Neutral Citation Number [2006] IEHC 294

THE HIGH COURT

[2003 No. 7764P]

BETWEEN

THE COMPETITION AUTHORITY

PLAINTIFF

AND

BEEF INDUSTRY DEVELOPMENT SOCIETY LIMITED AND BARRY BROTHERS (CARRIGMORE) MEATS LIMITED

DEFENDANTS

JUDGMENT of Mr. Justice William M. McKechnie delivered on the 27th day of July, 2006.

Background to the Proceedings:

1. The plaintiff in these proceedings, which were commenced by way of plenary summons dated 30th June, 2003, is a statutory body established pursuant to Part 3 of the Competition Act, 1991 and continued pursuant to Part 4 of the Competition Act, 2002. That body is entrusted with the duties and responsibilities conferred on it by the last mentioned Statute. As such, under s. 14(2), of the 2002 Act, it instituted the within proceedings.

2. The first named defendant ("BIDS" or "the Society") was registered on 2nd May, 2002 as an Industrial and Provident Society under the Registry of Friendly Societies. Membership as of 2nd February, 2004 and of 3rd June, 2005 comprised ten companies, all with limited liability, and all individually and in their own right carrying on the business of slaughtering and deboning cattle. These companies are as follows:
(i) Anglo Irish Beef Processors Limited - 14 Castle Street, Ardee, Co. Louth
(ii) Barry Brothers, Conna, Co. Cork (iii) Dawn Meats - Grannagh, Waterford (iv) Donegal Meat Processors - Drumnashear, Carrigans, Co. Donegal (v) Exel Meats - Kilbeggan, Co. Westmeath
(vi) Fair Oaks Foods - Royal Oak Road, Bagnelstown, Co. Carlow (vii) Kepak Group, Clonea, Co. Meath
(viii) Kildare Training Company Limited - Kildare Town, Co. Kildare (ix) Liffey Meats, Ballyjamesduff, Co. Cavan
(x) Slaney Foods Group - P.O. Box No. 8, Ryland, Enniscorthy, Co. Wexford.

3. The second named defendant, Barry Brothers of Conna, Co. Cork, which is a member of BIDS, entered into an agreement with the first named defendant on the 19th day of September, 2002. This company took no active part in these proceedings and the validity of its contract with BIDS is entirely dependent on the outcome of this action.

4. In simple terms, following *inter alia,* the publication of a report in September 1998, known as the "McKinsey report", and a report in June 1999, called the "Beef Task report", the Society was established with the objective of implementing the recommendations and conclusions of these reports and in particular to achieve the rationalisation of the Irish Beef Industry.

This task was to be approached in the manner as follows:-
(a) the major players in the industry would seek, by way of a coordinated plan, to remove 25% of the existing slaughter capacity by agreeing to pay those who would voluntarily leave "(the goers)" compensation from a fund which would be established by those remaining in the industry "(the stayers)".
(b) This fund would effectively be financed by the imposition of a levy of €2 on each animal killed up to that operator's traditional kill (as expressed in percentage terms) and thereafter a levy of €11 on each further animal slaughtered.
(c) In return for these payments the goers would:
  * decommission their plants and agree to restrictions on the sale/future use of their equipment;
  * refrain from using the associated lands for processing for a period of five years; and-
  * sign a two year non-compete clause with regard to processing on the island of Ireland.

This is a very brief summary of the proposals with the entirety of the Society's current plans under this rationalisation programme, being set out at para. 31 of this judgment.

5. Immediately after its establishment, and following a series of meetings between its members, the Society on the 13th day of May, 2002 and on the 4th of December, 2002 met and notified the Competition Authority of its intentions, and made submissions to it in the context of both domestic and European competition law rules. These submissions were made on 20th December, 2002, the 25th March, 2003, and the 28th May, 2003, with an oral presentation being given on the 15th day of April, 2003. Before, during and after these events there was much correspondence between the plaintiff and Messrs. Arthur Cox Solicitors on behalf of BIDS. Ultimately the authority, by letters dated the 5th and

26th June, 2003, communicated its views to the first named defendant on what has become known as "The BIDS arrangements".

6. The position adopted by the Competition Authority and so notified was as follows:-
(1) the rules of the Society, which reflect the desire to rationalise the beef industry, are in themselves, by reason of this and in that way, contrary to s. 4(1) of the Competition Act, 2002;
(2) the minutes of the rationalisation sub-committee meetings, reflecting a series of decisions to remove capacity and to finance the method of so doing, were by reason of object and effect contrary to s. 4(1)(b) of the 2002 Act;
(3) the agreement, referred to as the "exit agreement", by which "goers" in return for compensation would be bound by certain restrictive covenants, was anti-competitive in that such agreement sought to give effect to the objects of the Society; and
(4) the actual "exit agreement" entered into between BIDS and the second named defendant was objectionable for the same reasons and also because, again by way of object or effect, it sought to eliminate or reduce competition in the downstream market and moreover was an additional barrier to entry into that market.

