



Competition Authority

Competition Act 2002

Decision of the Competition Authority
No. E/04/001

Investigation into a proposed agreement/arrangement in principle whereby Monaghan Middlebrook Mushrooms Limited would acquire 100% Shareholding in Carbury Mushrooms Limited

26 January 2004

SUMMARY

The Competition Authority has decided to close its investigation pursuant to Section 4 and 5 of the Competition Act 2002 in relation to a proposed non-notified merger between Monaghan Middlebrook Mushrooms Limited and Carbury Mushrooms Limited.

On conducting a full investigation of the matter, the Competition Authority took the view that there was not a sufficient likelihood of anti-competitive effects arising as a result of this proposed merger to give rise to a breach of either Sections 4 or 5.

Since the parties were predominantly involved in the export of mushrooms, and only one of the parties was involved in the sale of mushrooms for domestic consumption, the merger would not impact on the domestic market for mushrooms to Irish consumers. Rather, the investigation focused on the impact of the merger in relation to Irish mushroom growers – both as buyers of mushroom compost, and sellers of mushrooms to the parties and other marketing companies for export sale.

A *prima facie* inquiry revealed, using the *Herfindahl-Hirschmann Index* (HHI), that the merger could significantly increase the level of market concentration in relation to the production and supply of compost to growers, and the acquisition of fresh mushrooms from growers to marketing companies that export mushrooms overseas – predominantly to the UK. It was found that the post-merger HHI of the combined entity would be 2237 with a delta of 361 in relation to compost sales, and at least 3341 with a delta of at least 1122 in relation to the acquisition of Irish mushrooms for export sale. However, the investigation revealed a number of other factors which showed that despite high concentration figures, the merger would not substantially increase the ability of the

parties to exercise market power against growers who buy their compost and sell mushrooms to the parties for export marketing.

1. THE ISSUES

Initiation of Investigation

1.1 The investigation was self-initiated by the Competition Authority (“the Authority”) in July 2003 as a result of a newspaper report¹ of the proposed merger between the parties. The parties advised that the matter was not subject to mandatory notification. The Authority did not dispute this conclusion. The Authority commenced a preliminary inquiry to ascertain whether opening a Section 4 or 5 investigation was warranted. On finding that the merger could *prima facie* give rise to competition concerns it opened an investigation. The parties co-operated fully in the investigation.

1.2 During the course of the investigation, the parties offered to voluntarily notify the proposed transaction for assessment by the Authority pursuant to Part 3 of the Act when the agreement to merge was concluded. Under the provisions of Part 3, no merger can be notified until there is a concluded agreement. However, as it was possible for the Authority to complete its investigation shortly after this and it concluded that there were no grounds to proceed under Sections 4 or 5 of the Act, it was not necessary for the parties to make a voluntary notification.²

The Parties³

1.3 Monaghan Middlebrook Mushrooms Limited (“Monaghan”) is a private company engaged in the marketing of mushrooms within the UK and Ireland, and in the production of Phase 2 compost.⁴ It operates several sites within the State, located in Monaghan, Tipperary and Cavan. It also operates, or has interests in, mushroom growing facilities within the island of Ireland and the UK. Monaghan’s marketing activities are

¹ The Irish Farmers Journal, *Mushroom growers to benefit from merger*, 26 July 2003.

² It should be noted that this investigation occurred prior to the release of the Competition Authority’s *Notice in respect of the review of non-notifiable mergers and acquisitions*, N/03/001 of 30 September 2003. Parties to proposed or completed non-notified mergers which come to the Authority’s attention after that date will be dealt with in accordance with the procedures set out in that Notice.

³ Information regarding the Parties activities supplied by the Parties.

⁴ The use of different types of compost in mushroom production is explained at paras 2.8 and 2.12.

predominantly focused on export markets, and it supplies a relatively small amount of mushrooms for domestic use.

1.4 Carbury Mushrooms Limited (“Carbury”) is a private company engaged in the marketing of mushrooms within Ireland and the UK, and in the production of Phase 2 and Phase 3 compost. It operates several sites within the State, located in Carbury, Co. Kildare and Claremorris, Co. Mayo. It also operates, or has interests in, mushroom growing facilities within the island of Ireland. A significant proportion of mushrooms sold by Carbury are supplied by its own growing facilities. It is not directly involved in marketing mushrooms to domestic suppliers.

1.5 The focus of the Authority’s investigation was to examine the impact of the proposed merger in the areas where the activities of the parties overlapped within the State. That is, the production and sale of compost within the State, and the acquisition of mushrooms from Irish growers to sell to the UK and/or domestically.

