

10 Conclusions

Introduction

10.1. Under the references dated 30 September 1992, as varied on 1 December 1992, we are required to report whether a monopoly situation exists in relation to the supply of animal waste in England and Wales, and in Scotland, and if so:

- (a) by virtue of which provisions of section 6 to 8 of the Fair Trading Act 1973 (the Act) that monopoly situation is taken to exist;
- (b) in favour of what person or persons that monopoly situation exists;
- (c) whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or those persons for the purpose of exploiting or maintaining the monopoly situation and if so by what uncompetitive practices or in what other way;
- (d) whether any action or omission on the part of that person or those persons is attributable to the existence of that monopoly situation and if so what action or omission and in what way it is so attributable; and
- (e) whether any facts found by the MMC in pursuance of their investigations under the preceding provisions of this paragraph operate or may be expected to operate against the public interest.

Full details of the references are set out in Appendix 1.1.

10.2. For the purposes of the references, 'the supply of animal waste' means the supply of animal material which is acquired for processing in rendering plants. The variations in the references brought a substantial volume of poultry waste within this definition. Fish waste is excluded unless it is part of butchery waste.

10.3. We first consider the existence of monopoly situations and the persons in whose favour the situations exist (questions (a) and (b)). In paragraphs 10.12 to 10.34 we describe the background to the inquiry, including the MMC's two earlier reports concerning the animal waste industry, and more recent developments. We turn to the rendering markets and barriers to entry in paragraphs 10.35 to 10.48. The subsequent questions (c) to (e) above are dealt with from paragraph 10.49 onwards.

The monopoly situations

England and Wales

10.4. Under section 6(1)(b) of the Act a scale monopoly situation would exist if at least one-quarter of the animal waste supplied in England and Wales were supplied to members of one and the same group of interconnected bodies corporate.

As we have shown in paragraph 2.18, Prosper De Mulder Ltd and its subsidiary companies John Knight (Animal By Products) Ltd, Granox Ltd, De Mulder & Sons Ltd, J L Thomas & Co Ltd and De Mulder (Market Harborough) Ltd¹ together acquired for processing in rendering plants over a quarter of the animal waste so acquired in England and Wales in 1992. There has been no material change since then. We conclude therefore that a monopoly situation exists by virtue of section 6(1)(b) of the Act.

10.5. We further conclude that this monopoly situation exists in favour of Prosper De Mulder Ltd and the following subsidiary and related companies:

Subsidiary companies

John Knight (Animal By Products) Ltd
Granox Ltd
De Mulder & Sons Ltd
J L Thomas & Co Ltd
G E and H Mitchell Ltd
Beacon Research Ltd

Related companies

Frazer (Butchers) Ltd
Chettles Ltd
Prosper De Mulder Transport
Prosper De Mulder Services
Oracle Motors Ltd
Francis Investments Ltd

All the above subsidiary and related companies benefit from their relationship with Prosper De Mulder Ltd. They are all owned by the De Mulder family and managed as a single entity. In this chapter we refer to Prosper De Mulder Ltd and its subsidiary and related companies as PDM.

Scotland

10.6. Under section 6(1)(a) of the Act a scale monopoly situation would exist if at least one-quarter of the animal waste supplied in Scotland were supplied to any one person. As we have shown in paragraph 2.24, William Forrest & Son (Paisley) Ltd (Forrest) acquired for processing in rendering plants over one-quarter of the animal waste so acquired in Scotland in 1992. There has been no material change since then. We conclude therefore that a monopoly situation exists by virtue of section 6(1)(a) of the Act.

10.7. We further conclude that this monopoly situation exists in favour of William Forrest & Son (Paisley) Ltd and its ultimate holding company, Hillside Holdings plc (Hillside).

Definition of the market

10.8. PDM submitted that the limitation of the terms of the reference to the consideration of the supply of animal waste to renderers created an artificial definition of the market for animal waste. Our studies show that the supply to renderers is about 73 per cent of the total supply. The rest is accounted for by sales to pet food manufacturers (15 per cent), disposal as waste (8 per cent)-the main items disposed of being blood and feathers-and sales of special items to manufacturers of particular types of food, pharmaceuticals and other products (4 per cent). PDM's share of total animal waste is around 50 per cent compared with a share of some 69 per cent of supplies to renderers.

¹The Market Harborough rendering plant was closed in February 1992.

10.9. From a competition point of view it is in our view reasonable to focus on the supply of waste to renderers, the subject of the reference. Rendering accounts for the majority of waste, and there are a number of other pertinent considerations. By law, abattoirs must dispose of their waste within 48 hours, and they need in practice to do so within 24 hours. They are thus not able to operate in a normal commercial way and sell what they can and dispose as they wish of the rest. Being able to sell certain high-grade materials to pet food and other manufacturers does not therefore have much effect on the arrangements they make for the sale of the main part of the waste material to renderers. Nor does the possibility of disposing of blood (by spreading on the land) and feathers (to a land-fill site) have much impact on those arrangements. The one effect of significance is that the alternative disposal methods do set some upper limit on the charges that renderers can make to abattoirs.

10.10. We conclude that we should not regard the total supply of animal waste as the relevant market for examining the economic relationship between renderers and their suppliers. The market strengths of PDM and of Forrest are best represented by their shares of supplies to renderers alone.

10.11. PDM also argued that the manufacture of edible fats for human consumption was not part of the animal waste rendering industry (see paragraph 3.13). We accept this, and so far as possible we have excluded such material from our calculations of market shares. In paragraphs 10.35 to 10.41 we deal separately with the red meat waste rendering and poultry waste rendering markets.

Background to the inquiry

General

10.12. Red meat waste supplied to the rendering industry in 1992 amounted to almost 1 million tonnes in England and Wales and 150,000 tonnes in Scotland. In the same year poultry plants in Great Britain provided commercial renderers in England with over 300,000 tonnes of waste. There is no commercial rendering of poultry waste in Scotland.

10.13. The main categories of animal waste for commercial purposes are offal, best fat, other fat, bones, blood and poultry carcasses and feathers. In accordance with Government regulations to control bovine spongiform encephalopathy (BSE) special arrangements are made to deal with offals of certain categories (known as Specified Bovine Offals-SBO).

10.14. The principal sources of red meat waste are abattoirs; fat and bones are also provided by butchers and boning-out plants; and knackers and others provide material from diseased or fallen animals. Some abattoirs, mainly the larger ones, operate a 'gut-room' where the different types of product such as tripes and pancreases are carefully segregated, and they sometimes contract out the operation to specialist companies, of which PDM is one. But frequently only a basic form of separation takes place at the abattoir.

10.15. The number of abattoirs in Great Britain has declined from 2,062 in 1968/69 to 709 in 1991/92, when 11 per cent of the abattoirs accounted for almost 63 per cent of slaughtering throughput (see paragraphs 2.9 and 2.11).

10.16. Virtually all red meat waste is removed from abattoirs within 24 hours of slaughter and the same applies to waste from poultry processing plants. Supplies vary seasonally and by day of the week and all must be cleared, bringing capacity implications for the renderer. It is a tribute to the industry in the discharge of a vital function that we received minimal complaint about the quality of services provided.

10.17. The principal products from rendering animal waste (a mechanical and heat treatment process) are meat-and-bone meal, and tallows of various grades. Greaves are a part-processed material, after extraction of some of the tallow, but before drying and milling to produce meat-and-bone meal. Greaves can be stored and are therefore a useful means of smoothing production when animal waste is in short supply; they are also used for pet food. An estimated 390,000 tonnes of meat-and-bone meal (valued at £53 million) was produced in the UK in 1992 for use mainly in animal feed. Tallow production amounted to an estimated 195,000 tonnes (value £36 million) in that year. Tallows are variously used for soap manufacture, for animal

feed, or in the production of chemicals. There are close substitutes for both meat-and-bone meal and tallow in most of these uses.

10.18. The charges made or prices paid for an abattoir's waste will reflect on the one hand the types of material, and their quality, quantity, distance from the processing plant and the extent of competition between renderers, and on the other hand the prices for end products. Sometimes there is just one overall price (or charge) which reflects the mix of the waste. Some types of material are of much less value to renderers than others, and this is reflected in the transactions. For low-yielding products, such as blood and offal, the abattoir generally pays a collection charge to the renderer; for high-yielding products, such as fats and poultry carcasses, the renderer pays the abattoir. Over the years, bones and poultry offal have sometimes been in the one category and sometimes in the other.

10.19. Renderers operate under strict regulatory controls both as regards the safety of their products and the environmental effects of their plants. The need for environmental protection relates mainly to the effluent and odours created by the process. It is now possible to treat effluent so successfully that discharge into a river can be accepted. As for odour control, the design of both process plant and the building housing it can substantially reduce obnoxious output. Standards laid down in legislation, in particular the Environmental Protection Act 1990 covering effluent and emissions, are monitored by local authorities who have a duty to ensure that the standards are attained (see paragraph 10.34). The plant and facilities of a rendering factory are also affected by the recent EC Directive (90/667/EEC) which seeks to harmonize the arrangements for the processing and disposal of animal waste and came into force at the start of 1993. Additional regulations have been made by the Ministry of Agriculture, Fisheries and Food (MAFF) in response to the threats to health from salmonella and BSE (see paragraph 10.26).