Having so concluded the authority, without detailed reasons, also decided that the arrangements of the Society could not benefit from the provisions of s. 4(5) of the Competition Act, 2002.

In consequence the plaintiff, in the absence of appropriate undertakings, threatened to institute proceedings against the defendants.

7. These proceedings, were duly issued on the 30th June, 2003. In its amended statement of claim dated 1st March, 2005 the authority sought a declaration that "each decision forming part of the (BIDS) arrangements, are prohibited and void by virtue of s. 4(1) of the Competition Act, 2002 and/or Article 81(1) of the EC Treaty". A similar declaration was sought in respect of the "exit agreement". Further ancillary relief was also prayed for.
On 18th March, 2005, an amended defence and counterclaim was delivered. Apart from denying that the BIDS arrangements were in breach of Article 4(1) of the Competition Act, 2002 and/or Article 81(1) of the EC Treaty, the Society claimed, that if contrary to this denial, such arrangements or any part thereof should breach these legislative provisions, then the same were legitimised by virtue of the provisions of s. 4(5) of the 2002 Act and/or Article 81(3) of the Treaty. At para. 35(a) of the defence it was admitted that these arrangements were "liable to have an appreciable effect" on inter-state trade. Finally, in its attached counterclaim the first named defendant sought a variety of declarations, which were designed to render lawful the entirety of the BIDS arrangements. Issue on the pleadings was thus drawn between the parties.

On the evidential side the following witnesses were called in this case. On behalf of the Competition Authority, Dr. Gorecki, the Director of the Monopolies Division and Mr. Derek Ridyard, an economist gave evidence. On behalf of BIDS, the economic evidence was given by Mr. Moore McDowell and Mr. Derek Scully both from Trinity College Dublin. Mr. Derek Breen, now of Enterprise Ireland, Mr. John Malone, who retired as Secretary General of the Department of Agriculture and Food in December 2004, and Mr. Tom McAndrews, the Secretary of BIDS were also called. In addition, the economists presented written reports of their intended evidence.

8. Background to the Beef Industry.
Historically the beef industry in this country largely operated on the basis that all prime cattle went "on the hoof" to England, which was the traditional market for such cattle. There were very few meat export factories and those which existed, slaughtered cows only. There was, in order to supply the domestic market, many small abattoirs, usually located at the back of butcher shops, some of which exist to the present day.
In the mid 1960s the situation changed somewhat, after the Department of Agriculture had negotiated an agreement, whereunder Ireland obtained access to the variable premium; much the same as English farmers had already enjoyed. This offered encouragement for the development of more factories which slaughtered clean cattle as opposed to cows. This largely was the structure of the industry up to Ireland's entry into the EEC.

9. Following this country's accession to the European Community, Irish farmers had access to the Common Agricultural Policy (C.A.P.) which had developed in Europe over the previous number of years. This access was of enormous importance to the development of the industry. It offered a whole series of benefits to farmers. The Policy offered support at the market end so that the finance involved went directly to the seller of the product. This type of support rested essentially on three pillars, namely a guaranteed price at a certain level for products going into intervention, secondly, the comfort of having financial aid for private storage, which was known as private intervention and thirdly, there were export refunds available which underpinned exports to third countries at prices not below certain thresholds. The net effect of these interventions was to guarantee to the farmer a floor or base price. In addition there was also support available under, what was known as the "Feoga system", whereby processors in any sector of agriculture could make applications for grants. When combined with other grants that might be available from the IDA, such processors were able to obtain, in the eastern part of the country, subsidies of up to 50% for the construction of meat factories and in less developed parts, in particular in the western half of Ireland, such assistance went as high as 75%. So overall the effect of the C.A.P. together with these grants, meant that there was an enormous increase in the number of factories being constructed and indeed also being upgraded. As a result compliance with the regulatory requirements of obtaining a licence, in order to export to the European Community and to third countries, was much more readily achievable. This became necessary when Ireland's derogation from Community requirements finished in or about 1990. Thereafter, any slaughtering in excess of 1,000 animals per year required approval.

10. Significant reform of the Common Agricultural Policy took place in 1992 following which, from that time onwards, the financial supports available were paid directly to the farmer by way of premium. This money was no longer channelled through the processor. Payments were available under a variety of schemes including a scheme providing for what was very commonly known as a "headage payment".

