 2006 and there remains uncertainty over the details of the new regime and the timing thereafter. There was considerable divergence of view on the eventual implications for different EU countries and companies within individual countries. Whereas some saw it as providing NBF and JBS with new opportunities to act as distribution channels for increasing imports, others saw it as posing a threat to their continuing role with reducing prices leading to a squeeze on the margins available to them. Whilst we do not underestimate the potential significance of the changes, we were unable to speculate with any certainty on the eventual outcome or its implications for individual sugar producers and resellers of sugar in the UK or form an expectation of what the results would be. In accordance

with the CC guidelines¹⁰ we therefore take the view that we must assess the implications of the merger under existing circumstances, whilst taking into account any changes in the relevant market(s) occurring in anticipation of reform of the EU sugar regime.

The transaction and rationale for the merger

- 3.7 On 7 July 2004 NBF acquired from ED&F Man and Greencore the entire issued share capital of JBS for £17.3 million, of which £16.8 million was payable on the date of acquisition (£11.5 million was in cash and the balance in new ordinary shares in NBF). A further £0.5 million cash was payable on the second anniversary of completion. This followed an original approach by NBF to ED&F Man regarding the potential acquisition of JBS in [REDACTED]. ED&F Man told us that no other approaches or offers were received or sought from any other parties.
- 3.8 NBF told us that its commercial strategy is to identify and take advantage of cross-selling opportunities across its customer base, to achieve cost savings where possible and to acquire businesses with added value products, with a view to diversifying and broadening its product range. Against this background, NBF told us that its rationale for the purchase of JBS was:
- to save costs and create efficiencies through integration of the two businesses, taking advantage of economies of scale through the [REDACTED], purchase of sugar at lower prices and negotiation of cheaper haulage costs;
 - to provide NBF with the opportunity to cross-sell its range of value-added products to an enlarged and largely complementary customer base; and
 - to increase NBF's volumes of sugar with a view to maintaining market share, and staying as well-placed as possible to take advantage of commercial opportunities presented by changes to the EU sugar regime.

Jurisdiction

- 3.9 We are required to establish whether a relevant merger situation has been created and, if so, whether the creation of that situation has resulted, or may be expected to result, in an SLC within any market or markets in the UK for goods or services. A relevant merger situation exists where two or more enterprises have ceased to be distinct and either the turnover test or the share of supply test specified in the Act is satisfied.
- 3.10 As a result of the transaction described in paragraph 3.7, NBF and JBS have ceased to be distinct enterprises.
- 3.11 Under section 23(1)(b) of the Act, for the turnover test to be satisfied the value of the turnover in the UK of the enterprise being taken over must exceed £70 million. For a completed merger, we are required to determine this by looking at the turnover for the business year¹¹ preceding the date when the enterprises concerned ceased to be distinct enterprises (in this case, 7 July 2004) or such date as we, as the decision-making authority, consider appropriate. JBS's business year preceding 7 July 2004

¹⁰Merger references: *Competition Commission Guidelines (CC2)*. Paragraph 1.22.

¹¹'Business year' is defined in S.I.2003/1370 as 'a period of more than 6 months in respect of which an enterprise or, if applicable, the business of which it forms part, prepares or is required to prepare accounts'.

ran from 1 November 2002 to 31 October 2003 and the turnover of JBS in the UK in that period was £119.1 million.

- 3.12 Since the turnover test is satisfied we are not required to consider the share of supply test.
- 3.13 We therefore find that the acquisition of JBS by NBF resulted in the creation of a relevant merger situation. This was not disputed by any party during the course of our inquiry.

4. Market definition

- 4.1 An important element in deciding whether a merger would result in an SLC is to define the relevant market or markets. There are normally two dimensions to the definition of a market, the product market and the geographic market. The boundaries of these are determined by substitutability; that is, the extent to which customers can readily switch between substitute products or locations, or suppliers can readily switch their facilities between the supply of alternative products or locations. The generally accepted conceptual approach seeks to identify the extent to which customers and suppliers could readily demand, or supply, adequate substitute products in response to a small but significant non-transitory increase in price (SSNIP) imposed by a hypothetical monopolist. The CC does not regard market definition as an end in itself, but rather as a framework within which to analyse the effects of a merger on competition.
- 4.2 The CC guidelines¹² note that where prices are already substantially above the competitive price level that might otherwise prevail, applying the SSNIP test might suggest that a significant number of purchasers would stop buying a product, or would switch to alternatives that, had the market been competitive and prices at competitive levels, would not otherwise have been regarded as reasonable substitutes.¹³ As described in paragraph 3.1, one consequence of the EU sugar regime is that existing prices for sugar within the EU are significantly above the prices on the world sugar market. The results of a SSNIP test might, therefore, suggest that other products should be included in the product market even though they would not have been seen as substitutes had the competitive price level been used as the starting point for the test. Although we have used the SSNIP framework to assist our consideration, we have not sought to conduct a quantitative SSNIP test in this case. In our considerations we have, however, taken into account a range of relevant information on past behaviour in the market regarding substitution between suppliers and products, physical characteristics of the product and technical substitutability, the existence of different categories of customers and price discrimination, barriers to and costs of switching. We have drawn on evidence provided by the main parties and a range of third parties including customers, competitors and suppliers, provided both directly to us and in response to the customer survey.

¹²*Merger references: Competition Commission Guidelines (CC2)*. Paragraph 2.9.

¹³This problem is generally known as the 'cellophane fallacy' after the Du Pont case in the US (US v Du Pont de Nemours & Co, [1956] 351 US 377).

Product market

Sweeteners

- 4.3 We began by considering whether sweetening products other than sugar should be considered part of the same product market. We considered High Fructose Syrup (HFS) and Inulin syrup, polyols approved for food use within the EU such as Sorbitol, Xylitol, Lactitol, Mannitol, Maltitol and Isomalt, and High Intensity Sweeteners (HIS) such as Aspartame, Saccharine, Cyclamate and Acesulfame-K. We examined in each case the technical feasibility of substitution, the economic viability of substitution and the implications of regulatory restrictions under the EU sugar regime. Further information summarizing the main functional properties of sugar and substitutability issues is in Appendix F.
- 4.4 HFS is technically substitutable for sugar in certain industries, particularly in the manufacture of soft drinks, although in other industrial processes HFS lacks some important properties of sugar (for example, its bulking properties are inferior to those of sugar and it is not possible to produce a jam that sets by just using HFS). The production costs of HFS are below those of EU-produced sugar, and so could potentially be an economically attractive alternative to manufacturers. However, since HFS is regulated by a quota under the EU sugar regime, it is at present not possible to use HFS as a substitute for sugar on a significant scale.
- 4.5 Inulin syrup is technically substitutable for sugar in certain industries (similar to HFS), but low demand for inulin syrup suggests that it is not an economically viable alternative. It is also subject to a quota restriction in the EU, and so, at present, is not a viable substitute for sugar.
- 4.6 Polyols have different characteristics to sugar, and so are generally only technically feasible substitutes for sugar in the production of diet products and diabetic foods. Polyols are more expensive than sugar, and so are not economically viable alternatives.
- 4.7 HIS are cheaper than sugar and so are economically viable substitutes. However, HIS have different characteristics from sugar, and, like polyols, they are generally only technically feasible substitutes for sugar in the production of diet products and diabetic foods so the potential for substitution is relatively small.
- 4.8 Given problems with technical feasibility of substitution, economic viability of substitution and regulatory restrictions on substitution, other sweeteners do not appear to form viable close substitutes for sugar. In response to a SSNIP of sugar, it is unlikely that industrial customers would switch to other sweeteners as an alternative to sugar on a sufficient scale to make this unsustainable. Therefore, we conclude that other sweeteners do not form part of the same product market as sugar. This conclusion is confirmed by evidence collected from industrial sugar users. Statements made to the CC suggest that the potential for substitution is limited not by cost, but by the technical characteristics of sweeteners and their ultimate impact on the quality of the product. Larger industrial sugar users appear to have already taken advantage of most of the substitution possibilities available to them and, therefore, an increase in the price of sugar would not lead to a significant increase in the use of alternative sweetening products.