Previous inquiries

10.20. This is the MMC's third report concerning the rendering industry. The first report,¹ submitted in January 1985, was on the supply of red meat animal waste (ie it excluded poultry waste) in Great Britain as a whole (the 1985 report). We are now, as already indicated, required to consider separately the supply of animal waste in England and Wales, and in Scotland, and to include poultry waste. The second report,² submitted in June 1991, was on the merger of Prosper De Mulder Ltd and Croda International plc (the Croda report).

10.21. Despite the groundwork of these earlier reports, we did not find it easy to assemble the facts and figures necessary for our wider inquiry. The rendering industry is not large, and contains a number of quite small family firms which have difficulty in providing data, particularly going back over a period of time. Business tends to be conducted informally with a minimum of paperwork; for example, written contracts for the supply of waste material for processing are rare. We outline below the findings of the earlier reports and the market environment they described. We then deal with subsequent developments and set out our current findings.

The 1985 report

10.22. The 1985 report (see Appendix 4.1) into red meat waste in Great Britain considered that the public interest had three main requirements of the rendering industry:

- (a) most importantly, that it should provide an effective and reliable waste disposal service to the meat industry;
- (b) that the collection, transportation and processing of animal waste should be carried on without unduly polluting the environment; and

¹ *Animal Waste: a Report on the supply of animal waste in Great Britain*, Cmnd 9470, April 1985.

² *Prosper De Mulder Ltd and Croda International plc: a report on the merger situation*, Cm 1611, August 1991.

(c) that the industry should be economically efficient.

While the report found that PDM satisfied the first two of these requirements, it was unable to reach firm conclusions on PDM's efficiency because the variability of conditions in the industry made comparisons difficult and PDM's management information systems were not well developed. It found no basis, however, for criticizing PDM's processing efficiency.

10.23. The report noted that PDM pursued a strategy of growth through acquisition, but found no evidence that it had deliberately eliminated competitors, nor did it consider that PDM's growth had been harmful to abattoirs. The report did, however, find that PDM used its market power to respond aggressively to competitors seeking to capture its raw material sources. It found that PDM's pricing policy was designed to exploit or maintain its monopoly and might be expected to operate against the public interest by restricting competition in rendering.

10.24. As a result of the report, PDM gave three main undertakings (the 1986 undertakings-see Appendix 1.2):

- (1) that it would not enter into gut-room contracts¹ at a loss or engage in cross-subsidy between its gut-room business and its other activities;
- (2) that it would not make the collection of any grade of animal waste conditional on that customer also supplying higher-grade waste to PDM; and
- (3) that it would notify the Director General of Fair Trading (DGFT) at least one month before it made any future acquisitions of animal waste enterprises.

The Croda report (submitted in June 1991)

10.25. The Croda report (see Appendix 4.2) found that the rendering industry had been experiencing difficult and turbulent trading conditions. First, the prices of tallow and meat-and-bone meal, which had been at peak levels in 1984, had fallen back sharply by 1986, and after stabilizing for a time had dropped even further in 1990. These price movements were initially due to reductions in the prices of competing commodities such as palm oil and soya meal which were in world-wide surplus.

10.26. Secondly, the industry had been hit by two major health scares. Concern over the extent of salmonella in animal feed had led to the imposition of tighter controls under the protein processing legislation in 1989. More important had been the impact of BSE, first identified in late 1986. The practice of feeding ruminant-based animal protein to ruminants had been banned from July 1988, effectively cutting off 10 to 15 per cent of the market for meat-and-bone meal. Further regulatory action had been taken in September 1990 when SBO material had been banned from being incorporated in meat-and-bone meal for use in any animal or poultry rations. As a result of the new regulation, SBO material had to be collected and processed separately from other material; and while rendering was still necessary to sterilize the specified material, the meat-and-bone meal produced no longer had any end use (the tallow still had a market in uses other than animal feed).

10.27. As a result of these developments, renderers had had to cut the prices they paid for high-grade waste and introduce progressively higher charges for collecting low-grade waste, and implement a high charge for collecting SBO material. At the same time growing public awareness of environmental issues had put pressure on the rendering industry to achieve higher standards of odour and effluent controls. For those renderers who wished to remain in business this had led to a need for capital investment on a scale which was substantial in relation to the turnover and profits which they could reasonably expect to achieve.

10.28. The report also found that concentration in the rendering industry had continued. Whereas the 1985 report had calculated that the number of rendering companies in Great Britain in 1983 was 57 (down

¹See paragraph 10.14.

from about 160 in the 1950s), the number trading early in 1991 was down to around 30, of which three operated only in Scotland and four processed edible fats only. Since the 1985 report PDM had acquired a further seven animal waste businesses. Only two cases of new firms entering the market since 1985 had come to the MMC's attention: B & E (Rassau) Ltd which had opened a rendering plant in South Wales in 1988 (since closed), and Cheale Meats Ltd, an abattoir company which had acquired a small plant near Canterbury in 1990 from a firm which was leaving the industry.

10.29. Over the same period PDM had further developed its strategy of concentrating production on a few large plants which specialized in processing high-grade waste, while Doncaster, Nuneaton (Hartshill) and Exeter concentrated on low-grade. Since the 1990 BSE regulations, PDM had dedicated the Nuneaton plant to processing solely SBO, knacker and other condemned material. This specialization had caused PDM's transport costs to rise as material had to be hauled longer distances to the appropriate plant; SBO material, in particular, was brought to Nuneaton from all parts of England and Wales.

10.30. The Croda report found that the merger had an adverse effect on competition in the collection of high-grade waste in the South-West and South-East of England, and had modestly enhanced PDM's position in the overall waste collection market in England and Wales. But these effects were marginal in relation to the structural defects in competition which existed before the merger. Moreover, Croda was a declining competitive force (see Appendix 4.2, paragraph 36). The report considered that the merger was likely to improve PDM's efficiency and bring wider public health and environmental benefits. These effects, though also modest, would assist PDM in carrying out functions which represented an important public service as well as a commercial activity. Having taken account of the limited adverse effects on competition on the one hand, and the important public issues of health and the environment as well as efficiency gains on the other hand, the MMC concluded that the merger did not and might be expected not to operate against the public interest.

10.31. The report went on to make certain observations. First, the report noted that the issues which arose in this industry concerned not only competition but also the relationship between its commercial and public service aspects. The monopoly powers under the Act and the provisions of the Competition Act 1980 dealing with anti-competitive practices might therefore not be appropriate for dealing with the whole range of these issues: a different kind of inquiry might be necessary to address the various questions relating to public health and the environment. Secondly, the report stated that it would be advantageous if, in the case of any future proposed acquisition by PDM of businesses engaged in the collection or rendering of animal waste, a longer period of notice of the proposed transaction, possibly three months, was given to the DGFT than the one month provided for in the current undertakings. Thirdly, the report also noted that PDM's published accounts did not cover the whole of the group's animal waste business. It suggested that a group of companies playing such a crucial role as PDM in an important market should arrange its financial affairs in such a way that its published accounts were sufficiently transparent and complete to give a full picture of its trading fortunes.

Developments since the Croda report

10.32. When publishing the Croda report, the Department of Trade and Industry announced that it would be working with MAFF and the Department of the Environment (DoE) to ensure that the regulation of the rendering industry following the implementation of the EC Directive on animal waste would, as far as possible, be organized so as to allow the development of effective competition in the industry. Essential public health and environmental interests would be safeguarded. The DGFT would also continue to keep the industry under review. The other observations mentioned in paragraph 10.31, which in the absence of an adverse finding were not enforceable, were not pursued.

10.33. PDM has since purchased a number of small animal waste collection businesses without notifying the acquisitions to the DGFT (see paragraph 10.70). Meanwhile PDM has ceased production at the high-grade waste rendering plant it acquired from Croda and moth-balled the plant. In the half-year immediately preceding the acquisition, the plant processed an average of 1,000 tonnes of fat and bones a week. PDM told us that the decision to close the plant reflected the decline in high-grade material available for rendering.

10.34. By virtue of Part I of the Environmental Protection Act 1990 and Schedule 1 to the Environmental Protection (Prescribed Processes and Substances) Regulations 1991, which consolidated earlier provisions, no new rendering process or substantial change is permitted without local authority authorization. In issuing any authorization, local authorities must have regard for guidance produced by the Secretary of State for the Environment on appropriate air pollution standards for rendering plants, in compliance with the BATNEEC concept (Best Available Techniques Not Entailing Excessive Cost). Existing plants are to be allowed until 1 April 1997 to comply with the conditions governing their authorization. DoE told us that in most cases it was likely that authorizations would be issued specifying that an upgrading programme must be submitted demonstrating how compliance was proposed to be achieved by the due date (see paragraphs 7.130 *et seq*).