11. As time progressed it became clear that Ireland did extremely well, financially, in the beef sector from its membership of the EC. Perhaps in some ways rather too well. Because of the very generous supports available, the beef sector became very dependent on such supports, and indeed, for a period during the 1980s, intervention became the dominant aspect of the industry. As a result, the industry operated in a market which was artificially supported, and which had not developed by the operation of ordinary market conditions. If, for example, there was no purchaser for slaughtered animals or if the price on export was weak, these factors had no deterring effect on supply as the supports intervened to maintain price structure. There was therefore, little inducement, (and perhaps even lesser constraints) on operators to ensure that supply would more readily accommodate demand. There was a great number of cattle being slaughtered, irrespective of markets for the resulting products. In many ways therefore supply became uncoupled from demand, with the result that the sector was not in any true sense market driven or led and in the process undoubtedly lost its market focus. Because of this overt dependence on financial support, which was structural in nature, and in the absence of any or any potent counterveiling circumstances prohibiting, or even arresting the resulting imbalance, there was within the sector a widespread mismatch between throughput and capacity.

This overview of the historical position is I think generally accepted but in case it remains a matter of challenge in these proceedings, the views which I have expressed should be considered as the court's findings in this regard. In so concluding I must of course emphasise that there is a real issue between the parties as to whether or not there is overcapacity within the industry and if there is, what competition consequences follow from that, in both a pre and post rationalisation regime.

12. Finally, in the context of its development and indeed also in its present state, it is useful to record even at this stage, that the industry suffered a number of major shocks in the past decade in particular the outbreak of BSE which reached a peak with its re-emergence in 2000, and the foot and mouth disease which followed in 2001.

13. **The Immediate Lead Up to the Establishment of BIDS**

Having joined the IDA in 1969 and having continued thereafter with Forbairt and more recently with Enterprise Ireland, Mr. Derek Breen has been for over 35 years in the industrial development business. Currently, he is the manager of the primary meats area within that organisation and has responsibility for the beef industry, the pork industry, the lamb and sheep industry and their by-products. This area has a combined-output, from a national prospective, of about €3 billion and employs approximately 10,000 people. It is evidently very important to the economy of this country. In 1997 at the request of the then Chief Executive, who previously had engaged with the Minister for Agriculture and Food and the Secretary General of that Department, he was asked to take on the role of establishing a development programme for the Irish beef sector. A role similar to that which he had performed with considerable success in the pork sector in the mid 1980s. His mission was to craft out a blueprint for the development of the sector in its totality. This involved contact with all of the relevant stakeholders including banks, producers, farming organisations, processors, trade unions, ICTU etc. In the third quarter of 1997 he decided that the movement of this project required external facilitation and after a process of consultation, the outside firm of McKinsey and Company was engaged to carry out a study into the sector. This piece of work cost approximately IR £300,000 and was financed, as to about 80% by Enterprise Ireland. Work began on the project in January 1998 with Mr. Breen, then of Enterprise Ireland, being appointed as the fulltime Project Manager of the team. A steering committee, of about 13 persons, was established to work in harmony with the consultants. This committee had representatives from the industry, from IBEC, the Department of Agriculture and Food, the IFA, the ICOS and the Irish Meat Association. A draft report was available in April and the final report was published in September 1998. This report became known as the "McKinsey report". It was to implement the rationalisation proposals of this report that fundamentally gave rise to BIDS.

"The McKinsey report"

14. The McKinsey report which was formally headed "Preparing the Irish Beef Sector for the 21st Century", was presented in a format which commenced with an executive summary and concluded with a number of appendices. In between there were six chapters which were titled as follows:-

Chapter 1: Background and Objectives,

Chapter 2: Structure, Conduct and Performance of the Irish Beef Sector;
Chapter 3: Threats and Opportunities Facing the Sector;
Chapter 4: Strategic Options open to the Sector and the Recommended Strategy;
Chapter 5: Integrated set of Initiatives to deliver the Recommended Strategy; and
Chapter 6: Moving Forward with Implementation.
As this report also formed the substantial basis upon which BIDS sought to defend the present action, it will be necessary to outline certain sections of the document under each chapter heading. First however, there is a brief overview which is taken from the executive summary.