Industrial and retail

- 4.9 We next considered whether the supply of sugar to industrial users is a separate market from retail. The British sugar producers and resellers tend to view demand for

sugar from industrial users and from retailers as being differentiated on the basis of size of packaging and branding. These distinctions appear to be sufficient to enable different prices to be charged to each of the two groups of customers as a result of consumers' unwillingness to buy the very large bags of sugar sold to industrial users and the constraints on arbitrage arising from the costs of repackaging and strong sugar brands in the retail sector. Whilst demand-side substitution between retail sugar and industrial sugar is very limited, there may be greater scope for supply-side substitution.

- 4.10 In the present case, we take the view that the relevant product market is the market for supply of sugar to industrial customers. However, inclusion of the retail sector is unlikely to have any significant impact on the assessment of the effects of the acquisition on competition in this case. JBS supplies sugar only to industrial customers, and the main suppliers of sugar for retail also supply sugar to industrial customers.

Types of sugar

- 4.11 Finally, we considered whether different types of sugar constitute separate product markets. On the demand side, different sugar products may not be close substitutes for each other in certain industrial processes. For example, granulated sugar may not be a close substitute for icing sugar from the point of view of a customer manufacturing cake decorations. However, on the supply side it appears that there is a high degree of substitutability between different types of sugar, and Tate & Lyle confirmed the ease of such substitution. The majority of sugars are derived from basic white granulated sugar, which is either sieved, ground or dissolved in order to manufacture the different types of sugar. These processes can be undertaken either by suppliers or by users. If the price of particular types of sugar to industrial customers, such as liquid sugar, were to increase we would expect supply-side substitution to make any SSNIP unprofitable.¹⁴

Geographic market

Impact of EU sugar regime on imports

- 4.12 The operation of the EU sugar regime not only inhibits imports from outside the EU but reinforces partitioned national markets for sugar. As stated by the European Commission in *Südzucker/Saint Louis Sucre* [2003]:¹⁵

As far as the markets in industrial sugar and retail sugar are concerned, the Commission would point out, first of all, that under the common organisation of the market in sugar a stated sugar quota is allocated to every Member State. This has a significant influence on the production and sale of sugar in the Community, and helps to consolidate a partitioning of national markets. The sales territories of the main European sugar manufacturers are consequently quite distinct, and this is reflected in the very different market shares they hold in the separate Member States... In its most recent decisions under Articles 81 and 82 of the EC Treaty, therefore, the Commission

¹⁴This conclusion concerns supply to industrial customers. We take no view on the position in relation to the retail market.

¹⁵2003/259/EC, *Südzucker / Saint Louis Sucre*, Decision of 24/04/2003, OJ[2003] L 103, para 25. In that case the European Commission subdivided the retail market into two sub-markets for branded retail sugar and own-brand retail sugar, but we do not feel a need to take a view on this for the purpose of our inquiry.

has taken the view that the relevant geographic markets for industrial and retail sugar are at most national.

- 4.13 The quota system has resulted in a level of production in the UK of quota and preferential sugar that is broadly equivalent to the level of sugar consumption. Although there are imports into the UK from other EU member states, amounting to 126,000 tonnes in 2002/03,¹⁶ these represent a relatively low level of imports compared with total domestic demand for sugar of around 2.25 million tonnes, roughly 75 per cent of which is supplied to industrial customers.¹⁷

Pricing strategies of British Sugar and Tate & Lyle

- 4.14 The most important constraint on imports from other EU countries arises from the pricing policies of British Sugar and Tate & Lyle. Under the EU sugar regime each sugar producer has an economic incentive to produce its full quota which it then sells either in its home market, in other EU markets, or exports from the EU under EU arrangements for subsidized exports (restitution—see Appendix D). The most profitable option for both British Sugar and Tate & Lyle is to sell their entire quota within the UK, and each told us that its strategy is to do this to the maximum extent possible. Since the combined quotas of British Sugar and Tate & Lyle are broadly in balance with demand in the UK, this requires them to follow a pricing strategy that, so far as possible, avoids creating opportunities for profitable imports. British Sugar told us that it attempts to ensure that its general price levels are such that no sustainable financial incentive exists for the import of material volumes of sugar into the UK. As previously noted, British Sugar is generally regarded as the price leader and Tate & Lyle takes its lead from British Sugar's prices. (See paragraph 3.2.) This strategy acts as a barrier to entry for European sugar producers.

Northern Ireland

- 4.15 In previous decisions by the European Commission, Northern Ireland has not been considered to be part of the same geographic market as Great Britain due to the different supply conditions, which reflect transport costs and the role of sugar imported from the Republic of Ireland.¹⁸ We therefore considered whether the relevant market in this case should be the UK or Great Britain. We concur with the view that Northern Ireland is more appropriately regarded as a separate geographic market on these grounds. However, since neither NBF nor JBS supply sugar to Northern Ireland, where the market is small compared with that in Great Britain, we do not believe that the assessment of the competitive effect of the merger is affected by this judgement.

Imports into Great Britain from other EU countries

- 4.16 On the basis of evidence from NBF and other suppliers, we were able to identify recent annual imports of just over 80,000 tonnes supplied to industrial users in Great Britain by EU producers other than British Sugar and Tate & Lyle, representing about 5 per cent of sugar in the British industrial market.¹⁹

¹⁶Source: EUROSTAT-COMEXT, provided by Defra.

¹⁷Source: House of Commons Environment, Food and Rural Affairs Committee, *Reform of the Sugar Regime*, Twelfth Report of Session 2003–2004.

¹⁸See EC Case No. IV/30.178. Napier Brown/British Sugar. Decision of 18/07/1988 OJ[1988] L284/52 and 1999/210/EC *British Sugar/Tate & Lyle/NBF/JBS* Decision of 14/10/1998, OJ[1999] L76/23.

¹⁹See Appendix H.

Relative prices

4.17 British Sugar's and Tate & Lyle's pricing strategies do not mean that prices in Great Britain are the same as those in other EU countries. Price information collected by the EU Association of the Chocolate, Biscuit and Confectionery Industries (CAOBISCO) in October 2001 suggested that British sugar prices were between 6 per cent and 13 per cent higher than those in six EU countries at that time. Whilst these figures have been disputed, and [redacted] told us that it believed average bulk prices to industrial customers in Great Britain are not widely out of line with ex factory prices in Europe once allowance is made for delivery costs, evidence we obtained from British Sugar, Nestlé and a large sugar user suggests to us that sugar prices in Great Britain remain higher than those on the Continent by perhaps 5 to 10 per cent.

Additional barriers to imports

4.18 We identified a number of barriers to imports into Great Britain, additional to the pricing strategies of British Sugar and Tate & Lyle, including :

- Customer confidence in ability to ensure a constant timely supply.
- Transport costs.
- Threat of retaliation from UK sugar producers.
- Customer perception of sugar properties and substitutability.

4.19 Some customers appear unwilling to rely on foreign sugar suppliers as their main source of sugar, due to a lack of confidence in their ability to ensure regular and adequate supplies from Continental Europe (a) over longer distances and (b) across the natural barrier of the English Channel. That this might be a real concern was confirmed to us both by the largest importer of sugar from the Continent and by a major user of industrial sugar. To the extent that fears over security of supply persist, despite the operation of modern logistics techniques, they constrain the ability of European sugar suppliers to increase their share of the British industrial sugar market.

4.20 There may be additional costs and logistical complications involved in transporting sugar across the English Channel that reduce the ability of Continental sugar producers to import sugar to Great Britain profitably. For example, NBF told us that for deliveries from Belgium and France in bulk tankers, the standard costs would be in the region of £[redacted] a tonne, or approximately [redacted] those of making an average delivery in Great Britain, reflecting the additional distance, labour and tanker hire charges. This was consistent with evidence from other suppliers that the cost of transporting sugar from a continental sugar factory to the customer's location in Great Britain could be in the order of £34 a tonne.

4.21 Because domestic production of sugar is roughly equivalent to domestic demand, and both domestic supply and domestic demand are relatively stable, any sugar imports brought into the country have the effect of 'squeezing out' some domestically-produced sugar, thereby reducing the UK producers' profits. The incumbent UK producers therefore have the incentive to defend vigorously the domestic market from competition from European importers. The act of supplying British users with imported sugar frees up domestic sugar for use as a potential retaliatory tool as a competitive export to the importer's own domestic market.