2. ASSESSMENT

Introduction

2.1. Section 18 of the Act requires undertakings to notify mergers and acquisitions that reach certain turnover thresholds.⁵ Section 18 also allows undertakings to notify mergers and acquisitions below these thresholds voluntarily. Sections 4(8) and 5(3) of the Act exempt mergers notified to and cleared by the Authority from prohibition under Sections 4 or 5, respectively. Mergers or acquisitions that are not otherwise notified will be subject to the provisions of Sections 4 and 5.

⁵ Proposed mergers must be notified where the worldwide turnover of each of two or more of the undertakings involved, and the turnover within the State of one of them, is not less than €40,000,000. In addition, each of two or more of those undertakings must carry on business in the island of Ireland.

2.2 Section 4 of the Act applies when undertakings are engaged in arrangements⁶ which have as their object or effect the prevention, restriction or distortion of competition in trade in any goods or services in the State. Section 5 of the Act prohibits an abuse by one or more undertakings of a dominant position in trade for any goods or services in the State or in any part of the State. Mergers between undertakings that compete with each other, or are potential competitors, or are involved in upstream or downstream activities within the State may have the object or effect of preventing, restricting or distorting competition by removing one independent competitor from a market and therefore could breach Section 4. Where an undertaking is dominant, the acquisition of another competitor, a potential competitor, or an upstream or downstream business could constitute an abuse of a dominant position by, for example, maintaining or strengthening a dominant position or having the effect of limiting production, markets or technical development to the prejudice of consumers and therefore could breach Section 5.

2.3 In determining whether there are grounds to initiate proceedings pursuant to Section 4 and 5 in relation to a non-notified merger, the Authority looks to the principles of assessing the competitive implications of a merger or acquisition set out in the Authority's *Notice in Respect of Guidelines for Merger Analysis*, N/02/004 of 16 December 2002.

The Relevant Markets

2.4 In analysing the matter, the Authority identified a number of possible markets that may be affected by this transaction, but because it concluded that on any reasonable alternative market definition the proposed merger would not raise substantial competitive concerns it was not considered necessary to form a definitive view on market definition in this case.

The Mushroom Industry

⁶ The arrangement can be either horizontal (i.e., between competitors in the same market) or vertical (i.e., between undertakings at different stages in the production/distribution/retailing chain).

2.5 The Irish mushroom industry primarily involves the production and sale of fresh mushrooms to wholesalers and supermarkets. The 2002 Farm Gate Production Value for mushrooms was approximately €137.6M.⁷ Approximately 80% of mushrooms produced in the State are exported to the UK, the remaining 20% being destined for sale within Ireland.

2.6 It was found that the Irish mushroom production industry did not participate to a significant extent in the production of mushrooms for processing, and accordingly, the analysis focused on the impact of the proposed merger in relation to the sale of mushrooms intended primarily for sale to the fresh mushroom market.

2.7 Mushrooms are produced by a large number of relatively small growers in Ireland, predominantly in Monaghan, Cavan, Mayo, Roscommon, Donegal, Tipperary, Kildare and Wexford. There are approximately 365 mushroom growers in Ireland.

2.8 Mushrooms are grown from specially produced compost which is generally sold to growers with mushroom spawn inserted into the compost. Compost is produced in specialist compost yards, and cannot be produced by a grower.

2.9 Growers may sell mushrooms to fruit and vegetable wholesalers/distributors or direct to retailers for domestic consumption, or to export marketing companies who predominantly market mushrooms in bulk to large UK buyers.

2.10 There are three main types of growers:

Satellite Growers: Generally buy compost from one company in order to sell mushrooms back to the same marketing company. Predominantly, satellite growers would be growing mushrooms destined for export to the UK,

⁷ Bord Glas, (2002) *Production Statistics*, Horticultural Industry Production, Dublin.

Independent Growers: Buy compost from any company and sell mushrooms to different marketing companies. These mushrooms would also predominantly be destined for export to the UK, and

Domestic Growers: Buy compost from any company and sell mushrooms to domestic buyers or fruit and vegetable wholesalers/distributors. These growers do not typically deal with marketing companies except to the extent that they may buy compost from them at times.