15. <u>Executive Summary:</u>
(a) In its first comment, the report identifies two major changes which it says are absolutely necessary, for the sector to remain operating even at its then current level of performance. One of these changes was expressed in this manner:-
"1. Radical Rationalisation of the Processing Industry: The waste created by excess processing capacity and the inability of a large number of small players to build sustainable markets highlights the need for rationalisation of players and plants. This should happen in the near term". In the author's view, if this was achieved, it had the potential to be the catalysing event to move the sector forward.
The second major change involved the relationship between producers (i.e. farmers) and processors.
(b) Dealing with the threats facing the sector, McKinsey says that both producers and processors alike "face potentially catastrophic outcomes over the medium term". This assessment, as it applies to the processors, is significantly related to the "huge amount of year round overcapacity in the industry - twice as much as needed". This overcapacity, for the reasons stated at p. 3 of the report, is likely to increase to three times what is required, with the result, that if such trends should continue the profitability of the sector, as currently structured, would be eliminated. As a consequence of this problem, there should be increased competition amongst the processors for cattle with the buy/sell spread, which largely determines profit margins, being narrowed. This will "have devastating consequences for processor profitability moving the average plant into a significant loss making situation".
(c) The "year round" overcapacity is largely a feature of the implementation of the deseasonalisation premium (DSP), an EU incentive for farmers to have their animals more evenly slaughtered throughout the year. This payment is explained in more detail when dealing with Exhibit no. 4 of the report, which is dealt with at paragraph 17(e) below.
(d) In this context of overcapacity, the authors then made a number of observations which the Competition Authority relies upon. They say that the effects of surplus requirements have not been felt to any significant degree as yet, but that this level of overcapacity, which will result in significant losses, will ultimately lead to players and plants leaving the industry over time. The significance of this observation from the plaintiff's point of view, is that it expresses a belief that the market, through its normal operational forces, will work if given time and accordingly, there is no justification for coordinated activity.
(e) Finally, when dealing with the threats to the industry McKinsey says that "in the long run the fundamental threat to the sector is that, in the absence of subsidies, it is not competitive in international markets" (see p. 4).
(f) Having identified the threats, the report then deals with the "Prizes" i.e. the "potential for improvement". On the processing side, it estimates that the cost associated with excess capacity is IR £18 million and that if plant performance improved and better returns could be obtained from fifth quarter realisations, a further IR £14 million could be generated.
(g) When discussing the strategic options open to the sector and the method of how best such options should be implemented, the report, in relation to the processors,
recommends that rationalisation should take place, thereby reducing the number of processors from 20 to between 4 and 6. To achieve this, a "buy out scheme" is required which would be funded by "stayers" so that "goers" could be compensated for exiting the market.
(h) Finally in this section of the report, an implementation strategy is set out, which it is hoped would achieve the objectives of the recommendations. These objectives it is claimed, have widespread acceptance within the industry, but despite this concerted action has not yet followed. Perhaps the reason is that "sufficient financial pain" has not as yet been felt by the processors who have not to date proactively pursued rationalisation. McKinsey then postulates some of the reasons why that is so, including a belief by some, that outside events, for example government intervention, will occur and that this will solve the industry's problem. The author's belief however is that "time is running out for such [a] solution".
The evidence of Mr. Breen clearly shows that there will be no outside aid for rationalisation itself.

16. **<u>Chapter 1- Background and Objectives:</u>**
The objective of the study was to identify "initiatives that would maximise the long term value (that is profitability) of all players in the Irish beef sector - processors, beef farmers and calf suppliers". To facilitate the study into this objective, a steering group which comprised representatives from the industry, An Bord Bia, IBEC, the Department of Agriculture and Food, the IFA, ICOS and from the Irish Meat Association was established. Mr. Derek Breen who was appointed the full time Project Manager of the team, was also a member of this group. This committee met frequently over several months leading up to September 1998 and was heavily engaged in responding to (or even prompting some

of) the McKinsey proposals. This occurred as such proposals evolved over the course of the study. This involvement of the steering committee was criticised as undermining the independence of McKinsey or as otherwise having an undesirable over-influence on the report. I do not believe that these criticisms are justified and I am quite satisfied to accept Mr. Breen's evidence as to the true purpose of the interaction between the consultants and this group. It was at all times the consultant's strategy to achieve a working consensus on its study as this progressed, with McKinsey seeing this method as offering the best chance or prospect of a successful implementation of its recommendations. I therefore, do not think that the independence of the consultants was in anyway compromised by this structure.