- 4.22 It was suggested to us that sugar from different sources sometimes has slightly different properties, which may result in imported sugar being considered unsuitable as a substitute for domestically-produced sugar where this could have a significant impact on the quality of the products manufactured. Real or perceived differences in the characteristics of sugar from different sources may make industrial customers reluctant to switch to a new supplier, particularly if they have a current domestic supplier to whose sugar their production processes have been aligned.²⁰

Trends in the level of imports

- 4.23 The overall level of imports has shown no discernible trend over recent years. (For further information on imports see Appendix G.) However, several of those who provided us with evidence said that they had recently seen signs of increased competition from French sugar producers. Three possible reasons for this were suggested:

- (a) Increasing constraints on funds available for restitution as a result of enlargement of the EU which, NBF and others told us, had led to a substantial decline over the past six months in the premium paid for restitution over the Intervention Price.
- (b) EU continental sugar producers seeking to establish market positions in Great Britain in anticipation of reforms to the EU sugar regime reducing or eliminating the scope for subsidized exports.
- (c) Increasing difficulties faced by some Continental producers in maintaining sales in other European markets as a result of increased competition from sugar from the Accession Countries.

- 4.24 To investigate this further we contacted Sucre Union, Irish Sugar, Tereos, Saint Louis Sucre, and Societe Vermandoise de Sucreries (Vermandoise), each of which has recently imported industrial sugar into Great Britain. [X] is the largest importer of sugar (through [X]) accounting for around one-third of EU sugar imports into Great Britain. [X] is the second largest source of imports. All of those contacted provided us with information on their recent sales into Great Britain and their plans for 2005.²¹ This data showed that several of these refiners are attempting to increase sales in Great Britain. However, no single factor appeared to be driving these attempts which, in some cases, appeared to be a continuation of an existing business strategy rather than in response to recent events or in anticipation of forthcoming changes to the EU sugar regime.

Competitive constraints imposed by imports

- 4.25 Whilst imports of sugar are sold into Great Britain by suppliers in other EU member states, it appears that these are subject to a variety of constraints, not least of which is British Sugar's stated strategy of pricing to exclude large volumes of imports from being sold into the domestic sugar market. In this way, the threat of imports essentially imposes an upper bound on sugar prices in Great Britain, since British Sugar wishes to avoid pricing at a level that would be sufficiently high to attract

²⁰In practice, the potential for significant differences in product characteristics to arise in the EU is limited by the operation of standard product specification/quality tests.

²¹In this report references to years are to calendar years unless otherwise specified.

imports from the Continent. Nevertheless, it appears that sugar prices in Great Britain are higher than those prevailing on the Continent, and that this pricing position has been sustainable over a period of time without causing imports to grow beyond their observed low level. This suggests that imports of sugar to Great Britain by other EU sugar producers have so far exerted an insufficient constraint on sugar suppliers in Great Britain for us to conclude that the relevant geographic market includes other EU member states. We acknowledge current attempts by some Continental sugar producers to increase sales in Great Britain. But, in view of the recent nature of these and the success so far of British Sugar's pricing strategy, it is too soon to say whether such attempts will be successful in practice, and/or be sufficient to force prices in Great Britain down to those prevailing in neighbouring Continental countries on either a delivered or an ex works basis.

Conclusions on market definition

4.26 We conclude that the relevant market is the supply of sugar products to industrial users in Great Britain. However, our assessment of the competitive effects of the merger would not be changed by inclusion of the retail sector (with or without a distinction between branded retail sugar and own-brand retail sugar), or by inclusion of Northern Ireland. Our definition of the relevant market was accepted by NBF for the purpose of this inquiry.

5. Assessment of the competitive effects of the merger

5.1 In this section we look at competitive effects of the acquisition of JBS by NBF in the relevant market. We first consider what was likely to have happened if the merger had not occurred (the counterfactual). We next describe other suppliers of sugar products to industrial users in Great Britain and their market shares. We then discuss factors affecting rivalry in the relevant markets, existing levels of competition and market entry, exit and expansion. We finally consider the expected impact of the acquisition.

Counterfactual and failing firm issues

Evidence from NBF

5.2 NBF told us that while JBS's operations were efficient in terms of minimization of overheads, it suffered from the fact that it purchased sugar from British Sugar and Tate & Lyle at prices that were £[REDACTED] a tonne higher than those to NBF, which made it less competitive in bidding for large volume, low margin customers. Moreover, it had seen a [REDACTED] decline in volumes and total profits over the last few years. [REDACTED]

Evidence from JBS

5.3 JBS told us that it had been pursuing a strategy of maintaining gross margins and overall profitability, rather than pursuing volume. This had involved sustained efforts to reduce its costs through measures such as [REDACTED]. In the face of pressure from British Sugar and Tate & Lyle on JBS to maintain volumes of sugar to keep its input prices down, the strategy had necessitated [REDACTED]. JBS believed that if, in the absence of a merger, its strategy had remained unchanged then the business would have continued to decline to approximately [REDACTED], but that, at this level, there was no reason why it could not continue as a profitable going concern.

Evidence from ED&F Man and Greencore

- 5.4 ED&F Man told us that if it had not been approached by NBF to acquire JBS then it would have allowed JBS to continue with its strategy of maintaining gross margins. JBS was a relatively small part of ED&F Man's business (an international commodity trading business, with major operations in sugar, cocoa, coffee and molasses, in many countries worldwide) and, therefore, provided JBS contributed an adequate return, ED&F Man saw little reason to interfere.
- 5.5 Greencore told us that JBS had been in decline for some years and that it had welcomed the opportunity to sell its holding, particularly in light of the impending reforms of the sugar regime. It had not previously actively sought a buyer. [REDACTED]

JBS financial performance, margins and customer gains and losses

- 5.6 Against this background we considered carefully evidence on JBS's financial performance, margins and recent customer gains and losses. Material on these is included in Appendix C. These confirm the impact of the pressures that JBS faced. Between the year ended 31 October 2001 and the 51 weeks up to 24 October 2004 the total volume of sugar sold declined from [REDACTED] to [REDACTED] (a drop of [REDACTED] per cent),²² during which period turnover and operating profit declined by [REDACTED] per cent and [REDACTED] per cent respectively. Furthermore, during 2003 JBS lost [REDACTED] customers and gained [REDACTED].

Future of JBS

- 5.7 On the basis of this evidence we accept that, had JBS continued to pursue its existing strategy and British Sugar and Tate & Lyle had continued to follow the pricing and marketing strategies that they had been pursuing immediately prior to the merger, JBS would have had difficulty in maintaining its previous scale of operation. However, we believe that competition for JBS customers over recent months may have been influenced at least in part by its acquisition by NBF and the subsequent announcement of our inquiry, such that no reliable conclusions can be drawn from events in this period regarding what its rate of decline might have been under the counterfactual. We judge that, for the timescale relevant to our inquiry, the likely further reduction in JBS's volumes would not have threatened its ability to compete. As NBF acknowledged, [REDACTED] JBS was not a failing firm. All the parties who provided evidence to this inquiry regarded JBS as competing effectively prior to the merger, notwithstanding the decline in its scale of operation over a number of years.
- 5.8 We considered whether there was a more likely alternative than JBS continuing to pursue the strategy it was following under its former shareholders prior to its acquisition by NBF.
- 5.9 Some third parties told us that they regarded the fact that JBS was owned by ED&F Man, a major international sugar trader, as an important strength that put JBS in a position to benefit from developments opening up opportunities for increased imports of sugar from LDCs or from within the EU as a result of the eventual reform of the EU sugar regime. In the absence of the merger with NBF, it is possible that ED&F Man might have encouraged JBS to follow an alternative strategy with a view to using it as a vehicle through which it would take advantage of these opportunities.

²²These figures include sugar sold by JBS on both a principal and nominal agency basis. The reduction in sugar sold as principal over the period was [REDACTED] and the equivalent figure for nominal was [REDACTED].