The rendering market: red meat waste

England and Wales

10.35. For many years the largest purchaser and renderer of animal waste in England and Wales has been PDM. It had an estimated 50 per cent of supplies for rendering in 1982 and about 64 per cent in 1992, a proportion similar to that estimated in the Croda report for 1990. In 1992 PDM processed 621,000 tonnes of red meat waste, which may be compared with an estimated half a million tonnes in 1982.

10.36. PDM has eight animal waste rendering plants and provides a collection service covering the whole of England and Wales apart from West Wales. The high-value business of rendering fat and bones is undertaken at Widnes and Silvertown; clean offal with fat and bones is processed at Doncaster and Exeter; and 'dirty offal' (ie SBO and knacker material) together with fat and bones is rendered at Hartshill. The Widnes plant handles all blood and some poultry waste, but the bulk of the poultry waste is dealt with at Ditchford and Nottingham. As already mentioned, the Market Harborough plant is currently moth-balled. PDM told us that it operated as an integrated business and that the strategic location of its plants and the specialized production processes gave it an advantage because it was able to produce final products with higher values than those of its competitors.

10.37. Each of the other renderers in England and Wales has one plant. The main companies and their shares are Fats & Proteins (UK) Ltd (7 per cent), Smith Brothers (Hyde) Ltd (6 per cent), Gilberts Animal By-Products Ltd (Gilberts) (5 per cent), A Hughes & Son (Skellingthorpe) Ltd (5 per cent) and Peninsular Proteins Ltd (Peninsular-a subsidiary of Hillsdown) (4 per cent). There are in addition a number of smaller operators who between them have a market share of approximately 9 per cent. Forrest does not collect red meat waste in England or Wales, nor does PDM collect such waste in Scotland. In fact very little red meat waste is transported across the border between England and Scotland. Most rendering plants are some distance from the border, and there are few major abattoirs in the border areas. We conclude that for most practical purposes England and Wales on the one hand and Scotland on the other may be regarded as two separate markets.

Scotland

10.38. There are only three commercial red meat waste renderers operating in Scotland. The largest is Forrest, which in 1992 processed over 100,000 tonnes of red meat waste at its Motherwell plant, about 71 per cent of all such waste rendered in Scotland. The two others are Dundas Brothers Ltd (Dundas Brothers) with a plant in the North-East of Scotland and Dundas Chemical Company (Mossbank) Ltd (Dundas Chemical) with a plant in the Borders. In 1992 Dundas Brothers rendered approximately 25,000 tonnes, a share of some 18 per cent, and Dundas Chemical 16,000 tonnes, a share of around 11 per cent.

10.39. Forrest has been becoming increasingly dominant in Scotland: ten years ago it had only around 50 per cent of the market compared with its current 71 per cent. Forrest is, however, a small producer compared with PDM and processes the equivalent of only around 10 per cent of all the waste processed by PDM.

The rendering market: poultry waste

10.40. Four of the main poultry producers process their own waste, and they may sell the product as feed for pigs and sheep. Not all of them use it to feed their poultry because of the risk of cross-contamination perceived by poultry retailers. They are not allowed under animal health regulations to dispose of the waste for other purposes and have no interest in competing with the renderers to process the waste of other poultry producers.

10.41. Since 1989 there has been an obligation to process poultry waste separately from red meat waste. There are only four significant commercial poultry waste renderers. PDM is by far the largest, with an estimated share of over 80 per cent of the commercial market of 300,000 tonnes. PDM has an agreement with Hillsdown, the largest poultry producer in the UK, enabling it to acquire all of Hillsdown's poultry waste (see paragraph 10.73). The other significant operators are Wildriggs Proteins Ltd (Wildriggs) in Cumbria, Mid-Norfolk Proteins and Hughes. All poultry waste produced in Scotland that requires commercial rendering is processed in England. PDM and Wildriggs collect poultry waste in Scotland.

Barriers to entry

England and Wales

10.42. There has been no significant entry into the rendering industry in England and Wales for many years. An important barrier appears to have been created by the health and environmental concerns that have led to the more demanding standards for the industry we have noted in paragraph 10.19 together with a reluctance on the part of the authorities to approve sites. Even if all the difficulties presented by environmental regulation can be overcome it is likely to take an entrant two or three years to gain all the requisite permissions.

10.43. Although we found little agreement between renderers as to the cost of entry, it is clear that environmental regulation has added substantially to that cost. Excluding very small renderers, cost estimates provided by renderers in England and Wales ranged from £2.5 to £10.0 million. Peninsular, which has had recent experience of re-equipping a plant with the latest technology, thought that the minimum cost would be £2.5 to £3.0 million.

10.44. Acquiring waste material would be a serious problem for an independent new entrant. The supply of red meat waste is at best static and probably declining (see paragraph 2.6); a new entrant can therefore only acquire material at the expense of an existing renderer. Here, PDM's reputation for taking vigorous action to safeguard its supplies is likely to discourage independent entry. The position is even less encouraging in respect of poultry waste; PDM has over 80 per cent of the commercial market and has reinforced its position by its agreement with Hillsdown to process all Hillsdown's poultry waste. The agreement is perceived in the industry to be a long-term arrangement (see paragraph 10.73).

10.45. PDM, as we have already indicated, has been active in the acquisition of rendering businesses. For the most part, the rendering plants PDM acquired were closed, and the machinery scrapped or used by PDM itself or sold, sometimes to overseas customers. We were told that other renderers often had no opportunity to bid for the business. In the case of Croda, we note that PDM acquired the rendering business and subsequently moth-balled the plant (see paragraph 10.33).

10.46. Our surveys produced some evidence that abattoirs have considered diversifying into rendering over the years; and some abattoirs indicated that, for them, this remained at least a possibility. We were also told of two examples of such diversification (see paragraph 7.68). We have heard that a New Zealand company has expressed interest in establishing a large integrated abattoir and rendering plant in Anglesey or southern Scotland on the sites of former abattoirs, but the market opportunity for such a plant is unclear. The disposal of animal waste by incineration, which might encourage entry, does not appear to represent a viable alternative to large-scale rendering. We understand that European Organic Processing Ltd is seeking planning permission for a site to open a combined maggot breeding, rendering and organic waste disposal plant and, with the support of MAFF, has applied for a grant from the EC (see paragraph 2.92).

Scotland

10.47. There has been no entry into the industry in Scotland for several years. The preceding comments on the difficulties of entering the industry in England and Wales apply similarly to Scotland, given Forrest's dominance.

10.48. We were, however, told of a possible joint venture for a proposed new rendering plant and associated incinerator in the Grampian region of North-East Scotland. This was seen as a contingency plan against possible future closure of Dundas Brothers notwithstanding the latter's determination to remain in business as a renderer (see paragraphs 7.83 to 7.84). The current situation was that Grampian Regional Council, which was a party to the joint venture, was committed to the point of selecting the most appropriate site for such a plant. Ultimately there was a political decision to be made on the matter. In addition, MAFF told us that it was currently assessing the new technological aspects of the scheme against the requirements of the Animal By-Products Order 1992, prior to any decision about putting it forward to the EC for consideration for grant.

The public interest issues

10.49. Public interest issues arise, both in England and Wales and in Scotland, with regard to pricing, market arrangements and behaviour, profitability and efficiency. There are further issues in England and Wales concerning the fulfilment by PDM of the 1986 undertakings, and concerning the transparency of PDM's financial performance. We found that the public service of animal waste disposal by the renderers and the arrangements in train in the industry for the protection of the environment were both working well.

England and Wales

10.50. We compared the complaints and allegations about PDM received during our earlier monopoly inquiry into animal waste (see paragraph 10.20) with those received during this inquiry and found a marked increase from 9 or so to 43 (see Chapters 6 and 8 and Appendix 6.1 in the 1985 report and Chapter 7 and Appendix 7.1 in this report).

Pricing

10.51. The main public interest issues concern PDM's pricing (including charging) policy and practices, and in this respect little has changed since the 1985 report. As before, we are concerned about the prices paid by PDM to its suppliers for high-grade waste and its charges for low-grade waste, and not about prices charged for its end products. The latter are, we believe, restrained by the international price of tallow, and by prices of palm oil and soya meal, which are close substitutes for tallow and meat-and-bone meal and are also traded internationally. There have been allegations from competitors that PDM engages in predatory pricing for supplies of waste, and from suppliers that PDM takes advantage of its dominant position by imposing excessive charges for collection of material such as offal or paying unduly low prices for the better material such as bones and best fat.

10.52. We considered PDM's pricing practices under two main headings: predatory pricing and discriminatory pricing. By predatory pricing we mean setting payments and charges for animal waste at levels that imply a financial loss (when other costs and expected sales revenues are taken into account) and doing so with the intention of prejudicing the survival of a competing renderer. By discriminatory pricing we mean that there is a substantial difference between prices paid to different suppliers for material of comparable quality and entailing similar collection costs. A firm that is dominant in the market can exploit its strength through discriminatory pricing.