17. **Chapter 2: Structure, Conduct and performance of the Irish Beef Sector**:
(a) As is evident from what is previously stated, the sector has two major constituents, namely the processors and the producers. The processors can be divided between those who are licensed exporters and those who are not. There were 22 processors who had export licenses at the time of the report and between them, they owned 38 plants, 6 of which had not been utilised for some time. In addition to the small abattoirs having a kill of less than 1,000 animals per year, there were also a number of abattoirs which were in the process of upgrading from purely domestic status to export approved plants. Most of the processors who slaughter animals also bone, pack and sell the resulting beef.
(b) Throughput, in the processing industry, rose from 1.27 million in 1994, to 1.5 million in 1996 and 1.65 million in 1997, but this increase was primarily due to the effective closure of the live export markets resulting from the 1996/2000 BSE crisis. This figure of approximately 1.6 to 1.7 million has remained to the present day.
(c) The profitability of the processors, which can be gauged by the buy/sell spread, is largely dependent on the plant's capacity relative to its throughput. Profit margins are not therefore directly dependent on the general level of cattle or beef prices.
(d) Where there is a substantial overhang of capacity which is not utilised, competition for cattle supplies should, according to McKinsey, increase and vice versa if capacity is tight.
(e) Exhibit 4 of the report demonstrates the effect which the DSP had on the pattern of kill since its introduction as part of the CAP reforms in 1992. This premium was in the nature of a financial incentive to farmers to deliver their cattle to factories at off peak periods. Historically, the peak period was in September, October and November of each year when the outdoor feed on pasture had been exhausted. To overcome the resulting problem, farmers were therefore encouraged by way of premium to have their animals slaughtered more evenly throughout the year. This scheme certainly worked in this country. In 1992, prior to its implementation, the average weekly throughput was 29,000 with a peak throughput of 60,000. In 1997 which was post deseasonalisation, the average throughput was 32,000 with peak being 44,000. Although this premium has effectively been discontinued since 1999/2000, the pattern achieved remains much the same to this day. The result according to BIDS is that there is now all year round overcapacity.
(f) The report also points out that in most industries where there is significant overcapacity, the least efficient players are squeezed out of the market. The authors therefore would have thought that plant closures would have occurred. However, for the reasons given at p. 18 of the report, this had not really happened in this industry.

18. **Chapter 3: Threats and Opportunities Facing the Sector**
(a) In summary, as applied to processors, the report says that this group "face the severe threat of a sharp reduction in throughput combined with increasing overcapacity. We are convinced that significant losses will be incurred amongst the processors and that, over the long term, a large number of players will withdraw from the industry or mothball plants".
(b) It is then predicted that there will be a reduction of over 300,000 cattle available for slaughter, and if that happens, which is quite plausible, it would eliminate "the profitability of the sector" and force players to leave the industry until capacity and throughput came closer into balance.
(c) In 1997, with 32 plants operating, the industry had an estimated capacity to kill 66,000 head of cattle per week. This compares with an actual maximum throughput of 45,000 and an average throughput of 32,000 per week. In addition, there were a number of dormant plants which if activated would add to this overcapacity.

19. (a) The report then identifies the financial prize, as it terms it, which would be available if the sector could move forward. Firstly, by removing plants with a throughput of 420,000 animals per annum, the report estimates a resulting saving of IR £18 million per annum. This is calculated by subtracting the sum of IR £21 million, being the marginal cost to the stayers of slaughtering the additional 420,000 animals, from the sum of £39 million which is calculated as being the current cost of processing such numbers; hence a net saving per annum of £18 million. Secondly, if plants could become more efficient and fifth quarter realisations increased, there would be additional revenue of IR £14 million per annum. This has been estimated by "assuming that the gap in performance, on costs and fifth quarter realisations, between the industry average (post rationalisation) and the top three plants can be halved".
(b) It is also pointed out, at p. 30 of the report that there is a close relationship between "scale and cost efficiency" when dealing with processing plant costs. A throughput of 100,000 cattle per annum is suggested as being the level at which most of these scale economies can be captured.

20. **Chapter 4: Strategic Options open to the Sector and the Recommended Option**

In view of what it is contained in the fifth chapter it is not necessary for the purposes of this case to outline in any detail what is stated in Chapter 4 of this report.

21. Chapter 5: The Integrated set of Initiatives to achieve the Recommended Strategy
Coordinated and concerted action to rationalise the processing sector is recommended. It is suggested that plants which kill 420,000 head per annum, as of 1997, should be encouraged to leave the industry. That figure is approximately 32% of active capacity. Such players, who are styled "goers" would in return for closing down and decommissioning their plants, be paid by the "stayers" from a buy-out scheme established and funded by such parties.

22. Chapter 6: Moving Forward with Implementation:
The report then goes into considerable detail as to how this plan should be designed, put in place, and implemented. As in principle, though subject to detail variation, this chapter reflects what ultimately became known as the "BIDS arrangements", it is not necessary at this juncture to recite any further details from this section of the report. See para 31 of this judgment for the Society's full proposals as now formulated.