5.10 Although ED&F Man, the majority shareholder, had not previously actively considered the sale of JBS we also considered what might have happened if they had decided to do so and whether there might have been potential purchasers other than NBF. ED&F Man told us that they regarded JBS as a non-core business. JBS told us its key assets were its people and customer relationships, [REDACTED]. ED&F Man told us that no other approaches or offers were received or sought from any other parties. However, one reseller [REDACTED] told us that the main difficulty it had had in establishing itself [REDACTED], was the time it took to establish relationships with customers so that they felt they could rely on it for deliveries of sugar in the quantities and at the times they wanted it. It was looking to increase volumes of sales and might be interested in acquiring JBS should NBF need to sell it.

Conclusions on the counterfactual

5.11 We concluded that there was no basis on which we might form an expectation that either of these possibilities was more likely than JBS continuing to compete under its existing strategy and with its pre-merger shareholders. Accordingly, we conclude that, in the absence of the merger, the relevant counterfactual is that JBS would have continued to compete in the supply of sugar to industrial users in Great Britain with its existing strategy and under the ownership of ED&F Man and Greencore.

Suppliers of sugar to industrial users

5.12 Suppliers of sugar to industrial users are of four main types: the UK sugar producers (British Sugar and Tate & Lyle), the large independent sugar resellers (NBF and JBS), other resellers, which typically supply sugar alongside other ingredients, and overseas sugar producers and their agents. The pre-merger market shares are summarized in Table 1. Further information on market shares, including shares of production, and sugar flows is in Appendix H.

TABLE 1 **Share of industrial sugar sales to end users (by tonnes of sugar supplied to industrial customers)***

<i>Supplier</i>	<i>% share</i>
British Sugar	38
Tate & Lyle	29
NBF	17
JBS	8
Other resellers (9)	4
Importers (6)	4
Total	100

Source: CC analysis.†

*The majority of data is for calendar year 2004. However, a small number of data points relate instead to the financial year 2003/04. We do not believe that this has led to a significant bias in the market share estimates. The figures in Table 1 are consistent with those provided by NBF. Note that the shares of NBF and JBS do not include sales made as a nominal merchant; these are attributed to the original sugar producer, since the customer negotiates with the original producer over the terms of supply. Having said this, sugar produced by Irish Sugar and sold through JBS is attributed to JBS [REDACTED].

†In this table and throughout this report percentage figures may not total 100 due to rounding.

British Sugar and Tate & Lyle

5.13 British Sugar and Tate & Lyle are the two largest suppliers to industrial sugar users, with market shares of approximately 38 per cent and 29 per cent respectively by volume, and the main suppliers to NBF, JBS and the other resellers of sugar. Whilst they are particularly strong in the supply to large sugar users, each told us that they were willing to supply all types of customer, although they levied additional charges for part load deliveries and did not believe that they supply very small users

economically, for whom it would probably be more efficient to purchase sugar alongside other ingredients. The prices charged by British Sugar and Tate & Lyle, in almost all cases other than for supply to NBF and JBS, are delivered prices, based on average transport costs for supply to all customers.²³

NBF and JBS

5.14 NBF and JBS each supply all types of industrial customer, although the evidence that we had seen showed that NBF has a larger number and proportion of very small customers (taking less than 100 tonnes a year) than JBS, probably reflecting its involvement in the supply of other ingredients. NBF had an overall market share of around 17 per cent by volume and JBS of around 8 per cent. NBF purchased a total of [X] of sugar from British Sugar and Tate & Lyle in 2003²⁴ and JBS a total of [X] as a principal merchant in that year ([X] if its sales as a nominal merchant are included). NBF and JBS each imported about [X] of sugar in 2003, from a variety of sources.

Smaller resellers, overseas sugar producers and their agents

5.15 We identified around 70 smaller resellers of sugar (including companies selling sugar alongside other ingredients to the food industry). [X] told us that Kent Foods Ltd, BAKO North Western (United Bakers' Buying) Ltd, BFP Wholesale Ltd, Ragus Sugars Manufacturing Ltd, Shepcote Distributors Ltd, Thornton Sugar, Kluman & Balter Ltd and Meadow Foods Ltd were the most significant independent resellers other than NBF and JBS, each supplying 1,000 tonnes a year or over.²⁵ Collectively the smaller resellers accounted for around 4 per cent of sales of sugar to industrial customers by volume. In the majority of cases they supply sugar alongside other ingredients and are particularly active in the supply of small users. However, we received evidence that they also supply some larger users with amounts exceeding 1,000 tonnes a year. The smaller resellers obtain sugar from a range of sources, including from British Sugar, Tate & Lyle, NBF, JBS, other EU producers, and some large industrial sugar users who sell sugar on to them.

5.16 The main importers are listed in paragraph 4.24 and discussed in Appendix G.

Factors affecting rivalry in the relevant markets prior to the merger

Concentration

5.17 In order to assess rivalry in the relevant market prior to the merger we first considered its level of concentration. Although there are numerous companies supplying sugar to industrial users, the majority of these have very small market shares. The Herfindahl-Hirschman Index (HHI), which is a measure of market concentration calculated as the sum of squared market shares, is 2,633, indicating that the market is highly concentrated.²⁶

²³British Sugar told us that it was willing to quote ex factory prices to all customers, but advised that only one customer other than NBF and JBS bought sugar on an ex factory basis at the time of the hearing. We subsequently learnt of one other having negotiated a similar arrangement.

²⁴This figure includes nominal sales by NBF amounting to [X] tonnes.

²⁵Billington is now part of the same group of companies as British Sugar, and hence excluded from this list.

²⁶The OFT Guidelines, to which reference are made in the CC's own guidance, categorize as 'highly concentrated' a market where the HHI exceeds 1,800. The HHI has been calculated on the basis of market share by volume of sugar supplied using disaggregated data reflecting the share of supply of the various resellers and importers on an individual basis rather than the aggregated figures shown in Table 1. As an alternative, it could be calculated on the basis of value of sugar supplied, that is,

- 5.18 Although the market shares and related estimates of concentration indicate that the market is highly concentrated, they take no account of the different position of sugar producers and resellers, and may underestimate the relative importance of British Sugar and Tate & Lyle since they do not reflect the strength of their position as both suppliers and competitors to the other suppliers. We take these concentration measures as providing only a starting point for assessment of rivalry in the relevant market.

Evidence from NBF

- 5.19 NBF told us that sugar prices in the UK are ultimately set by British Sugar, and NBF and JBS as non-refining resellers have no option but to follow this price. NBF argued that the UK sugar producers maximize profits by keeping margins high in production and very tight in the resale market. NBF and JBS cannot increase their prices above those of the UK producers because customers would source sugar direct from the UK producers, and cannot lower their prices below the cost at which they themselves purchase from the UK producers. Despite the relatively large volumes purchased from the UK producers, the negotiating power of NBF and JBS is limited since the UK producers always have the ultimate, and credible, threat to channel marginal output through their own sales operations. NBF and JBS have limited ability to threaten to increase their volume of imports because British Sugar sets prices at a level to make this unprofitable (import parity prices). NBF and JBS have attempted to protect their commercial position by optimizing the efficiency of their operations and, whenever possible, offering competitive prices to customers with whom they aim to build long-term relationships, but are constrained by the price and quantities at which they can source sugar from the UK producers with whom they compete. NBF told us that both it and JBS also faced intensive competition from other resellers and imports.
- 5.20 NBF further told us that annual contracts account for the large majority of transactions in terms of volume and revenue, with most contracts being negotiated in November or December covering the period January to December in the following year. During the negotiation process, users normally solicit offers or bids from their current supplier and a number of alternative suppliers, and may play bidders off against one another. It provided us with an analysis of the bidding process for industrial customers based on NBF and JBS records and the recollections of the relevant sales people. This showed that the average number of bids solicited is around 2.5, with slightly more for those purchasing larger volumes and slightly fewer for those purchasing smaller volumes. Of these bids, slightly less than two were typically sought from British Sugar, Tate & Lyle, NBF and JBS. The NBF data, which NBF considered to be more reliable, showed that in aggregate, NBF found itself bidding against JBS in less than 13 per cent of negotiations in which NBF was involved, and bid more frequently against [redacted] (25 per cent of cases), [redacted] (26 per cent of cases), [redacted] (17 per cent of cases), [redacted] (15 per cent of cases) and [redacted] (slightly over 13 per cent of cases). NBF argued that the market for industrial sugar has a number of characteristics that foster competition even in the presence of a relatively small number of bidders, including homogeneous products, low costs of bidding and multiple bidding rounds.