10.53. We studied five cases of possible *predatory pricing* by PDM. One arose from a complaint by Imperial Meat Company Ltd (IMC) and related to PDM's undertakings in respect of gut-room operations. It is dealt with in paragraphs 10.64 to 10.68. The other four cases are described in Appendix 6.2. In one of these, described in paragraphs 2 to 12 of the appendix, the prices offered by PDM were likely to lead to significant losses. We did not, however, find any clear evidence that PDM was seeking by this means to drive the competing renderer (in this case Gilberts) from the market: PDM's behaviour was consistent with, and explicable by reference to, its avowed intention of maintaining its level of supplies. We have not, therefore, been able to identify any cases that are predatory in the sense of which we are using the term.

10.54. Regarding *discriminatory pricing*, we carried out a detailed analysis in order to examine the extent to which suppliers to PDM whose supplies entailed similar collection costs experienced different payments/charges for material of comparable quality. The main aim of the analysis was to compare the range of actual payments/charges with the range that could in theory result from variations in quality or differences in collection or processing cost. This proved to be a long and complicated exercise, mainly because of the breadth of the quality range within each category of material. We had extensive discussions with PDM about facts and figures used in the analysis and about the methodology. PDM was highly critical of our approach and suggested a number of changes. We have been able to reflect a number of PDM's suggestions in the analysis; others we have not accepted. After taking careful account of PDM's representations, we are satisfied that the analysis is robust. To a significant extent variations in payments/charges cannot be explained by reference to variations in yields of end products or by other physical factors, even when combined with a reasonable degree of variation to account for ordinary competition. The details of the analysis are set out in Appendix 6.1.

10.55. In order to check whether the range of prices paid by PDM was greater or smaller during the period of more intense competition in the middle months of 1992 than at other times, we examined the range of PDM's prices in April 1993 and compared them with those of May and October 1992. We found that there was no significant difference between April 1993 and October 1992 and little difference between April 1993 and May 1992. Our various studies show, in sum, that:

- (a) PDM's payments/charges varied widely in a way that was not always related to physical factors (see paragraph 6.9 and Appendix 6.1);
- (b) PDM sometimes made significantly lower charges or paid significantly higher prices when another renderer bid for an abattoir's supplies (see paragraph 6.7 and Appendix 6.2);
- (c) at times of acute competition PDM sometimes lowered its charges or raised its payments to a level that meant that it made losses on the contracts (see paragraph 6.14 and Appendix 6.2, paragraph 12); and
- (d) PDM negotiated a single set of charges/payments with some large suppliers operating from a number of locations, and therefore did not make charges or payments that reflected the economic value to it of the supplies it collected from each of those locations as it would for single-location suppliers (see paragraph 6.3).

10.56. We also considered whether PDM's practice of offering package deals to abattoirs for different types of material was anti-competitive (see Appendix 6.1, paragraphs 18 and 19). PDM assured us that it only offered such deals at the request of its suppliers, and the evidence we have found is insufficient to support a conclusion that the deals were damaging competition.

10.57. We conclude that PDM has engaged in discriminatory pricing. The wide range of charges/payments we have found is to a significant extent unaccounted for by physical factors, even when combined with a reasonable degree of variation to account for ordinary competition. PDM has been able to set different charges/payments unrelated to cost differences. It has admitted that in some cases it set charges/payments which resulted in a loss in the price war during the middle months of 1992; this behaviour fell short of predatory pricing in the cases we studied (see paragraph 10.53), though we believe that PDM will generally have been aware when prices offered would mean that the contract would be loss-making (see paragraph 6.14).

10.58. PDM and Gilberts both say that the origin of the price war was Gilberts' acquisition of material from certain of PDM's suppliers. We understand that the war affected other renderers, particularly in England and Wales, but also to a limited extent in Scotland because suppliers, notably the larger firms with operations in both Scotland and England, compared charges/payments and sought parity of treatment. PDM assured us that it was not in the normal course its policy to compete for another renderer's supplies. It tended, however, to retaliate if its own supplies were under threat. We were told that this latest price war ended after a telephone conversation between PDM and Gilberts, which was initiated by PDM.

10.59. It might be thought that the intermittent price wars which occur in the industry are indicative of a healthy climate of competition. It seems to us, however, that there is generally little competition amongst renderers. As we have noted in the preceding paragraph, PDM admits that it does not normally compete for other renderers' supplies, and we believe that for the most part its policy of selective retaliation keeps other renderers in their place, allowing PDM to become increasingly dominant (see paragraphs 8.34 and 8.36).

10.60. As to the telephone conversation between PDM and Gilberts referred to in paragraph 10.58, it appears to us that this may have given rise to an agreement which is subject to registration under the Restrictive Trade Practices Act 1976. Section 54(5) of the Fair Trading Act 1973 directs the MMC to exclude from their investigation consideration of whether an agreement which is subject to registration under the Restrictive Trade Practices Act 1976 operates against the public interest. We are therefore debarred from reaching any public interest conclusions on this matter. No doubt the DGFT will take any action he considers necessary.

10.61. PDM's pricing practices need to be seen in the context of the company's position in the industry. It is the only renderer that obtains supplies from the whole of England and almost the whole of Wales; it is a much larger company, and has much greater financial strength, than other renderers; and the size of its acquisitions of animal waste is such as both to make it much less vulnerable than other renderers to the loss of individual large suppliers and to provide it with opportunities for discrimination between customers of different types and locations. The practices set out in paragraph 10.55 show that PDM has market power which it exercises over-zealously to protect its supplies. By engaging in price discrimination, it squeezes smaller competitors, particularly any competitor which attempts to gain supplies at PDM's expense.

10.62. We conclude that PDM's practice of discriminatory pricing (see paragraph 10.57) is a step taken for the purpose of exploiting and maintaining the monopoly situation and that this constitutes a fact which operates and may be expected to operate against the public interest. The particular effect adverse to the public interest is the restriction of competition in rendering.

The 1986 undertakings

10.63. We have been concerned about certain aspects of PDM's undertakings, which are set out in full in Appendix 1.2.

Gut-room undertakings

10.64. Undertaking 1(iv)(b) requires PDM to provide to the DGFT in respect of each gut-room contract into which it proposes to enter a statement providing estimates of throughput, yield of product and expenses. It is clear that this undertaking requires a budget to be submitted to the DGFT *before* PDM enters into a new contract. PDM has not done this. Therefore when IMC, a specialist gut-room operator, complained to the DGFT in 1991 that a contract at West Devon Meats, Hatherleigh, had been taken on by PDM at uneconomic prices in breach of the 1986 undertaking, the DGFT had no budget to hand against which to check the complaint. In this instance PDM supplied a budget 20 weeks after the contract had begun (see paragraph 7.47 and Appendix 6.3).

10.65. Undertaking 1(iv)(c) requires PDM to submit to the DGFT 'an audited annual statement, within three months of the end of the relevant accounting reference period, of the profit and loss of its gut-room business, together with reconcilable management accounts showing the profit and loss of each gut-room contract separately'. PDM's actual returns to the DGFT have comprised a list of the profits for each gut-room

and an audited profit and loss account statement for the gut-room business as a whole, but without 'reconcilable management accounts' for each gut-room. Revenues and expenses from transactions with PDM's other businesses have not been shown separately from revenues and expenses from transactions with third parties. It follows that, as a large proportion of the sales, most of the haulage expense and all of the administration charges are of this nature, there is no basis for determining whether such revenues and expenses are on an arm's length basis. Moreover, PDM has not demonstrated to the DGFT that the weekly administration charge of £50 for each gut-room is based on a reasonable allocation of overheads, as required by undertaking 1(iii)(a). We also note that the returns have generally been submitted late, usually in October, six months after the 31 March year-end, and that the statement for 1991/92 was not submitted until January 1993 (see Appendix 6.3).

10.66. We have found that PDM has failed to adopt and operate accounting systems and accounting procedures in the manner required by undertaking 1(iii). In particular:

- (a) PDM's administration charge of £50 per week for each of its gut-rooms is only sufficient to cover the direct administration costs. It is not sufficient to cover indirect costs, as required by undertaking 1(iii)(a).
- (b) We do not believe that PDM's inter-company transfer prices for the Hatherleigh gut-room were equal to those that would be credited in respect of an equivalent transaction at arm's length, as required by undertaking 1(iii). When we costed the Hatherleigh gut-room using the prices paid to IMC and charges made to its associated abattoirs by PDM for similar material, we found that the gut-room had operated at a loss.

10.67. There is no evidence that PDM deliberately took on the Hatherleigh gut-room on loss-making terms with the intention of damaging IMC, which would be necessary to sustain a charge of predatory pricing. However, PDM has been cross-subsidizing its gut-room operations in breach of undertaking 1, thus continuing the effect, identified at paragraph 9.42 of the 1985 report, that PDM has been enabled to pay prices or make charges which a gut-room operator who is not also a renderer might not be able to match.

