6 The pricing practices of PDM and Forrest

6.1. The way in which prices for animal waste are set is described in paragraphs 2.61 to 2.73. In brief, agreements are generally made orally between abattoir and renderer and can be renegotiated at short notice. The prices of animal waste reflect major changes in the prices of the renderers' own products. Abattoirs generally agree prices with renderers for each of the main categories of waste they supply, and the prices reflect not only the quality and quantity of material and the costs of transportation and collection, but also the degree of competition for the abattoir's supplies.

6.2. In this chapter we shall consider the pricing practices of PDM and then of Forrest and describe the analysis we have carried out of their prices, both overall and in specific cases. We shall in this chapter use `prices' to refer to both prices and charges, except when otherwise indicated.

The pricing practices of PDM

6.3. PDM told us that of its own contracts about 10 per cent were for more than one month, 60 per cent were for one month, and the remainder operated on a day-to-day basis. In most cases it agreed contracts with individual abattoirs but there were also some 14 cases, covering 80 abattoirs, where PDM negotiated with companies that owned more than one abattoir and reached a single agreement for the abattoir group. In such cases prices might be agreed that did not vary between the abattoirs in the group on account of quality or cost of collection, and an overrider discount was occasionally agreed that applied to the group as a whole.

6.4. PDM told us that the operators of abattoirs were aware of changes in its output prices and that this formed part of the basis of the negotiation. When output prices changed substantially the prices for animal waste followed suit, and usually more rapidly in the case of increases than with decreases. In a few cases involving major suppliers PDM had agreed a formula with the abattoir linking the price to be paid for animal waste to the prices for tallow and meat-and-bone meal.

6.5. PDM told us that the main factors determining its prices were the end-product prices, the quality and quantity of the supplies, the nature of the arrangements for collection and transportation, and competition. The factor that had the largest impact on prices was the quality of material. Quality was measured mainly by the yield of the material in terms of tallow and meat-and-bone meal and the water content. We discussed in detail with PDM the way in which the various factors affected the prices of each category of raw material, and this is reflected in our analysis of PDM's prices set out in Appendix 6.1 (and discussed further in paragraphs 6.8 to 6.11).

6.6. PDM said that its buyers assessed the quality of the material by inspection and on that basis offered a price to the abattoir. The buyer was also familiar in most cases with the inputs and processing methods of the abattoirs which provided some indication of the quality of each of the categories of material available. PDM did not, however, normally test the quality of material it acquired either at the abattoir or at its processing plant. PDM told us that it would be logistically and administratively impossible to separate, weigh, test and price all the different types of material bought from each abattoir. The only precise data available to PDM on the yields that could be expected from the material acquired were the yields actually achieved by each processing plant. These yields reflected the mix of raw material processed. PDM said that these actual yields varied by only 2 or 3 per cent compared with estimated yields, ie it was able to estimate overall yields for a given plant fairly exactly. The only circumstances in which PDM currently tested the quality of materials purchased was when the actual yields of a plant diverged significantly from those expected. Using its information on average yields, expected end-product prices and expected total costs, PDM was able to provide its buyers every month with average target prices for each category of material. A more detailed account of this and other aspects of PDM's pricing and costing system is set out in paragraphs 8.24 to 8.67.

6.7. As regards competition, PDM accepted that its intensity could vary on a geographical basis. In reference to the period in 1992 when competition was more intense (often referred to as the `price war' and described in paragraph 2.73), PDM agreed that higher prices were paid to those suppliers affected by the price war whereas unaffected suppliers continued to be paid prices at previously prevailing levels. Thus, certain abattoirs in the Midlands were cited to us by PDM in order to show that prices had increased where an abattoir had been approached by Gilberts but had not increased where an abattoir was not considering a change of renderer. PDM also said that prices were influenced not only by the continuing competition between renderers for particular abattoirs' supplies but also by the bargaining strength of large suppliers.

6.8. We considered whether PDM, given its market share and lack of competitors of comparable size, might be able to discriminate between suppliers in its prices and charges in the sense of charging suppliers different prices for material of comparable quality and similar cost of collection. If this were so, we would expect to find that prices were dispersed over a range much wider than what might be considered the natural competitive range. In order to investigate this possibility we analysed PDM's prices and charges for the months of May and October 1992. We attempted to estimate the range of prices arising from physical factors (principally the quality and quantity of material and the arrangements for collection and transportation) and to compare these ranges with actual prices. We also considered the relationship between actual prices and PDM's target prices. All the information we have used, both as to prices and yields, was supplied by PDM and relates to its own operations. PDM was not, however, able to provide us with information on the quality or expected yields of materials supplied by individual abattoirs (as explained in paragraph 6.6), and hence the need for the more extended analysis we have carried out.

6.9. The details of our investigation are set out in Appendix 6.1. We found that while the range of prices actually paid was very wide indeed, the price differences that might in theory be attributable to the physical factors were also large when they are added together. In particular, the differences in quality within a particular category of material could, because of their effects on output yields, lead to a wide variance in the value of the material to PDM. However, our investigations showed that many individual prices could not be explained by differences in physical factors combined with a reasonable price range to account for competition. The analysis of price ranges revealed an unexplained residual of price differences of £23 per tonne for SBO and of at least £36 for other offal in May 1992 and of £29 per tonne for best fat in October 1992. We also found that the majority of best fat and SBO bought in May and October 1992 and of bone in October 1992 was priced well above PDM's target prices. In addition there were many cases where the prices paid were far higher than could be accounted for by variation in output yields, even if yields were used that maximized end-product sales. For example, the prices of most of the tonnage of bone collected in May 1992 were in the range £20 to £30 per tonne, whereas the target price based on yields that maximized end-product sales would be £16 per tonne.