Evidence from third parties

- 5.21 Evidence we received from third parties broadly confirmed the importance of annual bidding rounds and the key role paid by the UK sugar producers, and British Sugar in particular. They also confirmed the central role of price in negotiations over supply,

share of total revenue. This calculation has not been performed due to lack of relevant data; however, we would not expect the HHI to differ significantly from that calculated on the basis of market shares by volume.

whilst drawing attention to the importance of continuing relationships with suppliers with proven reliable and flexible distribution arrangements and the role of resellers in providing greater flexibility over credit terms than the UK producers. However, they typically described a less dynamic market than might be envisaged from the description in paragraph 5.20, in which all suppliers focus primarily on maintaining their existing customer base and in which opportunities to switch substantial volumes of sugar between suppliers are limited. Several told us that competition is weak compared with that in the supply of other commodities and noted practices such as that of both UK producers in quoting a delivered price for sugar that includes a standardized delivery charge irrespective of distance even where customers have requested ex factory prices.

Assessment of customer survey and bidding data

- 5.22 In order to understand better competition and pricing in the relevant market we analysed data from our customer survey and information on negotiations supplied by British Sugar, NBF and JBS. The results are discussed in the following paragraphs with further information on the analysis of the customer survey and the extent to which it is representative in Appendix I.
- 5.23 The results of our analysis were broadly consistent with those provided by NBF regarding the role of annual negotiations for purchases of other than very small volumes (although ad hoc purchases of sugar represented nearly half of all purchases, the vast majority of these were for volumes of less than 99 tonnes a year so the total volume is relatively modest), the number of bids sought and obtained and the extent to which the various suppliers compete against one another.
- 5.24 However, the analysis also confirmed a market characterized by a high degree of inertia, in which negotiations are conducted chiefly between users and their incumbent suppliers; where suppliers primarily court new customers to replace those they have lost and users typically approach alternative suppliers either to gather reference prices against which to judge their incumbent supplier or where negotiations with the incumbent supplier are not going well. This was consistent with NBF telling us that its strategy approaching each annual contract season was [§]. Our customer survey showed that over two-thirds of those responding had not even considered using an alternative supplier during the past three years, and that almost three-quarters had remained loyal to their main supplier over that period.
- 5.25 The data showed considerable differences in the price paid for sugar by different users. We considered how far these differences could be explained by factors such as total volume purchased, number of bidders, identity of participating bidders, identity of the winning bidder, multiple-round contests, multiple lots, incumbent supply, spot/contract bids, and year of supply. We found that models including these as explanatory variables were only able to explain between 43 and 57 per cent of the variation.
- 5.26 In view of its potential significance for competition between the sugar producers, NBF and JBS, and the smaller resellers, we examined the data for evidence of volumetric pricing (ie whether the price paid for sugar is related to the volume bought) and stratification of the market by volume (ie whether the UK producers sell directly to the largest users, and the resellers compete primarily to supply smaller users). We found only a weak relationship between price and volume.²⁷ Equally, although British Sugar, Tate & Lyle, NBF and JBS have different customer profiles, we did not

²⁷Further details of the analysis and its limitations are given in Appendix I.

observe clear stratification. Whilst British Sugar, in particular, sells to many of the largest users direct, a significant proportion of its and, to an even greater extent, Tate & Lyle's direct customers purchase less than 100 tonnes a year. While customers taking small amounts of sugar were considerably more likely to be supplied by one of the smaller resellers, smaller resellers were also supplying customers taking in excess of 1,000 tonnes a year. JBS told us that volumetric pricing had been more of a feature of the market in the past than now appeared to be the case.

- 5.27 We also examined the data to see what light it could throw on how competitive British Sugar, Tate & Lyle, NBF and JBS are perceived to be on price and the extent to which the presence of JBS imposes a competitive constraint on NBF. Respondents to the customer survey perceived NBF to be most prepared to offer a competitive price (63 per cent agreeing or agreeing strongly), followed by JBS (58 per cent agreeing or agreeing strongly), British Sugar (44 per cent agreeing or agreeing strongly) and Tate & Lyle (38 per cent agreeing or agreeing strongly). Analysis of the data suggests that the final price decreases as the number of bidders increases, but does not suggest that the outcome of the negotiation process is significantly affected by the presence of JBS as opposed to another supplier. Nor does it suggest that JBS is consistently more competitive on price than British Sugar, Tate & Lyle or NBF.

Conclusions on existing competition in the relevant market

- 5.28 In the light of this analysis, we largely concur with NBF's view as summarized in paragraph 5.19. It is clear that competition in the supply of sugar to industrial users in Great Britain is significantly affected by the operation of the EU sugar regime, with the extent and nature of competition between the UK sugar producers and the resellers strongly influenced by the decisions of the producers on whom the resellers are largely dependent for the supply of sugar. Since the producers cannot increase beyond their quota limits the volume of sugar they sell within Great Britain, there is an enhanced incentive for them to sell to those customers from whom they can obtain the greatest margins. The marketing and pricing strategies of the UK producers are influenced by the fact that NBF, JBS and other resellers are both customers of, and competitors to, them. The market appears to be characterized by a high degree of price discrimination in which the UK sugar producers can, and do, target particular customers and exert considerable influence over the ability of NBF, JBS and the other resellers to compete both with the producers themselves and with each other. British Sugar plays a particularly influential role in this as price leader. NBF, JBS and other resellers that are reliant, either directly or indirectly, upon the UK producers for supply are able to exercise little constraint on the prices to sugar users charged by the UK producers beyond the limited amount arising from their potential to sell imported sugar to industrial sugar users which otherwise would not be in a position to obtain imported sugar or do so only at a higher price.
- 5.29 Our analysis further leads us to conclude that:
- (a) The market is characterized by extended and complex negotiation processes in which resellers (whether NBF, JBS or smaller resellers) often negotiate with customers in competition with their suppliers and negotiate, around the same time, for the sugar they need to supply those customers. The contracts negotiated are not binding in respect of the volume of sugar specified for the following year but may take into account the volume actually purchased compared with that contracted in previous years and include various types of rebate.
 - (b) Whilst considerations such as volume of sugar purchased and transport costs are taken into account when setting prices there is no predictable volumetric

pricing relationship. The terms of supply with each customer are agreed by a process of bilateral negotiation for which the relative negotiation strength and skill of the parties involved will be important factors in determining the outcome.

- (c) There is considerable inertia in the market with customers switching supplier infrequently. Where switching does occur, price appears to be the most significant factor triggering a switching decision.
- (d) Only a few of the contracts are sufficiently large for a bidding market characterization to apply and the market lacks the generally accepted characteristics of a pure bidding market.

5.30 This has implications for the ability of the smaller resellers to compete with NBF and JBS. To the extent that the producers chose to price volumetrically NBF and JBS would have a competitive advantage over other resellers, by virtue of their greater scale of operations. Further, to the extent that only NBF and JBS can obtain ex factory prices from British Sugar and Tate & Lyle, this may give them a competitive advantage over other resellers. However, volumetric pricing does not now appear to be a strong feature of the market, and at least some other customers now appear able to obtain ex factory prices from British Sugar. If, as increasingly appears to be the case, the UK sugar producers choose to supply directly a growing number of industrial sugar users, the role of resellers will become restricted to supplying those customers where they have a natural economic advantage. For example, where they supply sugar alongside other ingredients, or supply customers that require extended credit or have other needs that the UK producers do not wish to meet. Under those circumstances there appears little reason why smaller resellers should not be able to compete effectively with NBF and JBS.

Market entry, exit and expansion

5.31 We next considered the impact of market entry, exit and expansion. We found only two examples of genuine entry of new resellers of sugar in the UK in the past 10 years, Kent Foods and Henley Bridge Ingredients Ltd, and one example of exit, the Danish sugar producer Danisco.²⁸ Nor did we find any examples of significant expansion by domestic companies in the last ten years. Whilst Kent Foods has grown over its ten-year history to the point where it supplies [X] tonnes annually, it remains far smaller than both NBF and JBS. The most significant example of expansion has been by Sucreco, acting as agent for Sucre Union.