10.68. We conclude, therefore, that PDM is in breach of undertaking 1 through failure to adopt and operate accounting systems and accounting procedures in the manner required, through failure to charge adequate administration costs to its gut-room operations and through failure to make arm's length payments/charges for the collection of raw materials from abattoirs where it operates gut-rooms. These are steps taken for the purpose of maintaining the monopoly situation and constitute facts which operate and may be expected to operate against the public interest. The particular effects adverse to the public interest are that the DGFT has been deprived of information concerning the financial results of PDM's gut-room activities which would have enabled him to intervene with timely measures to protect competition in the operation of gut-rooms and in rendering, and that competition in the operation of gut-rooms and in rendering has been restricted.

Undertaking to notify intended acquisitions

10.69. Undertaking 3 requires PDM to notify the DGFT at least one month before the date on which PDM or its subsidiaries (as the case may be):

- (a) acquire directly or indirectly or do anything with the intent that an associated person will acquire directly or indirectly any animal waste enterprise; or
- (b) do anything alone or with others which would result in any animal waste enterprise ceasing to be distinct (within the meaning of section 65, interpreted, where appropriate, in accordance with section 77, of the Fair Trading Act 1973) from any enterprise carried on by or under the control of PDM or any of its subsidiaries.

10.70. PDM has failed to notify 12 small acquisitions of the goodwill of certain businesses (all but one being a collector), with a total value of £168,250 and involving some 180 tonnes of animal waste a week (see Appendix 4.3). This amounts to nearly 1 per cent of the supply of red meat waste in England and Wales, not an insignificant tonnage to the smaller renderers. Such acquisitions illustrate the problem of creeping

purchases: individually they may be insignificant but collectively they enhance PDM's market dominance. PDM has argued that 'in the majority of cases pre-notification was not necessary because no acquisition of a business actually took place' (see paragraph 8.20). In our view, by purchasing the goodwill of the businesses, PDM acquired animal waste enterprises as defined in the undertaking.

10.71. We conclude, therefore, that PDM is in breach of undertaking 3 through failure to notify acquisitions of animal waste enterprises, and that this is a step taken for the purpose of maintaining the monopoly situation which constitutes a fact that operates and may be expected to operate against the public interest. The particular effects adverse to the public interest are that the DGFT has been deprived of information which would have enabled him to intervene with timely measures to protect competition in rendering, and that competition in rendering has been restricted.

10.72. In our view, these failures to fulfil undertakings given to the DGFT following the 1985 report (see paragraphs 10.68 and 10.71) are a serious matter.

Market arrangements and behaviour

PDM's agreement with Hillsdown

10.73. In October 1992 PDM entered into an agreement with Hillsdown, whereby PDM agreed to collect all of Hillsdown's UK poultry by-products. Prior to the agreement all but one of Hillsdown's processing plants were serviced by PDM. Hillsdown and PDM agreed a uniform price for each product (with some exceptions), which we understand was similar to that already being paid to the majority of the poultry companies. To reflect the volume of materials to be supplied by Hillsdown and the value of those materials to PDM, PDM agreed that it would make an additional payment of £3 per tonne, quarterly in arrears. We were informed by the parties that these arrangements did not form the subject of a written contract and that it was intended that the agreement would be reviewed on a quarterly basis. We found no support for the common belief in the industry that the agreement was set to last for five years, but noted that both parties expected it to be ongoing.

10.74. Hillsdown was able to produce notes of meetings and other documentation concerning the agreement. We asked PDM for its records of the same agreement, but were told that it had no such documentation. Given the importance of the contract in securing a large volume of poultry waste for PDM, we found this unsatisfactory, and it adds to our concern about the lack of transparency in PDM's activities (see paragraphs 10.82 to 10.87).

PDM's informal links with other companies

10.75. Three competitors alleged that PDM enhanced its dominance of the supply of animal waste in England and Wales by informal links with other enterprises in the industry such as the Klein family and G H Klein & Son Ltd (the Kleins), Specialpack Ltd and E Clutton & Sons (Marchwiel) Ltd. We looked carefully into PDM's dealings with these enterprises but were unable to find any evidence of informal links that were detrimental to competition (see paragraphs 4.49 *et seq*).

10.76. We found that PDM's arrangements with the Kleins were particularly complex. Various allegations were made to us that the Kleins acted as agents for PDM. The allegations are no doubt partly based on the Kleins operating from a temporary building on PDM's Silvertown site, having their vehicles maintained by PDM, and generally making use of PDM's Silvertown facilities (for which they are invoiced by PDM). The most serious of the allegations was that the Kleins were acting on behalf of PDM when in 1991 they acquired and sold the rendering assets of Faversham Animal By-Products Ltd. PDM told us that it did not in any way encourage the Kleins to acquire these assets. It was only later when G H Klein & Son Ltd had liquidity problems that PDM decided to grant that company an interest-free loan of £200,000. PDM said that it was motivated by a desire to support an animal waste collector with whom it had been connected for more than 20 years, and that it was concerned to protect its investment in the building site owned by Stannard & Co (1969) Ltd, a non-trading company jointly owned by PDM and the Kleins.

PDM's relationship with Hi-Cal Proteins Ltd

10.77. Over 40 per cent of PDM's sales are made through Hi-Cal Proteins Ltd (Hi-Cal), a Jersey-based broker. Under the arrangements PDM sells meat-and-bone meal to Hi-Cal and that company invoices PDM's customers and provides a sales force through its UK agent, Thomas Mawer Ltd. PDM told us that the arrangements 'often quite understandably raise a few eyebrows'. It had itself heard comments implying a device to hide profits in Jersey. In fact they were long-standing arm's length arrangements for which Hi-Cal made a reasonable charge of some 2.2 per cent of sales. We asked PDM whether it had any interest in Hi-Cal directly or indirectly, and it said that it had no such interest. Nevertheless these offshore arrangements for products which are primarily sold in the UK add to the lack of transparency which is not infrequently associated with PDM's activities.

PDM's surveillance of a competitor's premises

10.78. Our attention was drawn to PDM's surveillance of a competitor's premises (see paragraph 7.56). We did not find PDM's explanation entirely convincing (see Appendix 7.1, paragraph 11(c)), but as no current instances of such conduct were brought to our attention, we did not consider that it was necessary to pursue this matter further.

Alleged collusion between PDM and Hillsdown's subsidiaries

10.79. It was put to us that PDM and Hillsdown's subsidiaries, Forrest and Peninsular, had reached understandings not to encroach on each other's territories. The parties strongly denied that there were any such arrangements.

10.80. So far as PDM and Peninsular are concerned, we found that following re-equipment of its West Country plant in 1991/92 Peninsular had acquired sufficient suppliers to absorb the plant's peak capacity, and that it had gained some supplies at the expense of PDM. While we saw no indication that PDM had competed strongly with Peninsular, there was no evidence of any understanding between the companies.

10.81. So far as PDM and Forrest are concerned, we found that Forrest did not in the normal course of business attempt to collect material in England and Wales. Forrest argued that it was apparent from the location of renderers in southern Scotland and northern England and the volumes of raw materials available to those renderers that there was a natural geographic division at or about the border between England and Scotland. It would find it difficult to collect material in England unless it could establish a base south of the border, in practical terms by taking over an existing licensed plant. It had tried to acquire such a base, so far without success (see paragraph 9.14). We found no evidence of collusion with PDM. We deal with PDM's activities in Scotland in paragraph 10.106.

Transparency and profitability

10.82. We considered whether the results of PDM's rendering operations (carried on by Prosper De Mulder Ltd and its subsidiary and related companies) were sufficiently transparent.

10.83. PDM told us that as a private limited company it wished to keep its financial performance private. We found that it had achieved this by splitting itself into six separate companies, of which four were important:

Prosper De Mulder Ltd and subsidiaries;
Prosper De Mulder Transport (an unlimited company);
Prosper De Mulder Services (an unlimited company); and
Frazer (Butchers) Ltd and subsidiaries.

10.84. The unlimited companies which do not file accounts with the Registrar of Companies incur expenses on behalf of the other companies which they rebill with a mark-up. The existence of this mark-up

depresses the reported profits of the other two companies which do file accounts. The retention of profits in the unlimited companies and the existence of loans between the various companies (which are not described in the accounts of the individual companies as being due to or from associates) give an incomplete impression of PDM's overall profitability and of its financial position to any person who has to rely on publicly available sources (see paragraph 3.11). By disclosing only part of its profits in Prosper De Mulder Ltd, PDM is less likely to face pressure from suppliers for improved prices for raw materials or to alert potential entrants into the rendering industry of the profitability of rendering. The authorities are also left in ignorance of PDM's true financial performance.

10.85. PDM calculated for us its return on capital employed (ROCE) by all its companies engaged in the rendering business for the five years ended 31 March 1992. These figures may be compared with the ROCE of (a) 56 food manufacturers and (b) 10 meat processors, as shown in Table 10.1.

TABLE 10.1 PDM's ROCE compared with food manufacturers' and meat processors'

	<i>per cent</i>			
	<i>PDM</i>		<i>Food manufacturers</i>	<i>Meat processors</i>
1987/88	16.0	1988	19.1	13.9
1988/89	21.2	1989	21.3	16.9
1989/90	11.9	1990	23.3	18.5
1990/91	17.8	1991	22.6	17.6
1991/92	30.3	1992	23.3	9.8
1987/88 to 1991/92	19.4	1988 to 1992	21.9	15.3

Sources: PDM; MMC from MicroEXSTAT.