6.10. Some of PDM's prices that do not wholly reflect physical factors may be the result of its negotiations with abattoir groups (as described in paragraph 6.3). We found that the highest prices paid in May and October 1992 to abattoir groups for best fat were £17 and £19 higher respectively than the highest prices paid to other abattoirs.

6.11. In order to check whether the range of prices paid by PDM was different during the price war that took place during the middle part 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 (see also paragraphs 14 and 15 of Appendix 6.1) between April 1993 on the one hand and May and October 1992 on the other.

6.12. As a result of a number of complaints, we also considered whether there was any evidence that PDM's pricing had been predatory. The approach that we adopted for predatory pricing involved a twofold test: first, that the prices paid should mean that average total costs were not fully covered by the increase in sales revenue; and secondly, that there should be an intention on the part of PDM to prejudice the survival of its competitor in the market.

6.13. We looked at a number of cases. Most related to acquisitions of material direct from abattoirs and arose during the price war of 1992; they are described in Appendix 6.2. We also looked at a case involving a gut-room operated by PDM. It is dealt with in paragraph 6.16.

6.14. The cases described in Appendix 6.2 do not provide evidence that PDM's prices were predatory in the full sense of that term as defined in paragraph 6.12. It could not be demonstrated in any of the cases that it was PDM's intention to eliminate or undermine a competitor. It is clear nevertheless that during the price war PDM was offering prices that were too high to allow recovery of average total costs-and the case of the Anglo-Dutch Meats abattoir at Charing is an example of this. PDM accepts that some of the contracts that it undertook in the middle months of 1992 were not profitable, and those contracts meant overall losses for PDM in each of the months of May to August, as shown in its management accounts.

6.15. PDM emphasized to us its determination to retain its supplies of raw material. It has been able to sustain considerable losses in the course of carrying out that strategy-PDM estimated at around £2 million the cost to it of the 1992 price war, and this meant a considerable reduction in its profits on rendering in that financial year. In some of the cases where contracts were loss-making it may be the case, as PDM indicated, that it was only after prices were agreed that it was realized that the prices paid would mean a loss on the contract. PDM has, however, a system of average target prices for each of the main categories of raw materials and this, combined with its considerable experience of the business, provided an indication of the extent of losses being incurred during the middle months of 1992. PDM told us that the losses incurred at that time were greater than the losses often incurred in the middle months of the year when supplies were at their lowest.

6.16. The gut-room case we examined occurred before the 1992 price war. IMC, a specialist gut-room operator, complained to the DGFT that in September 1991 PDM had taken on a contract at West Devon Meats, Hatherleigh, at uneconomic prices in breach of its 1986 undertakings. We found that PDM's administration charge of £50 per week to each of its gut-rooms, while sufficient to cover its direct administration costs, did not cover indirect costs. PDM uses a system of inter-company transfer prices for materials transferred from its gut-room operation to its rendering operation and, when these were used, PDM appeared to have taken on the contract on a profitable basis. However, when we costed the contract using the prices actually paid at that time by PDM to IMC and the charges for the removal of offal and SBO made by PDM to the abattoirs where IMC operated the gut-room, we found that the Hatherleigh contract had been taken on at a loss. There was no evidence that PDM had intended to damage IMC. A full account of our investigation of IMC's complaint is set out in Appendix 6.3.

The pricing practices of Forrest

6.17. Forrest told us that the prices and charges it offered were determined by the quantity and quality of material, the economics of collection and particular features of each individual contract. However, it also said that in order to gain sufficient throughput to cover its costs and gain a reasonable profit margin it would on occasion have to offer higher prices as required in order to obtain supplies. Forrest stated that in determining the maximum prices it would offer when competing for an abattoir's business with another renderer it would be looking for at least some contribution to overheads in addition to covering incremental costs. A fuller account of Forrest's pricing system is set out in paragraphs 9.24 to 9.40.

6.18. As in the case of PDM, we considered whether Forrest might be carrying out a discriminatory pricing policy in the sense of charging suppliers differently for material that was comparable in quality and similar in cost of collection. We carried out a similar investigation to that mentioned in paragraph 6.8 and this is described in detail in Appendix 6.4. We found that Forrest's prices varied substantially in a way that was not always attributable to physical factors.

6.19. Adopting the same approach as set out in paragraph 6.12 we also looked at a number of cases in which Forrest offered high prices for its supplies. These cases are described in Appendix 6.5. We were not able to identify any instances where it could be demonstrated that Forrest's intention was to eliminate or undermine a competitor. We did, however, identify two cases, those of abattoirs at Turriff and Biggar, where prices were such that revenues were insufficient to cover average total costs. This would tally with Forrest's policy of paying whatever prices were necessary to gain the required throughput consistent with making some contribution to overheads.

6.20. The cases we examined (involving both Dundas Brothers and Dundas Chemical-see Appendix 6.5) showed that Forrest, where it thought it necessary to obtain supplies, had offered prices that reflected competition as well as other factors and had on occasion been prepared to pay prices that, while they meant that incremental costs were covered, did not cover average total costs, ie they made only a partial contribution to overheads. While we do not have any evidence that it was Forrest's intention to undermine the position of its competitor, Dundas Chemical, the effect of Forrest's pricing practices is to have deprived Dundas Chemical of a significant portion of its supplies.