5.32 NBF told us that large scale entry has not occurred due, [X]. We considered barriers to imports in paragraphs 4.14 to 4.22. We identified no legal or regulatory barriers to entry and expansion by British resellers, but identified several factors in the market that may act as a deterrent. These include the presence, size and protected position of the UK sugar producers and the importance of negotiating supply contracts with them, the need to establish a reputation with customers as a capable and trustworthy supplier, the existence of annual supply contracts, customer inertia, the volume of sugar required to compete for larger customers and the fact that most sugar in Great Britain is sold on a delivered price basis. Further details on these are given in Appendix J.

²⁸We omit Sucreco from this list of entrants. Sucreco was set up in 1997 by former directors of Yorkshire Food Group to take over from Sugar Solutions (part of the Yorkshire Food Group) the selling of sugar from Sucre Union after Yorkshire Food Group went into liquidation. It is likely that, in addition to the examples identified, there have been examples of entry and exit by industrial sugar users selling some sugar on an opportunistic basis.

- 5.33 We conclude that whilst market entry and expansion are clearly possible, they are not significant features of this market.

Effects of the merger

Effect on concentration

- 5.34 The immediate effect of the acquisition of JBS by NBF was to raise the level of concentration in an already concentrated market, increasing the HHI by 265, to 2,898.²⁹ However, the eventual change could be either larger or smaller if, following the merger, customers were to switch to other suppliers.³⁰ As previously noted, JBS has been losing market share for some time and one consequence of the acquisition may have been to unsettle existing commercial relationships leading to a further loss of volume. [X]. We are not in a position to make a reliable assessment of the sales the merged company might eventually lose, and to which other suppliers. Hence we cannot calculate the precise impact on future levels of concentration. Nevertheless, we are confident that the merger increased market concentration by an amount sufficient to raise potential concerns over competition.

Effect on prices

- 5.35 Although these calculations indicate that the acquisition potentially raises concerns, they provide no more than a starting point for our assessment of its effect on competition. Third parties were split in their assessment of the impact of the merger. Of those who took part in our customer survey, 48 per cent said that it would make no difference to prices, 26 per cent said that it would tend to increase prices and 12 per cent thought that it would be likely to decrease prices. The third parties who provided us with written submissions displayed a greater level of concern, although in some cases this appeared to be over the operation of the market rather than the effects of the merger itself, and even in this case more believed that the merger would have little effect or a positive effect than argued that it would lead to an SLC. Among those that thought prices would rise, the most commonly cited factor was loss of competition between NBF and JBS. Our attention was drawn in particular to the advantages of having two large resellers from which quotes could be sought both as a check on prices being offered by British Sugar and Tate & Lyle and as a tool for negotiation. It was also drawn to the increased risk that other resellers, which were previously buying sugar from JBS but competing largely with NBF, might find themselves competing with their supplier. Among those that believed that the merger would make no difference, the most commonly cited factor was the lack of competition in the market already. Among those who thought that prices would fall, the most commonly cited factor was the ability of the merged company to reduce prices as a result of cost savings.
- 5.36 In our analysis of competition in the relevant market we noted the importance of the EU sugar regime and the central role of the UK sugar producers in both supply and pricing. We concluded that resellers were able to exercise little constraint on the prices charged by the UK producers beyond the limited amount arising from their potential to sell imported sugar to industrial sugar users which otherwise would not be in a position to obtain imported sugar or do so only at a higher price. (See paragraph 5.28.) This position is not affected by the acquisition of JBS by NBF. It follows that, where the merged company is in competition with British Sugar and Tate

²⁹The calculation of the increase in the HHI is on the basis that all JBS customers transfer to NBF.

³⁰To the extent that NBF and JBS lost market share to British Sugar and Tate & Lyle, the increase in the HHI would be higher, whereas loss of market share to other suppliers would reduce it.

& Lyle it will have limited ability to raise prices other than as a result of coordinated effects involving those companies. We consider the question of coordinated effects in paragraphs 5.44 to 5.63.

- 5.37 This reasoning led us to consider carefully whether there are areas of the market that are not contested, or not actively contested, by British Sugar or Tate & Lyle, and the implications of the merger for competition in those areas.
- 5.38 British Sugar and Tate & Lyle both told us that it was their policy to quote competitively whenever a quote was sought. However, the British Soft Drinks Association told us that some members had reported that UK sugar suppliers (which they did not name) had on occasion declined to supply or failed to respond to a request to bid citing lack of available capacity or inability to supply specialist grades, and we received conflicting evidence on whether British Sugar had submitted a bid in response to one tender exercise. We sought to explore this issue further through the customer survey. 11 per cent of those responding to the customer survey reported cases of suppliers not responding to requests for a price quotation, mainly among those purchasing 2,500 tonnes a year or more. Such cases were broadly spread in terms of the supplier involved and did not clearly identify a particular difficulty in obtaining quotes from British Sugar or Tate & Lyle.
- 5.39 Nevertheless, it is clear to us that the UK producers focus more on winning the business of some customers than others. British Sugar told us that its strategy was to achieve a mix of customers, which it believed were going to be more valuable; for example, because they might want some of British Sugar's service offerings, technical advice, or engineering support. Tate & Lyle told us that it was unlikely to prove efficient for it to service customers taking smaller amounts (less than [X] a year). This led us to enquire further into the position of smaller users and others that would appear not to be preferred customers for British Sugar or Tate & Lyle.
- 5.40 One constraint on the ability of the merged company to raise prices to these customers is competition from other resellers and importers. As previously noted, the smaller resellers have a greater share of supply for purchases of smaller volumes, and may have a competitive advantage over 'sugar only' suppliers where these are most economically delivered alongside other ingredients. We considered how far the ability of such smaller resellers to compete was in practice limited by a dependence on NBF and JBS for supplies of sugar, and thus their relationship to NBF and JBS mirrored that of NBF and JBS to the UK sugar producers. We concluded that no equivalent dependency exists. In addition to obtaining supplies from NBF and JBS, smaller resellers have the option of sourcing sugar from the UK sugar producers, from imports or from large industrial users which sell sugar on to them. In all the cases we examined they obtained sugar from one or more of these sources. As discussed in paragraph 5.26, we found only a weak correlation between price and volume that might leave the smaller resellers at a consistent disadvantage.
- 5.41 More generally, if the merged company were to raise prices to particular types of customer, making those customers increasingly profitable to supply, we believe that it is unrealistic to suppose that British Sugar and Tate & Lyle would forgo the profit opportunity available through choosing to compete for those customers. British Sugar and Tate & Lyle have a further incentive to avoid prices to particular types of customer becoming out of line with those in the market generally, since this would potentially create an opportunity for imports. British Sugar, in particular, would risk undermining its policy of pricing to avoid creating financial incentives for the import of material volumes of sugar into Great Britain if it were to allow prices in identifiable segments of the market to rise significantly.

Effect on service, support, product choice and innovation

5.42 We also considered whether the acquisition of JBS by NBF is likely to lead to a reduction in service, support, product choice or a reduction in innovation. Although price was universally agreed to be most important single factor affecting competition in the supply of industrial sugar, a range of non-price factors were reported to play a role, including quality of service, payment terms and provision of additional advisory and management services. We were told that all the main suppliers offered the full range of sugars and provided effective service, including stock management and related services. NBF and JBS appeared to be [X] comparable over payment terms once allowance was made for [X] JBS [X] strategy of focusing on removing costs from the business may have adversely affected its scope for investment in innovation. Overall, we found little reason to expect that the acquisition of JBS by NBF will lead to significant effects in terms of reduction in service, support, product choice or innovation.

Conclusions on the effect of the merger on prices, service, product choice and innovation

5.43 The acquisition of JBS by NBF reduces the choice of supplier available to users of industrial sugar in Great Britain. Any adverse impact is most likely to occur in the small number of cases where JBS was the main competitor to NBF and suitable alternative suppliers are not brought into the negotiating process. However, the considerations in paragraphs 5.36 to 5.41 lead us to conclude that any impact will be limited in terms of the overall market, and we would not expect any general rise in prices. Accordingly we do not expect that the acquisition of JBS by NBF will, in the absence of any impact on coordinated effects, lead to prices being higher than would otherwise have been the case. Nor, on the basis of the considerations in paragraph 5.42, do we expect that it will lead to a reduction in service, support, product choice or innovation.