10.86. PDM's ROCE of 30.3 per cent in 1991/92 is high, but the average over the five years is much lower, at 19.4 per cent. Moreover, we have examined PDM's unaudited management accounts for 1992/93; they clearly indicate that the price war in that year has been costly (see paragraph 3.26) and that there will be a sharp fall in the ROCE compared with 1991/92. We have already referred to the suggestion that PDM's arrangements with Hi-Cal may allow PDM to understate its profits in the UK (see paragraph 10.77). There is, however, no evidence that such understatement has taken place, and we therefore conclude that there are no grounds for an adverse public interest finding on PDM's level of profits.

10.87. Nevertheless, we conclude that, for the reasons stated in paragraph 10.84, PDM's arrangement of its accounts in such a way as to avoid disclosure of the true profitability of its rendering business is a step taken for the purpose of exploiting and maintaining the monopoly situation and that this constitutes a fact which operates and may be expected to operate against the public interest. The particular effects adverse to the public interest are that it deprives PDM's customers and potential competitors of information which could help to redress the market imbalance resulting from PDM's dominance, and deprives the relevant authorities of a clear picture of PDM's continuing ability to make a major contribution to the provision of a vital public service.

Efficiency

10.88. We compared PDM's financial results with the weighted averages of three smaller renderers in England and Wales, and with those of Forrest, over the three years 1989 to 1991, on the basis of £ per tonne processed (see paragraphs 3.46 to 3.62).

10.89. We calculated three components of cost: transport, processing and other operating costs. PDM's costs under all these headings were significantly higher than those of the smaller renderers, and its total operating costs were higher than those of Forrest and the weighted average of the smaller renderers. As PDM told us that it incurred higher costs because of its separation of raw materials and the expense of

transporting them to specialist plants, but that these costs were more than offset by higher yields of grade 2 tallow and of other high-grade products, we deducted end-product sales from operating costs to give a 'processing margin'. We found that PDM had a lower processing margin than Forrest and the smaller renderers.

10.90. We also found that PDM had paid less on average for its materials than the smaller renderers, but some allowance needs to be made for the different mix of materials purchased by PDM. PDM's profit before interest and tax (PBIT) was on a rising trend while that of the smaller renderers was falling.

10.91. We looked at the components of capital employed. The net book value of PDM's plant and machinery, per tonne processed, was much lower than that of the smaller renderers.

10.92. A review of processing costs suggested that PDM had higher energy and repair costs per tonne processed, but a lower depreciation charge than the smaller renderers. Other fixed assets were lower for PDM than for the smaller renderers. This reflected lower net book values for land, buildings and vehicles. Overall the net book value per tonne processed of fixed assets of the smaller renderers was almost three times that of PDM.

10.93. The overall comparison showed that PDM's ROCE had averaged 20 per cent and was on a rising trend, while that of the smaller renderers was 13 per cent and declining despite their lower operating costs. The average ROCE of the smaller renderers disguised a very wide range of performance.

10.94. PDM was critical of our analysis of comparative performance of renderers. In its view 'the business of PDM cannot be compared with those of other renderers on pure financial grounds because they are different in so many fundamental respects from those of the other single plant renderers in England and Wales'. We have given careful consideration to PDM's arguments and we acknowledge that there is some force in them. Nevertheless we believe that limited conclusions can be drawn from the analysis. We had expected that PDM's practice of channelling materials to particular specialized plants in order to maximize the value of end products would result in higher transport costs, but were surprised that its processing margin was lower than the other renderers.

10.95. We conclude that there is little indication in our analysis that PDM is more efficient than the smaller renderers, and there must be at least some doubt whether it achieves the network benefit claimed from its multi-site operation.

10.96. The 1985 report noted, at paragraph 9.18, a lack of formality in PDM's information systems and felt that a rather more formal style of management was becoming appropriate. We have already commented on the lack of records concerning the Hillsdown agreement (see paragraph 10.74). It also became clear to us in the course of our inquiry that PDM did not have the information readily to hand to justify its pricing decisions, but had to carry out special studies in order to attempt to justify its pricing decisions some time after the events. We do not go so far as to make an adverse public interest finding with regard to PDM's record-keeping, but we note that PDM's management information systems fall well short of best management practice.

Scotland

10.97. There were eight complaints concerning Forrest. These included particularly detailed allegations of predatory pricing from its two competitors in Scotland, Dundas Brothers and Dundas Chemical (see Appendix 6.5). We comment further on these allegations in paragraph 10.99.

Pricing

10.98. The main public interest issues concern Forrest's pricing policy and practices. We are concerned about the charges made and prices paid by Forrest to its suppliers, and not about prices charged for its end products. As mentioned in the preceding paragraph, there have been complaints from competitors that Forrest engages in predatory pricing, and the evidence shows that Forrest makes a wide range of charges and payments for the collection of low-grade waste and pays a wide range of prices for high-grade material. We adopted the same approach to studying Forrest's pricing practices as we took for PDM (see paragraphs 10.52 *et seq.*).

10.99. We studied four cases of alleged *predatory pricing* by Forrest (see Appendix 6.5). The studies show that Forrest has competed hard for supplies necessary to maintain what it considers to be an adequate level of profitability, and that in two cases it made losses on the relevant contracts, but there was no evidence that Forrest intended to prejudice the survival of its competitors.

10.100. Regarding *discriminatory pricing*, we carried out a detailed analysis in order to examine the extent to which there was variation between the charges/payments experienced by different suppliers to Forrest whose supplies were of comparable material, entailing similar collection costs. As with PDM this was a difficult exercise because of the quality variation within each category of material. Details of the study are set out in Appendix 6.4.

10.101. Our various studies show:

- (a) Forrest's charges/payments varied substantially in a way that was frequently not attributable to physical factors (see paragraph 6.18 and Appendix 6.4);
- (b) Forrest sometimes made significantly lower charges or paid significantly higher prices, not related to costs, when another tenderer bid for an abattoir's supplies (see paragraph 6.19 and Appendix 6.5); and
- (c) at times of acute competition Forrest sometimes lowered its charges or raised its payments to a level that meant that it made losses on the contracts (see paragraph 6.20).

10.102. Forrest pointed to physical factors that explained many of the charges/payments variations, but accepted that it sometimes made offers that varied according to the existence or extent of competition from other tenderers. Such offers sometimes resulted in losses on particular contracts. Having carefully considered all the evidence we are satisfied that many individual payments/charges cannot be explained by differences in physical factors even when combined with a reasonable degree of variation to account for ordinary competition.

10.103. As with PDM, Forrest's pricing practices need to be seen in the context of its position in the industry. It is the only tenderer that obtains supplies from the whole of mainland Scotland, and the only significant competitive pressure it faces is from Dundas Brothers and Dundas Chemical. Forrest is a much larger company than these competitors, has much greater financial strength and the size of its acquisitions of red meat waste is much larger than theirs. These factors make it much less vulnerable to the loss of individual large suppliers and provide it with opportunities for discrimination. Forrest's practices show that it has market power which it exercises over-zealously to protect its supplies. It exploits this by engaging in price discrimination, which has the effect of squeezing its two smaller competitors.

10.104. The low marginal cost of processing animal waste associated with the kind of continuous plant operated by Forrest and the other large tenderers provides a powerful incentive to seek extra tonnage by price discrimination. When a dominant supplier, such as Forrest, engages in this practice, it is likely to damage smaller competitors to the extent that they are forced out of business. This would be particularly detrimental to competition in Scotland, where there are only two such competitors.

10.105. We conclude that Forrest's practice of discriminatory pricing (paragraph 10.103) is a step taken for the purpose of exploiting and maintaining the monopoly situation and that this constitutes a fact which

operates and may be expected to operate against the public interest. The particular effect adverse to the public interest is the restriction of competition in rendering.

Market arrangements and behaviour

10.106. We referred in paragraph 10.79 to the belief in the industry that PDM and Forrest had reached an understanding not to encroach on each other's territory. We noted in the course of our inquiry that PDM collected poultry waste in Scotland for processing in Widnes, and enquired why PDM had not adopted a similar strategy for red meat waste. PDM told us that its entry in the late 1970s into the red meat waste market in Scotland had not been a success. It had found it difficult to service the rendering business from England, and had sold out after three or four years. It would be so difficult to gain adequate supplies of red meat waste in Scotland that it could only contemplate re-entering the market on the basis of acquisition (see paragraph 8.15). As we say in paragraph 10.81, we found no evidence of collusion between PDM and Forrest.

Profitability

10.107. We calculated Forrest's ROCE for the five years ended 31 December 1992 on the basis of the company's audited accounts. The ROCE averages 41.1 per cent over the period. Forrest told us that an independent valuation of its property in 1987, on the basis of open market value for existing use, had reduced the value by nearly £1 million, and that the revaluation had been incorporated into the statutory accounts. It argued that the ROCE should be adjusted to take account of the revaluation, reducing the return to an average of 28.2 per cent over the five years. The results of the alternative calculations are set out in Table 10.2.