2.11 Growers who supply export markets will generally sell to marketing companies through a Producer Organisation (“PO”), i.e., a co-operative structure. Accordingly, while marketing companies may deal with growers directly on a day-to-day basis, growers actually sell mushrooms to their PO who will on-sell to a marketing company (however the marketing company will be nominated by the grower). The PO will negotiate price with marketing companies and purchase mushrooms from growers at a price which provides it with a service charge fee.

2.12 Two types of compost are used in mushroom growing in Ireland – Phase 2 and Phase 3 compost. Phase 3 compost differs from Phase 2 compost because it undergoes a further stage of treatment in a compost yard prior to being distributed to growers. As this requires significant further investment by the compost producer, Phase 3 compost is significantly more expensive than Phase 2 compost. However, Phase 3 compost may be capable of producing higher yields and offer growers the benefits of a shorter growing cycle. This is discussed further in paras 2.17 – 2.18.

2.13 The price of mushrooms is established by negotiation between a marketing company and a PO, or where relevant with growers directly. Generally, the marketing company will produce a “list price” which is reviewed periodically. However, grower returns may differ significantly from the list price depending on how a marketing company grades the grower’s mushrooms. Accordingly, actual prices are not very transparent or comparable across marketing companies.

Treatment of compost production and supply, and mushroom marketing as separate or integrated markets

2.14 The parties main activities in this case were the supply of compost to satellite growers in order to acquire mushrooms to sell to large UK buyers. Given that these activities are closely related, the Authority considered whether the relevant market in this case should be treated as a single, integrated market or a number of separate product markets.

2.15 It was found that there is a close relationship between marketing and compost production. Nevertheless, there are several marketing companies that do not operate a compost yard, and compost yards that are not involved in marketing. The parties themselves sold significant amounts (approximately 20%) of compost to growers who do not use their marketing facilities. While growers tended to supply one marketing company, with the express purpose of “growing on demand” to fulfil the company’s orders, a small but significant proportion of mushrooms would be sold via other channels. These factors tended to indicate that the three distinct stages of production i.e., the sale of compost, the supply of fresh mushrooms to marketing companies and others by growers, and marketing mushrooms to wholesalers and retailers are likely to be separate markets rather than a single integrated market.

2.16 While on balance it appeared likely that each of these three distinct phases of the mushroom production and sale process should be treated as separate markets, the Authority did not form a determinative view on this issue, because it was found that even on the narrowest view of the functional areas of relevant market, there was not a sufficient likelihood of anti-competitive effects arising as a result of the proposed merger to give rise to a breach of either Section 4 or 5 of the Act.

Market for the production and supply of mushroom compost

2.17 The parties submitted that the production and supply of Phase 2 and Phase 3 compost should be treated as separate competitive markets. If that view was accepted,

then the merger would have no impact in relation to Phase 3 compost, as one of the parties, Monaghan, did not produce Phase 3 compost.

2.18 The Authority found that producers cannot switch easily between Phase 2 and Phase 3 production, which indicated a lack of supply-side substitutability between Phase 2 and Phase 3 producers. However, on the demand-side growers can and do change between use of Phase 2 and Phase 3 compost. On this basis, the Authority took the view that Phase 3 compost is a close substitute for Phase 2 compost. Nevertheless, the Authority noted that over time the level of competition between Phase 2 and Phase 3 compost may change, as production techniques for Phase 3 compost advance and yields on Phase 3 compost become more reliable.

2.19 The Authority found that overall, there were few geographic constraints on the sale of compost within the whole of the island of Ireland.

2.20 On the basis of the above analysis, the Authority concluded that one of the relevant markets affected by the transaction was likely to be the production and supply of Phase 2 and Phase 3 compost within the island of Ireland.

Markets for the acquisition of fresh mushrooms

2.21 The Authority found that the parties participated in two separate areas of competitive activity in relation to the supply of fresh mushrooms by growers. The parties are both acquirers of fresh mushrooms from satellite growers or independent growers for export sales, and one party is also an acquirer of fresh mushrooms from domestic growers for domestic sales.

2.22 The Authority found that domestic sales are not close alternatives for growers producing for export markets. It was found that technically it is not difficult for growers to move between domestic or export orientated business and to a certain degree growers may sell their crop via both domestic and export channels. In practice however, it was found that growers do not appear to switch often, or switch significant amounts between the two areas. As domestic demand is very small compared to export demand, a

significant number of growers would not switch from export to domestic buyers because this would lead to excess supply in the domestic market, prices would fall, and ultimately growers would not benefit from switching. Switching large amounts on a speculative basis (i.e., to move between the domestic and export markets to gain advantage of price differences and then retreat when prices equalise) was not likely to occur, because growers would lose the benefits of a steady relationship with an export buyer.