Coordinated effects

5.44 We next considered coordinated effects. The CC guidelines on merger references identify three conditions that are generally regarded as facilitating coordinated effects and its approach to assessing coordinated effects under the Act.³¹ The three conditions are:

- (a) Awareness of competitor behaviour: the market must be sufficiently concentrated for firms to be aware of the behaviour of their competitors and for any significant deviation from the prevailing behaviour by a firm to be observed by other firms in the market.
- (b) Incentives to conform to the prevailing behaviour: it must be costly for firms to deviate from the prevailing behaviour, such that it is in their interests to conform.
- (c) Weak competitive constraints: competitive constraints in the affected market(s) must be relatively weak, so that the actions of non-coordinating firms, potential competitors and customers do not jeopardize the expected outcome of coordination.

³¹Merger references; Competition Commission Guidelines (CC2). Paragraphs 3.37-3.39.

5.45 Under the CC's approach, it is first necessary to ask whether coordinated effects were present before the acquisition.

Pre-merger conditions

5.46 A recent investigation into EU sugar markets³² concluded that the EU sugar regime is highly conducive to collective effects, noting that:

- Regulation blocks non-preferential imports from outside the EU and prevents entry of new firms by assigning quotas to incumbent producers.
- It helps firms to separate markets geographically by assigning fixed quotas on a national level.
- By subsidizing excess production and exports it provides a retaliatory mechanism enabling firms to use the threat of shifting quantities from exports to sales within EU markets.

5.47 In the present case we are concerned with the supply of sugar products to industrial users in Great Britain, involving both sugar producers and resellers. In examining the pre-merger case, we therefore considered whether:

- (a) the factors facilitating coordinated effects referred to in paragraph 5.44 were present in the supply of sugar products to industrial users in Great Britain; and
- (b) there was evidence of coordination prior to the acquisition.

Awareness of competitor behaviour

5.48 The discussion of market shares and concentration in Table 1 and paragraph 5.17 showed that the relevant market is highly concentrated, with British Sugar, Tate & Lyle, NBF and JBS collectively supplying over 90 per cent of the market. The high degree of concentration means that any actions taken by British Sugar, Tate & Lyle, NBF or JBS (for example, in attempting to win new business) will be likely to have observable impacts on their competitors.

5.49 We identified six further factors that increase transparency within this group of firms affecting the supply of sugar products to industrial users in Great Britain:

- (a) Supply structure: The fact that British Sugar and Tate & Lyle supply JBS and NBF with the majority of their sugar means that the two producers have access to a large amount of accurate information about the level of NBF's and JBS's costs. They also have significant information on the total volume of sugar that NBF and JBS sell, since the majority is sourced from either British Sugar or Tate & Lyle. To a lesser, but still significant, extent, NBF and JBS can estimate the costs of each other, since the majority of their supplies are sourced from the same two producers and the differential between the prices paid by NBF and JBS has remained stable over several years.
- (b) Delivery by British Sugar and Tate & Lyle: Bulk granulated sugar is generally delivered by NBF and JBS to their customers. However, because a significant proportion of the other sugar sold by NBF and JBS to industrial users is

³²*Sweet Fifteen: The Competition on the EU Sugar Markets*: Swedish Competition Authority Report 2002:7. December 2002.

delivered directly to those customers by British Sugar and Tate & Lyle, the UK sugar producers have data concerning the identities of many NBF and JBS customers, including volumes and types of sugar purchased and pattern of demand.

- (c) Producers' costs: The sugar regime provides significant information of the level of the producers' costs, since it specifies the price that beet processors pay to farmers for sugar beet and the cost to refiners of importing sugar cane.
- (d) Product homogeneity: The high degree of homogeneity among products, and the fact that the majority of sugar sold by NBF and JBS is supplied by British Sugar and Tate & Lyle and identical to the sugar they themselves supply, increases ease of comparison and therefore transparency.
- (e) Circulation of price increase letters: The circulation to all customers, including NBF and JBS, of letters from British Sugar and Tate & Lyle indicating the price increases they will be seeking in advance of each contract negotiation round increases transparency in the market of the pricing and negotiation strategy of each.
- (f) Negotiation with customers: Following the circulation of the price increase letters from British Sugar and Tate & Lyle, British Sugar, Tate & Lyle, NBF and JBS approach their existing customers to negotiate over their sugar requirements for the following year. During the course of negotiations, suppliers can often find out from their customers which companies are actively soliciting to sell sugar and obtain information on prices, since the customer will frequently present such information as part of their negotiation strategy (although there may be issues of credibility in relation to data provided in such a way). This increases transparency of information about sales and pricing in the market. In this context we note that NBF's and JBS's customer lists are larger than those of British Sugar and Tate & Lyle, and particularly extensive in the case of NBF. NBF's knowledge about alternative suppliers involved in negotiations with customers was confirmed by its ability to establish the data used as the basis of the Lexecon analysis.

5.50 It is not necessary for firms to have perfect knowledge of each other's business for there to be sufficient transparency in the market to facilitate coordinated effects; each merely needs sufficient information about its major competitors for any deviations from the prevailing behaviour by a competitor to be readily apparent. Whilst the discussion in paragraph 5.49 suggests that British Sugar and Tate & Lyle are likely to have more and better information on NBF and JBS than the latter companies will have on them, the significant amount of transparent information available to British Sugar and Tate & Lyle and, to a lesser but still significant extent, to NBF and JBS, leads us to conclude that this condition is met.

Incentives to conform

5.51 We identified several features of the market that would make it costly for any sugar suppliers to deviate from a coordinated outcome (if one had been achieved), including:

- (a) Constraints on NBF's and JBS's price-cutting ability: The margins made by NBF and JBS are far lower than those made by British Sugar and Tate & Lyle. Therefore, NBF and JBS are well aware that, in the event of a price war, British Sugar and Tate & Lyle could significantly undercut their prices and still make a

profit. Whilst competition law limits how far they could reduce prices, it is possible that the threat of retaliation remains sufficient to prevent NBF and JBS from initiating a price war with the sugar producers in the first place. This reluctance will be exacerbated further by the fact that British Sugar and Tate & Lyle are supplying most of the sugar that NBF and JBS are attempting to sell to customers and, therefore, substantially influence (a) the costs of NBF and JBS (by setting the price charged for sugar supplies) and (b) the quantity of sugar available to them. This limits the ability of NBF and JBS to cut prices, and also ensures that any reduction in prices across the board will be unlikely to be compensated by higher sales volumes overall. NBF's and JBS's need to maintain a working relationship with British Sugar and Tate & Lyle means that it is unlikely to be in their interests to 'rock the boat' by targeting those companies' industrial customers.

- (b) The ability of sellers to adjust prices quickly downwards and customers to respond: Whilst prices tend to be agreed with customers during the annual negotiation rounds in November/December, the resulting agreements do not bind customers to take particular volumes of sugar at those prices and actual prices could be adjusted downward quickly on an individual customer basis, in response to a competitor's price cut. This reduces the incentive to a competitor to attempt to win business by cutting prices, since it is unlikely to lead to winning and maintaining new business for a sufficient period to generate profits.
- (c) The possibility of a targeted response: In response to aggressive competition by a particular sugar supplier (whether that supplier is a producer or a reseller), it would be possible for sugar producers to target that competitor's customers with price reductions. This potential is accentuated by the transparency of information available on the identity and demand profile of their competitors' customers discussed in paragraph 5.49. The ability to target responses to particular customers reduces the incentive to deviate from the coordinated outcome, since any firm attempting to win new business may reasonably expect to have its profit margins competed away across its entire existing customer base.³³

5.52 We conclude that there are significant costs to deviating from prevailing behaviour in the supply of sugar products to industrial users in Great Britain, so the second of the conditions for coordinated behaviour is also met.