TABLE 10.2 **Forrest's ROCE**

	<i>Unadjusted</i>	<i>Adjusted</i>
1988	47.1	37.3
1989	36.6	23.1
1990	43.8	29.3
1991	50.7	33.8
1992	27.1	17.3
1988 to 1992	41.1	28.2

Source: Forrest.

10.108. In our view it is generally advisable when considering the profitability of companies to adopt the conventions and information in the audited accounts. Here, however, we see no need to come down on one side of the argument or the other. On either basis of calculation the average level of profitability exceeds by a wide margin the 19.4 per cent achieved by PDM, or the average returns achieved by food manufacturers (21.9) or meat processors (15.3) (see Table 10.1). Forrest told us that its profitability declined in 1992 partly because of repercussions from the price war in England and Wales (see paragraph 10.58). We are, however, still inclined to our view that the markets for red meat waste in England and Wales, and Scotland, are separate (see paragraph 10.37). Looking to the future, Forrest's forecasts indicate, perhaps conservatively, that ROCE of [*], [*] and [*] per cent will be achieved in the years 1993, 1994 and 1995 respectively and that purchases of fixed assets would be [*], [*] and [*] per cent of operating cash flow respectively in those years, indicating that the expenditure would be well covered.

10.109. We conclude that Forrest's profitability reflects higher charges and lower payments for animal waste than would have been the case under more competitive conditions, and that such a level of profitability is likely to continue. These higher charges and lower payments are steps taken for the purpose

*Figures omitted. See note on page iv.

of exploiting and maintaining the monopoly situation and constitute facts which operate and may be expected to operate against the public interest. The particular effects adverse to the public interest are that charges have been higher and payments lower than they would have been under more competitive conditions, and that this situation may be expected to continue.

Efficiency

10.110. For reasons of confidentiality concerning Forrest's two competitors in Scotland we compared Forrest's financial results over the three years 1989 to 1991 with the weighted averages of the same three renderers we used in the PDM comparison (see paragraph 10.88), again on the basis of £ per tonne processed.

10.111. We calculated three components of cost: transport, processing and other operating costs. Forrest's transport and processing costs per tonne were significantly higher than those of the smaller renderers. The long distances travelled and the costs of Forrest's two depots may explain the higher transport costs. However, Forrest's processing costs were higher than those of any individual renderer included in our calculations. We note that Forrest's capacity utilization at about 45 per cent was below that of any of the smaller renderers and far below the 85 per cent achieved by PDM. Forrest had the additional expense of its solvent extraction plant (now closed) which gave higher yields of tallow than the plants of the smaller renderers and PDM.

10.112. We deducted end-product sales from operating costs to give a 'processing margin', to see if the higher operating costs were offset by a higher value of end products. It appeared that this was the case for Forrest, because its processing margin is similar to the average for the smaller renderers. Forrest paid less for its materials than the other renderers (much less if the purchases of greaves are taken into account), so that it has enjoyed higher profits. PBIT has remained level while that of the smaller renderers has fallen.

10.113. We looked at the components of capital employed. The net book value per tonne of Forrest's plant and machinery (before deduction of investment grants) was much lower than that of the smaller renderers.

10.114. Other fixed assets per tonne processed were lower for Forrest than for the smaller renderers, even if adjustments were made to restate leasehold properties at historical cost and to add back £3 or £4 per tonne for investment grants. Overall the net book value of fixed assets per tonne of the smaller renderers was about two and a half times that of Forrest.

10.115. The overall comparison showed that Forrest's ROCE averaged 43 per cent and was on a rising trend, while that of the smaller renderers was 13 per cent and declining, in spite of their lower operating costs. Forrest had high operating costs, particularly for processing. It had paid less for its materials than the smaller renderers and, with its low asset base, had enjoyed much higher returns.

10.116. Forrest told us that it did not consider it appropriate or sustainable to compare Forrest with smaller renderers and simply to apply a weighting in terms of tonnes processed (see paragraph 3.51). We have carefully considered Forrest's detailed comments on our analysis, and have taken them into account in reaching our conclusions.

10.117. Forrest has higher operating costs than the average of the three smaller renderers. Given the long distances over which it has to transport much of its waste, we can understand that it has high transport costs. But its average processing costs were significantly higher than those of the average of the smaller renderers. Unlike PDM, Forrest did achieve higher selling prices for its end products in 1989 and 1990 benefiting from its use of solvent extraction (see paragraph 10.111) to obtain higher tallow yields. In 1991, when its end products achieved less of a premium, it paid less for its materials than the small renderers, so that in all three years, assisted by the relatively low level of its capital employed, it earned the highest ROCE of all the renderers.

Summary of conclusions

England and Wales

10.118. We have concluded that the following steps taken by PDM for the purpose of exploiting and/or maintaining the monopoly situation constitute facts which operate and may be expected to operate against the public interest:

- (a) PDM's practice of discriminatory pricing, which has the particular adverse effect of restricting competition in rendering (see paragraph 10.62);
- (b) PDM's breach of undertaking 1 through failure to adopt and operate accounting systems and accounting procedures in the manner required, through failure to charge adequate administration costs to its gut-room operations and through failure to make arm's length payments/charges for the collection of raw materials from abattoirs where it operates gut-rooms, which have the particular adverse effects that the DGFT has been deprived of information concerning the financial results of PDM's gut-room activities which would have enabled him to intervene with timely measures to protect competition in the operation of gut-rooms and in rendering, and that competition in the operation of gut-rooms and in rendering has been restricted (see paragraph 10.68);
- (c) PDM's breach of undertaking 3 through failure to notify acquisitions of animal waste enterprises, which has the particular adverse effects that the DGFT has been deprived of information which would have enabled him to intervene with timely measures to protect competition in rendering, and that competition in rendering has been restricted (see paragraph 10.71); and
- (d) PDM's arrangement of its accounts in such a way as to avoid disclosure of the true profitability of its rendering business, which has the particular adverse effects that it deprives its customers and potential competitors of information which could help to redress the market imbalance resulting from PDM's dominance, and deprives the relevant authorities of a clear indication of PDM's continuing ability to make a major contribution to the provision of a vital public service (see paragraph 10.87).

10.119. We have found no actions or omissions attributable to the monopoly situation (see paragraph 10.1(d)).

Scotland

10.120. We have concluded that Forrest's practice of discriminatory pricing is a step taken by Forrest for the purpose of exploiting and maintaining the monopoly situation and that this constitutes a fact which operates and may be expected to operate against the public interest. The particular adverse effect is the restriction of competition in rendering (see paragraph 10.105). We have further concluded that Forrest's profitability reflects higher charges and lower payments for animal waste than would have been the case under more competitive conditions, and that such a level of profitability is likely to continue. These higher charges and lower payments are steps taken for the purpose of exploiting and maintaining the monopoly situation and constitute facts which operate and may be expected to operate against the public interest. The particular adverse effects are that charges have been higher and payments lower than they would have been under more competitive conditions, and that this situation may be expected to continue (see paragraph 10.109).

10.121. We have found no actions or omissions attributable to the monopoly situation (see paragraph 10.1(d)).

Recommendations

Introduction

10.122. Having identified particular effects adverse to the public interest concerning the conduct of PDM in England and Wales (paragraph 10.118) and Forrest in Scotland (paragraph 10.120), we have to consider what action (if any) should be taken to remedy or prevent these.

10.123. In addressing this task we have been mindful that the business of animal waste collection and rendering constitutes a vital public service as well as a commercial activity. We have also noted the continuing substantial concentration that has taken place in the industry over many years (see paragraph 2.16). Against this background we considered going to the lengths of subjecting the industry to a comprehensive system of regulation, including perhaps the creation of an Office of Animal Waste. Such a regulatory body might be given responsibility for regulation of prices; licensing of renderers and collectors of animal waste; environmental controls and the associated monitoring; and the monitoring of our recommendations.

10.124. We have rejected this approach. As regards the public service aspect of the industry, there is already in place an adequate regime to protect the public health and control environmental pollution, and large and small firms alike have impressed us with the progress they have made in meeting the stringent requirements being placed upon them. The problems arising from concentration are dealt with in the recommendations which follow.

PDM

Remedying the adverse effects on competition

10.125. We have found that the adverse effect of PDM's discriminatory pricing is the restriction of competition in rendering in England and Wales. We considered whether a pricing formula should be imposed on PDM for its purchase of raw materials which took account of yield and selling prices of end products; costs of transport and processing of the raw materials, and related overheads; and a reasonable level of profit.

10.126. PDM told us that in negotiating prices it already took account of such variables. But the price paid for each category of animal waste was influenced by other significant factors: quantity, quality, method of handling, location, collection service required, nationally negotiated contracts (covering, in particular, multiple collection points) and considerations of competition. Although there were a few formula-based contracts, general imposition of a pricing formula would, in PDM's view, be impossible to apply objectively and would unduly distort the competitive process. It also considered that determining a reasonable level of profit raised very considerable problems.