23. Appendices
(a) Appendix 1: This contains the identity of those who served on the "steering group" which, as I have noted at paragraph 13 above, interacted considerably with the consultants during the course of their study. It should be pointed out that there was no consumer voice on this group nor were the multiples as such, represented.
(b) Appendix 2: This part of the document sets out details of the rationalisation scheme and puts that scheme into a working context within the industry. The main features are stated to be as follows:-
In 1997, the active plants had a capacity to kill 66,000 animals per week, with the average throughput being 32,000 and a peak throughput of 45,000. Having assumed/predicted that a total of 300,000 live animals would be exported, the consultants felt it reasonable to assume that throughput would fall from 1.65 million to 1.35 million per annum. If that occurred both the average and peak throughputs would decline to 26,0000 and 37,000 respectively. Cautioning against any certainty in this drop of available raw material, the authors believed that the sector should target a reduction in active capacity to 45,000 per week.
(c) Having discussed the most appropriate basis for both generating the required funds and for calculating compensation for those who would leave the industry, McKinsey then outlined a number of approaches which could be used for identifying those who might go and those who might stay. In addition, a number of other matters were discussed in some detail including the potential problems with "free riders", and the minimum requirements on both "goers" and "stayers" to make sure that the rationalisation plan was a success.

24. As can therefore be seen, McKinsey's major point with regard to the processing industry, was that there existed significant and substantial overcapacity and that such overhang had a serious cost factor attached to it. This was impeding the competitive nature of the industry in certain markets. The existing under-utilisation throughout the year was likely to increase, if its prediction of a fall in raw material should be borne out. Unlike what would be expected as a normal market reaction to this overcapacity, high cost plants, by and large, had not in fact ceased to operate and the consultants had little confidence in that situation naturally occurring. Being thus concerned at the state of the industry, it recommended that an agreed plan, from within the industry, should be put in place with the objective of removing plants which had a current annual throughput in 1997 of 420,000 cattle. That would have to be financed by those who would be in receipt of the resulting benefits. Accordingly, the proposal for an industry funded buyout scheme.

25. Report of the Food Industry Development Group (1998)
McKinsey was not the only report in or about this period which dealt with, or at least touched upon, the beef sector. At the request of the Minister of State at the Department of Agriculture and Food, the Food Industry Development Group was established and reported to the Minister in December 1998. Under the chairmanship of the Secretary General of the Department, its membership drew on a wide range of bodies and people, including the IFA, the Purchasing Manager of Superquinn, the former Chief Executive of the Consumer Association of Ireland as well as several others from the industry and from other outside groups and associations. Whilst its remit was much wider than McKinsey, covering as it did almost the entire food industry, it nevertheless made certain observations of a general nature and also some specific comments about the beef sector. Right throughout the report, emphasis was laid on the absolute requirement of competitiveness and the need to be ever demanding in that regard. Not only in respect of the domestic market but also in respect of any successful penetration of the EU and third world markets. The report commented on the fact that in general the food industry suffered from scale related difficulties and that both general and specific steps were required in order to address this problem.

It then dealt specifically with the beef industry. It referred to the McKinsey review, and highlighted the section thereof which found, that both the competitiveness and viability of the sector were being negatively impacted upon, by certain factors which it listed at pp. 19 and 20 of the report. The problem most prominently identified was the "massive overcapacity" in the slaughtering and processing sector with all of the attending difficulties which resulted from that. It also mentioned at point No. 2 the question of scale.

26. In addition, without apparently relying on McKinsey, it made certain observations in its own right, evidently from its own study and investigations, on these questions of overcapacity and competitiveness. At p. 29 of the report it refers back, and at least by implication, seems to accept what McKinsey had said about competitiveness, and then continued:-

> "At slaughtering and processing level, rationalisation at the primary stage is essential. It needs to be complemented by investment in modern plant and equipment, and greater attention to value added products ..."

Without in anyway attempting to over read this report insofar as the beef industry is concerned, I think a reasonable conclusion nevertheless would be, that in broad terms it was supportive of the McKinsey's finding in relation to overcapacity and the need for immediate action in that regard.

27. Report of the Beef Task Force (1999)

Whereas the report last mentioned undoubtedly dealt in general terms with the food sector, the report of the Beef Task Force, was, as its name implies, specific to the beef industry. It was set up by the Minister for Agriculture and Food in November 1998 and reported to him in June 1999. Its relevance to this case lies in its view of the industry, which in very brief terms can be described as follows:-

(a) The Task Force expressly accepted the conclusions of the McKinsey report and described its recommendations as involving "major changes and a quantum improvement in the way the beef sector operates and performs across all levels of the chain". Having agreed that the totality of the gains as mentioned in McKinsey were achievable over time, it then focused on each of the three main elements of the industry, namely marketing, processing and production. From our point of view, the most relevant is its treatment of the processing sector.

(b) Following upon a recital of the data obtainable from McKinsey in respect of capacity and throughput, both average and peak, the report at para. 3.7 then stated,

"The Task Force accepts that there is at present underused slaughtering capacity in the beef industry and that there are considerable benefits to be gained from a rationalisation process leading to better matching of capacity with actual requirements. The Task Force recommends that the processing industry should create a special buy out fund to facilitate the removal of the surplus/obsolete capacity to expedite this rationalisation process. The mechanism for funding a buy out scheme was examined in depth ...". Discounting the possible introduction of a statutory levy, it then continued by saying,

" … that the most appropriate and effective mechanism is a fund created and managed by the meat processing industry itself... The cost of the buy out scheme should be significantly lower than the benefits to be derived by the industry as a whole from a reduction in slaughtering capacity. In view of this, the impact of the creation of the fund on producer prices should, at worst be neutral and probably positive."