Competitive constraints

5.53 We considered the strength of competitive constraints from outside the main group of suppliers posed by:

- (a) Potential entrants: Evidence of, and barriers to, entry were discussed in paragraphs 5.31 to 5.33. We noted that there were few examples of entry in the past ten years, and that the total volume of imports has remained at a low level with no discernible trend over that period. We identified several factors that may act as a deterrent to entry. Whilst we noted evidence of recent attempts by

³³It could be argued that in the British sugar market (where capacity is controlled by production quotas) the inability to raise production beyond quota makes it difficult to make targeted responses to competitors. This argument was put to the European Commission by Südzucker in *Südzucker/Saint Louis Sucre* [2003/259/EC, *Südzucker/Saint Louis Sucre*, Decision of 24/04/2003, OJ[2003] L 103]. However, as the European Commission stated at paragraph 130, despite the operation of the quota system, 'targeted price cuts aimed at individual, strategic customers of competitors are quite possible and even common in the sector'.

some Continental sugar producers to increase sales in Great Britain, we concluded that it was too soon to say how far such plans will be realized in practice or sufficient to force prices down to those prevailing in neighbouring Continental countries.

- (b) Non-coordinating firms: We found no examples of suppliers that aggressively compete with British Sugar, Tate & Lyle, NBF and JBS on a scale sufficient to disrupt a coordinated outcome, if coordinated effects were to occur.
- (c) Customers with countervailing buyer power: Any potential countervailing buyer power appears to be concentrated among a small number of large industrial sugar users, but even for large users the evidence did not suggest that they have sufficient buyer power significantly to alter the pricing and marketing strategies of British Sugar and Tate & Lyle. The ability of NBF and JBS to respond to buyer power by reducing prices is constrained by the prices at which they themselves can buy sugar from British Sugar and Tate & Lyle.

5.54 We conclude that the types of competitive constraint that might inhibit the emergence or maintenance of coordinated effects have so far been relatively weak.

Additional evidence of coordinated effects prior to the acquisition

5.55 Several pieces of evidence suggest that coordinated effects were in fact features of the relevant market prior to the acquisition of JBS by NBF. These include:

- (a) Sustained high prices without competition driving prices down towards the floor set by the intervention price under the Sugar Regime.
- (b) Sustained high returns for British Sugar and Tate & Lyle, and possibly higher returns for NBF and JBS than might be expected if this market were fully competitive, without attracting significant new entry.
- (c) Timing of price change announcements by British Sugar and Tate & Lyle.
- (d) Perceptions of some customers along with evidence of limited customer switching.

5.56 This is consistent with evidence from previous competition cases.³⁴ In the intervening period the structure of the market does not appear to have changed fundamentally and mergers have reduced further the number of independent suppliers.

5.57 On the basis that the conditions for coordinated effects were met, and there was some additional evidence indicative of coordinated effects, it appears to us likely that coordinated effects were present prior to the acquisition of JBS by NBF.

Effect of the merger on coordinated effects

5.58 We considered the argument that the merger increases the risks of coordinated effects as a result of increasing market concentration, since the merged firm would

³⁴1999/210/EC *British Sugar/Tate & Lyle/NBF/JBS* Decision of 14/10/1998, OJ[1999] L 76.

have complete information on the business of its two constituent parts and a smaller number of firms involved would find it easier to coordinate their behaviour.

- 5.59 We previously concluded (in paragraph 5.28) that competition in the supply of sugar to industrial users is significantly affected by the operation of the EU sugar regime and the role this gives to incumbent national sugar producers, with the extent and nature of competition between the UK sugar producers and the resellers strongly influenced by the decisions of the producers on which the resellers are largely dependent for sugar. We further concluded that NBF, JBS and other resellers that are reliant, either directly or indirectly, upon the UK producers are able to exercise limited constraint on the prices charged by the UK producers, and that competition between NBF, JBS and other resellers is significantly affected by the supply and pricing strategies of the UK sugar producers. In short, that market power in the supply of sugar products is concentrated in the hands of the UK sugar producers. The position of the UK sugar suppliers and associated dependency of the resellers is not fundamentally disturbed by the merger.

Impact on awareness of competitor behaviour

- 5.60 Against this background, we judge that the merger can be expected to have little or no impact on the general structure of supply, with British Sugar and Tate & Lyle continuing to supply the bulk of the sugar supplied to the merged company (and other resellers); on delivery by British Sugar and Tate & Lyle; on the level of information on producers' costs; on product homogeneity; on circulation of price increase letters by British Sugar and Tate & Lyle; or, on the volume of information flowing from customers during negotiations (the factors discussed in paragraph 5.49) and hence awareness of competitor behaviour.

Impact on incentives to conform

- 5.61 Nor do we expect that the acquisition will significantly alter the constraints on aggressive price cutting by the merged company, the ability of sellers to adjust prices quickly and customers to respond nor the scope for targeted responses (the factors discussed in paragraph 5.51), and hence the incentives not to deviate from any coordinated outcome.

Impact on competitive constraints

- 5.62 Similarly, we do not expect the acquisition of JBS by NBF to affect significantly the potential for entrants, the ineffectiveness of non-coordinating firms or countervailing buyer power (the factors discussed in paragraph 5.53, and hence the level of other competitive constraints on the market.

Conclusion on impact of merger on coordinated effects

- 5.63 On this basis we do not expect the reduction in the number of firms to make coordination significantly more sustainable or effective in this case.

6. Findings

- 6.1 On the basis of paragraph 5.43 we do not expect that the acquisition of JBS by NBF will, in the absence of any impact on coordinated effects, lead to prices being higher than would otherwise have been the case, or to a reduction in service, support, product choice or innovation. On the basis of paragraph 5.63 we conclude that the

acquisition of JBS by NBF will not make coordination significantly more sustainable or more effective. We therefore find that whilst, as noted in paragraph 5.43, the acquisition of JBS by NBF reduces the choice of supplier available to users of industrial sugar in Great Britain, the acquisition of JBS by NBF has not resulted, and may not be expected to result, in an SLC.

- 6.2 At a late stage in the inquiry, on 8 March 2005 NBF announced that it was in discussions with a third party, which might or might not lead to an offer being made for its share capital. We are satisfied that these developments do not affect our conclusions or finding.
- 6.3 Our assessment of the competitive effects of the merger of NBF and JBS had to be conducted against the background of the structure and features of the sugar market in the UK (and the EU as a whole) which has long been recognized as not being competitive. Our inquiry is the most recent in a long line of reports and investigations that have examined aspects of the sugar market and the behaviour of particular companies within it at certain times.³⁵ Reform of the EU sugar regime has been contemplated by the member states on a number of occasions and changes have been introduced from time to time. Fundamentally, however, it retains features that inhibit effective competition. The July 2004 Communication to the EU Council and Parliament is the most recent move towards reform. It commences with the statement that:

The present sugar regime is often subject to fierce criticism for a lack of competition, distortions in the market, high prices for the consumers and users, and its effect on the world market, particularly in relation to developing countries. Yet, despite calls for reform, it has remained essentially unchanged for four decades.³⁶

- 6.4 In assessing the competitive effects of the merger, we considered the implications of the possible changes to the regime, but concluded that we must assess the implications of the merger under existing circumstances, whilst taking into account any changes in the relevant market(s) occurring in anticipation of reform of the EU sugar regime. Accordingly, in reaching our decision on an SLC, we took into account only those changes that were occurring in anticipation of reform.
- 6.5 It was not part of our remit to assess the wider implications of the current EU sugar regime. However, we observe that in terms of its overall competitive effects, consumers are materially disadvantaged in having to pay prices for sugar that are three to four times the level prevailing in the international market outside the EU. The proposed reform of the EU regime has the potential to address these concerns but, as has been noted by other competition bodies,³⁷ its impact will depend upon the detail of the measures adopted. The full impact on competition within the UK of whatever changes are agreed may not be apparent until sometime after the new regime is implemented. We therefore welcome the OFT's statement that: 'The OFT will press for reforms to promote greater competition in the sugar market and will assess the market in the light of the changes that the Commission's reforms should bring.'³⁸

³⁵See Appendix E.

³⁶Communication from the Commission to the Council and the European Parliament—accomplishing a sustainable agricultural model for Europe through the reformed CAP—sugar sector reform. Brussels, 14.7.2004. COM(2004) 409 final.

³⁷*Sweet Fifteen: The Competition on the EU Sugar Markets*: Swedish Competition Authority Report 2002:7. December 2002.

³⁸OFT press statement dated 24 November 2004 'Supply of industrial sugar'.