10.127. We acknowledge that imposing a pricing formula on PDM alone in England and Wales would distort competition, even though it could help to redress the competitive balance in a market already distorted by PDM's dominance. We also recognize that the implementation of a pricing formula would be difficult in this market and it would in our view be justified only if no other remedy were available.

10.128. We believe that other pricing remedies are available, and we considered two in particular, both of which would enhance competition by increasing the transparency of PDM's pricing of raw materials. One is a system of *posted prices*, under which PDM would be required to post in advance the ranges of prices for raw materials which it would offer. The other is a system of *published prices*, under which PDM would be required to publish in arrears details of prices recently paid.

10.129. PDM argued that because of the great variability between batches of raw material, *posted prices* could at best be merely a broad starting point for negotiations; a rigidly enforced posted price would preclude PDM from negotiating a price which more closely reflected the real economic value of the particular material.

10.130. We believe that a *posted price* system would need to be detailed. The main drawback of such a structure is that it would require not only that a new pricing system be implemented throughout the industry but also that there should be a much greater degree of separation of materials at the abattoir. This would impose on the abattoir an additional and exacting task, solely for the purpose of implementing the pricing system. We do not consider that this additional burden for the suppliers and the extra costs that would be entailed would be justified.

10.131. A *published price* system would not require as detailed a pricing structure, as it would be designed not to determine prices, but to provide information, in particular to suppliers and competing renderers, to assist the market to work more effectively. But even for this purpose of providing information the current system of pricing by main categories of material would be insufficiently precise. For example, it would not be of great advantage to a supplier to know what had been the range of prices paid by PDM during the previous week for best fat: he would have little idea what point on that range was appropriate to his own circumstances given the quality of his material and the cost of collecting it.

10.132. An effective *published price* system would therefore require additional detail to be provided regarding each contract and the prices to be reported in order to indicate in particular the quality and quantity of material purchased. A possible system is outlined in Appendix 10.1. We expect that such a system would provide suppliers with additional useful information on price and would place them in a stronger position in negotiating with PDM. It would be more difficult for PDM to pay particularly high or low prices to one supplier but not to others in similar circumstances.

10.133. PDM told us that it would be willing to publish a summary on a monthly basis of prices which it had paid for generic categories of animal waste if we came to the conclusion that such information would better enable all suppliers of animal waste to know what 'the approximate going rate' was for animal waste material. However, it believed that at best such information could only indicate general rather than specific levels of prices being paid. In our view such general information will not go far enough.

10.134. To diminish the effects of discriminatory pricing (see paragraph 10.118), we recommend that PDM should be required to publish weekly, together with detailed related information, a representative sample of prices and charges it has negotiated in the preceding week, commencing with the week ending 9 October 1993, in a form approved by the DGFT.

10.135. We also considered whether the divestment of one or more of PDM's major rendering facilities would be an appropriate remedy for the adverse effects on competition. PDM told us that 'the forced break-up' of its rendering organization would put at risk the integrated, safe and efficient system currently prevailing in England and Wales. We do not accept that the divestment of a major plant would have the dire effects predicted by PDM, but believe that such a requirement would be disproportionate to the adverse effects we have found.

10.136. Divestment of the Market Harborough plant, however, is another matter. The plant has been moth-balled and is clearly not central to PDM's needs. Nevertheless, in the hands of another renderer this recently refurbished plant is likely to augment the competition faced by PDM. The attraction for an existing renderer or a new entrant is that the plant already has a licence to process animal waste and many of the difficulties associated with starting a rendering activity may therefore be avoided.

10.137. In order to diminish the adverse effects of discriminatory pricing (see paragraph 10.118), we recommend that PDM should be required to dispose of its Market Harborough plant including its rendering capacity within six months from the publication of our report to a purchaser (not associated directly or indirectly with PDM) approved by the DGFT and that, pending disposal, the plant should be kept in good repair but not be operated.

10.138. We have described in paragraphs 10.42 to 10.46 and 2.82 to 2.92 a number of barriers to entering the rendering industry. If, as a result of these, or for any other reason, no bid is forthcoming from a new entrant or from an existing renderer within the six-month period, we recommend that the Market Harborough plant should be decommissioned and the machinery sold by public auction, with a prohibition on sale to a PDM company or related organization or person. The licence for animal waste processing at Market Harborough should be surrendered at the same time.

Breaches of the 1986 undertakings

Gut-rooms

10.139. In order to remedy the adverse effects identified (see paragraph 10.118), we recommend that PDM should be required to transfer all its gut-room operations to a separate subsidiary limited company and should adopt and operate accounting systems and accounting procedures in the manner required in undertaking 1. We have made detailed suggestions as to such systems and procedures in Appendix 10.2.

10.140. If, within three months after the publication of our report, the DGFT is not satisfied that PDM is carrying on its gut-room business on an arm's length basis, or if there is a breach of any undertaking given by PDM in respect of its gut-room operations, we further recommend that PDM should be required to dispose of its gut-room business within a further six months to a purchaser approved by the DGFT.

Prior approval of acquisitions

10.141. In order to remedy the adverse effects identified (see paragraph 10.118), we recommend that PDM should be prohibited from acquiring all or any part of an animal waste enterprise, unless the DGFT has approved the acquisition in advance as being in the public interest.

Lack of transparency in published accounts

10.142. Towards the end of our inquiry, PDM told us that it would be prepared to publish consolidated accounts for its rendering activities, subject to continuing to keep private its service company, which paid directors' salaries. It argued that the results of the entirety of its business were irrelevant. In our view it will be necessary to look at the totality of PDM's business and the results of reference and non-reference activities, and for PDM to provide information which explains how overall results have been apportioned across business segments.

10.143. In order to remedy the adverse effects identified (see paragraph 10.118), we recommend that PDM should file with the DGFT, within nine months of the end of each accounting period, consolidated accounts for that period for the PDM enterprise as defined in paragraph 3.6. These consolidated accounts should as far as possible meet all the reporting requirements of the Companies Acts for a single holding company and its subsidiaries. In addition, they should include in accompanying notes a segmental analysis distinguishing between three categories of activity: red meat waste rendering, poultry waste rendering and all other PDM businesses. For each category the following items should be reported:

- (a) end-product sales (reconciled to turnover);
- (b) operating profit before interest and tax;
- (c) capital employed as defined at paragraph 3.63 of this report; and
- (d) number of employees;

and the analysis should set out the manner in which revenues, costs, assets and liabilities have been calculated and apportioned between segments.

10.144. The notes accompanying these consolidated accounts should also include details of any loan (whether interest-bearing or not), commission, consultancy fee or similar payment made by PDM, its directors, managers, proprietors, agents or related parties to any person engaged in the animal waste or related industries.

10.145. All the information described in paragraphs 10.142 to 10.144 should be covered by the report of the auditors of Prosper De Mulder Ltd, or such other registered auditors as may be specified by the DGFT,

and should be made available for public inspection. In addition PDM should deliver to the DGFT within three months of its half-year an unaudited consolidated profit and loss account, and this also should be made available for public inspection.

Forrest

10.146. We put the same pricing formula to Forrest as we had put to PDM (see paragraphs 10.125 to 10.127). Forrest's reaction was similar to PDM's. Forrest argued in addition that a pricing formula would remove any degree of flexibility in the prices it offered to its suppliers. For example, suppliers might attach differing values to the categories of raw materials which they supplied. The effect of this was that whilst the overall package offered to abattoirs was broadly the same, the individual prices would vary. Again, we believe that implementation of a pricing formula would be difficult and would only be justified if no other remedy were available.

10.147. The considerations regarding a *posted price* system and a *published price* system, discussed earlier (see paragraphs 10.128 to 10.132) in relation to PDM, apply equally to Forrest. To diminish the adverse effects of discriminatory pricing (see paragraph 10.120), we recommend that Forrest should be required to publish weekly, together with detailed related information, a representative sample of prices and charges it has negotiated in the preceding week, commencing with the week ending 9 October 1993, in a form approved by the DGFT (see Appendix 10.1).

10.148. We expect that the remedy we have proposed in respect of Forrest's discriminatory pricing will be a sufficient restraint on the company's excess profits to remove the need for any additional remedy.

Overview

10.149. We have been concerned about the high levels of concentration in the animal waste industry in England and Wales and in Scotland. There are no compelling reasons (eg economies of scale) to suggest that only a large firm can survive in the industry. On the contrary, the evidence indicates that efficient smaller firms can continue not only to survive but to flourish. What is required at present, therefore, is the minimum amount of additional regulation necessary to curb the over-zealous protection of their supplies of animal waste by the two monopolists, and to stimulate competition. The other renderers make a valuable contribution to the rendering industry and should be encouraged to continue to do so; the preservation of competition for supplies of animal waste is likely to be the best way of ensuring that the public service performed by the industry is provided economically. Our recommendations have been framed with these considerations in mind.

P H DEAN (*Chairman*)

C C BAILLIEU

A L KINGSHOTT

P K R MANN

J S METCALFE

S N BURBRIDGE (*Secretary*)

29 June 1993