2.23 In terms of geographic constraints, it was found that the parties operated predominantly in different geographic areas, and did not compete vigorously against each other for growers, Monaghan's main activities being centred in the northern and border regions, and Carbury's main activities located further south in Kildare. Nevertheless, it may be technically possible for marketing companies to compete with others in different geographic areas.

2.24 On the basis of the above analysis, the Authority concluded that one of the relevant markets affected by the transaction was likely to be the acquisition of fresh mushrooms for export within the island of Ireland, with closer areas of competition within local regions.

Barriers to Entry

2.25 In relation to the production and supply of compost, the Authority found that significant new entry was not likely in the short to medium term. Enquiries indicated that the production of compost is a high fixed cost business and yards cost several million euro to establish. Further, there are significant costs for compliance with environmental regulations involved in establishing a compost facility. It was found that given the difficulties Irish mushrooms currently face in competing against larger producers in other jurisdictions for export sales, new entry was unlikely. Accordingly, the Authority's view on this matter was that barriers to entry into the production and supply of compost were likely to be high.

2.26 The infrastructure costs of establishing a marketing business were not found to be high. However, it was found that there may nevertheless be significant barriers to entry

or expansion to establishing a marketing company to service export markets due to the structure of the UK buyer market. The UK market consists predominantly of a small number of large supermarket chains. They require suppliers capable of providing a large volume of mushrooms at a competitive price and are increasingly reducing the number of suppliers they deal with. The Authority found that this prohibits growers from marketing on an individual basis and reduces opportunities for smaller marketing businesses to build up business. Nevertheless, although barriers to entry were considered to be significant for most firms it was found that there was considerable potential for downstream integration by POs, because POs already aggregate large volumes of mushrooms for sale to export markets.

2.27 Barriers to entry to sell mushrooms domestically were found to be significantly lower because domestic demand is lower and smaller growers are capable of dealing directly with an Irish supermarket or Irish fruit and vegetable wholesalers.

Competition Law Assessment

2.28 The Authority identified the following three possible areas of competitive concern in relation to the proposed merger and these are examined below:

- Effect on the market for the production and supply of compost;
- Effect on the market for the acquisition of fresh mushrooms for export; and
- Effect on the market for the acquisition of fresh mushrooms for domestic sale

Effect on the market for the production and supply of compost

2.29 In relation to total sales of compost, it was found that the combined market share of the parties would be significant, that the post-merger HHI of the combined entity would be 2237 with a delta of 361, and barriers to entry were likely to be significant. Nevertheless, the Authority took the view that the proposed merger would not be likely to raise sufficient competitive issues to give rise to a breach of Sections 4 or 5 for the following reasons:

- The Authority confirmed that there was spare capacity for Phase 2 compost in Ireland, which would indicate that other existing competitors would be able to constrain the price charged to growers post-merger.
- The Authority confirmed that independent and domestic growers had sufficient alternative suppliers of compost, and that the merger would have little impact on their ability to source compost in the future at competitive prices. It was found that there were at least five other businesses supplying compost from whom growers considered they could obtain supplies.
- The Authority confirmed from enquiries with satellite growers that growers believed there would still be sufficient alternative sources of compost available to them to prevent the combined entity increasing prices and decreasing output post-merger.
- The Authority found that the parties to the transaction did not compete vigorously against each other in the sale of compost due to differences in the type of compost used, and the linkages growers had with particular compost yards because they also acquired mushrooms back from the grower. In fact, the merger could have a pro-competitive effect by enabling the new management structure to improve the quality of compost produced at one particular plant, and encourage the accessibility of Phase 3 compost within Ireland.
- Further, the Authority noted that because the sale of compost is closely linked to the parties acquisition of mushrooms from satellite growers, increasing price and reducing output could have a detrimental effect on the parties' ability to meet its obligations to supply UK multiples. This was found to lessen the incentive to exercise market power to some degree.

Effect on the market for the acquisition of fresh mushrooms for export

2.30 In relation to the acquisition of fresh mushrooms for export supply, the Authority's view was that the combined market shares of the parties would be significant, that the post-merger HHI of the combined entity would be at least 3341 with a delta of at least 1122, and barriers to entry were likely to be significant. However, it was found that the parties only buy minimal quantities (if any) of mushrooms from independent growers. Accordingly, the key issue considered by the Authority was whether, as a result of the merger, the parties would be able to exercise a substantive degree of monopsony power against satellite growers.