(c) On the question of public funding, the Task Force recommended that access to an industry investment and development programme should be subject to strict criteria and in particular "that it should be contingent on better matching of slaughtering capacity with cattle supplies." It then offered some advice on such criteria by identifying qualifying factors, such as the requirement for capital investment in slaughtering facilities. If this occurred it would in its view lead to greater economies of scale.

(d) The overall objective of such a programme should be " … to bring about a modern efficient and market led processing sector which takes into account the need to maintain competition for cattle on the domestic market and regional balance in the distribution of facilities … (and to) … provide full time skilled jobs and thereby improve the attractiveness of employment in the sector".

(e) The Task Force was chaired by the Secretary General of the Department of Agriculture and Food and included amongst its members the Chief Executive of An Bord Bia, a representative from Enterprise Ireland, SIPTU, the IFA in the person of its then President Mr. Tom Parlon, as well as individual players from within the beef processing industry.

28. **Other reports:**

In the years following there were several other reports, including a report produced in March 2000, headed "Irish Beef Processing, Trends, Market Structure and Value Chain Analysis" by Peter Bacon and Associates in conjunction with Mr. Moore McDowell and Mr. Vincent Hogan both from the Economics Department of University College Dublin. Under the chairmanship of Mr. Pat O'Neill and having senior members of industry as well as the Director of Consumer Affairs on its committee, the Agri Food 2010 Group reported to the Minister in March 2000. In its executive summary it stated that "the industry must develop the necessary efficiencies and scale of operations, and face the need for considerable rationalisation in many sub sectors especially beef processing, dairy processing and poultry processing. Public funding to the primary processing sector should be dependent on structural change, but primary responsibly for action lies with the private stakeholders". In 2002 Professor Sheehy from UCD issued a publication entitled "The Irish Cattle/Beef Industry 2002: Facing Reality" and also in May of that year, the Irish Meat

Association published a document entitled “Positioning the Irish Beef Processing Industry for the Future”. See also the Bonner report of September 2000.

Disregarding for a moment what weight should be attached to these reports and leaving aside McKinsey, as the case focused strongly on its findings and recommendations, one can only reasonably conclude, that all sectors of industry who signed up to these reports, did so with a firm believe that, firstly, there was extensive overcapacity in the beef slaughtering sector, secondly, that such surplus capacity required removal, thirdly, that an industry driven and funded scheme was necessary in order to accomplish this, and fourthly, that there were considerable gains to be achieved by so doing.
In addition, in the context of outside support, a delegation from BIDS met with Mr. Joe Malone, the Secretary General of the Department of Agriculture and Food on 2nd May, 2002 and received from him an indication that the Department would support the rationalisation initiative. Moreover, a meeting took place on 16th May, 2002 with Mr. Dermot McCarthy, Secretary General to the Department of An Taoiseach where again an indication was given that this Department would also support the initiative.

29. **<u>The Establishment of BIDS:</u>**
The Beef Industry Development Society Limited (“BIDS” or “The Society”) was as I have previously said, registered under the Industrial and Provident Societies Acts 1893 to 1978 on 2nd May, 2002.
The objects of the Society, as outlined in its rules are:
“4(a) To provide funding from the beef industry to implement the conclusions and recommendations of the September 1999 McKinsey and Company report titled “Preparing the Irish Beef Sector for the 21st Century” and the “report of the Beef Task Force” dated June 1999 and any other reports commissioned by the Society.
(b) To commission and finance reports into any aspect of the beef industry.
(c) To assist and support members by the provision of information and advisory services,
(d) To promote contact between persons engaged in the industry and individual members and
(e) To do all things necessary or expedient to the attainment of the above objects or any of them.”
As one would expect the rules then deal with the admission and expulsion of members, financial matters, procedural matters, the establishment of committees, the engagement of staff, with other miscellaneous areas also being covered.