2.31 Generally, the development of monopsony power is considered to substantially lessen competition when it enables the buyer to exercise its market power against suppliers to reduce prices paid so that output is reduced below otherwise efficient levels. While the buyer may, as a result of this, reduce its own output it may nevertheless be profitable to do so, particularly if the buyer faces no competition in downstream markets. Where the buyer faces competition in downstream markets, inquiry is necessary in each case to determine whether or not it will have the incentive and ability to exercise market power against suppliers and reduce competition in the upstream market, i.e. whether the profits generated by reducing its own costs outweigh the detrimental impact of loss of quantity of sales in the downstream market.

2.32 In this case, the Authority took the view that it is unlikely that the parties would be able to exert any significantly greater degree of market power post-merger and would try to significantly decrease prices paid to growers as a result of the merger for the following reasons:

- There is very little geographic overlap between the activities of the parties in terms of marketing. An analysis of the company records of the parties over a three-year period indicated that no satellite growers had switched between the two firms during that period. Growers supplying Monaghan said they would not switch to Carbury because it would be too far away to transport mushrooms economically. Within Carbury, a significant proportion of growers were vertically integrated with the marketing company, or located in such close

proximity that they would not consider moving. Growers did not consider the parties were price responsive against each other.

- The Authority found that overseas market forces were driving the price of mushrooms, not competition between Monaghan and Carbury. Furthermore, the parties would have little incentive to reduce prices because profit levels within the industry are such that growers were already leaving the industry, and thus it was in the parties' interests to retain current levels of throughput in order to meet their obligations with UK multiples and protect the profitability of their compost facilities. In this regard, a key factor was that in terms of contribution to turnover, it was found that sale of compost was a more profitable business than marketing mushrooms.
- As outlined above, with the development of PO's which can control large quantities of mushroom supplies, if the merged entity were to increase prices substantially, PO's would be in a position to market themselves.
- The Authority also found that the nature of competition in downstream export sales was such that the parties would be unlikely to be able to manipulate their output of mushrooms significantly. Because marketing companies are required by their customers, the UK multiples, to provide exact amounts rather than being in a position to sell any amount for a set price, it is unlikely that the parties would be able to successfully restrict output in order to increase profits on a smaller volume of throughput. If they were to reduce output, they could lose the entire business. Indeed, in times of domestic shortfall, the parties would buy mushrooms from other sources, even if they make significant losses in order to meet their commitments.

Effect on the market for the acquisition of fresh mushrooms for domestic sale

2.33 As outlined above, as one of the parties, Carbury, is not directly involved in marketing mushrooms to domestic suppliers, the Authority is of the view that the proposed merger will have no direct impact on the domestic market.

2.34 The investigation revealed a concern that as a result of the merger, the combined parties would have access to such volumes of mushrooms that it could supply the domestic market at lower prices and thus drive domestic suppliers out of the market, resulting in ultimately higher prices for domestic consumers in Ireland.

2.35 First, the Authority is generally sceptical of concerns that lower prices resulting from a merger might be harmful. In this case the Authority found that the concern outlined above was unlikely to be realised for a number of reasons. As outlined above, existing domestic growers will not, as a result of the merger, become reliant on the merged entity for compost and therefore the parties will not obtain any leverage to prevent existing domestic growers continuing to supply domestic buyers – as long as domestic growers can provide competitive prices. Second, even if the merged entity were to enter the domestic market, it would not be in a position to increase prices significantly. Enquiries indicated that barriers to supplying domestic supermarkets were not particularly high. In particular, one large Irish-based supermarket stated that if the parties were to move into the domestic sector and later try to increase prices, it could support the development of individual growers as suppliers to constrain price increases. In fact, it would appear that if the merged entity were to enter the domestic market by offering lower prices to domestic buyers, this may result in the entry of an efficient competitor into the domestic sector to the benefit of consumers.

3. DECISION

3.1 On the basis of the facts in its possession and for the reasons set out above, the Authority has decided that there was not a sufficient likelihood of anti-competitive effects arising as a result of this merger to give rise to a breach of either Sections 4 or 5 of the Act.

3.2 The Authority's decision to close its investigation is based on the information provided by the parties, and other information before it. Nevertheless, if further material information comes to the Authority's attention, or information the parties have provided in relation to this matter is materially incorrect or misleading, the Authority reserves the right to reopen this investigation.

3.3 This decision of the Authority does not affect the rights of private parties to take action under the Act.

For the Competition Authority

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13/02/2004