30. Immediately after its formation, the Society (essentially through its rationalisation sub-committee) held a series of monthly meetings commencing on 23rd May, 2002, in respect of which there are available detailed minutes of the discussions held and the agreements and decisions ultimately arrived at. As this case is essentially concerned with the ultimate proposals relied upon in defence of this action, it is unnecessary to outline in any detail how these proposals evolved, save to indicate that, as would be normal, details of the major components of the plan changed from time to time. For example, there was some considerable debate as to the precise level at which the levies should be pitched, as to the duration of the restrictive covenants both in terms of decommissioning and restraint of trade, and as to the completion period for the project, which at one stage was felt ought to be completed in two phases. A “master plan” was produced in July, a detailed draft of the “exit agreement” was available for the following meeting with a further “master plan” being on the table for the 7th November, meeting. Ultimately, it was agreed on the 5th December, 2002 that matters had progressed sufficiently to enable the Society to engage fully with and to respond to the Competition Authority on competition law issues and that at the end of such discussions a further meeting would be convened. Despite the way in which the details of the rationalisation scheme evolved, it should be said that the essential ingredients of the plan did not materially alter over this passage of time.

31. The Society, however, even after its last meeting and following upon the rejection of its views by the Competition Authority, did make some further amendments to its plan for the rationalisation of this industry. That plan in its entirety, as now formulated, is as follows:-

“THE PROPOSALS UNDER THE RATIONALISATION PROGRAMME”

<u>Definitions</u>
“Decommission” means placing the premises in a state that they can no longer be used for the slaughter and de-boning of cattle and, without prejudice to the generality of the foregoing, the action or acts required by the Goer to achieve Decommissioning are set out in Schedule 6 to the Exit agreement (a copy of which is attached) and "Decommissioned" shall be construed accordingly.
“Goers” means the members of BIDS who would voluntarily agree to exit the beef industry under the Programme.
“Programme” means the proposed rationalisation programme of BIDS.
“Stayers” means the members of BIDS who would not exit the beef industry under the Programme.
<u>The proposals under the Programme</u>
The proposals under the Programme are as follows:
• The Programme would be once-off and would be implemented (in terms of plant closures) within a twelve (12) month period.
• Under the Programme, plants processing at a maximum 420,000 cattle per year (in total) would leave the beef industry.

• Goers would sign a two (2) year non-compete clause in relation to the processing of cattle in the island of Ireland.
• The plants of goers would be Decommissioned.
• Land associated with the Decommissioned plants would not be used for the purposes of beef processing for a period of five (5) years.
• A voluntary fund would be set up to compensate goers, subject to receiving agreed payments from stayers. The fund would operate as follows:
• Following the resolution of the proceedings, the industry would meet, as in the period June to December 2002, to identify goers and stayers, and to agree the compensation to be paid to goers. The meeting would decide on an acceptable
minimum of capacity to be decommissioned (not exceeding a total capacity of 420,000 cattle per year).
• Exit agreements would be signed with goers with the compensation paid in staged payments as per the Exit agreements provided to the Competition Authority on 20 December, 2002.
• Loan agreements would be signed with stayers to provide the funding for the payments to goers.
• A levy system would be established under which stayers would pay BIDS levies based upon an agreed formula in relation to stayers' existing traditional (percentage) cattle kill and cattle killed in excess of this traditional (percentage) kill. The formula would apply a £2 levy on the traditional (percentage) cattle kill level of stayers and a £11 levy on cattle kill above the traditional (percentage) cattle kill level.
• The levies paid to BIDS would be used to repay the stayers' loans under the Loan agreements. The levies would cease when the stayers' loans under the Loan agreements were repaid.
• The equipment of goers used for primary beef processing would only be sold (within three months) to stayers for use as back-up equipment or spare parts or sold outside of the island of Ireland.
• The freedom of stayers in matters of production, pricing, conditions of sale, imports and exports, deliveries, mergers and acquisitions and other commercial activity would not be affected by the Programme. In particular, no plant would be prohibited from increasing capacity and there would be no understanding that animals previously slaughtered by a Decommissioned plant would be secured or slaughtered by any given stayer.

The membership of BIDS

The final determination of the identity of members of BIDS, goers, stayers and factories/plants involved in the Programme will only be decided upon following the outcome of the proceedings.

SCHEDULE 6

Acts or action required by the Existing Party to achieve Decommissioning

1. The Exiting Party will disconnect, take down and remove from the Premises the Fixtures and Fittings and the Plant including without limitation:
• pens, troughs, water piping and all other equipment from the lairage;
• the slaughter box, the slaughter line and all equipment from the abattoir including stands, conveyors, scales and sterilising equipment, etc.;
• all equipment for handling and packing offals and by products;
• all the rails from the slaughter area, corridors and chills;
• the main refrigeration plant and all the coolers and condensers;
• the boning hall's rail system, boning line and tables and all other related and ancillary equipment including conveyors, scales, sterilisers etc.;
• the rail system and all related and ancillary equipment in the marshalling and loading area;
• all equipment from the plant room;
• the boiler;
• all water storage tanks;
• truck wash; and
• all tanks and related and ancillary equipment from the effluent treatment plant.

2. The Exiting Party will move off site the items listed in paragraph 1 above and dispose of them in accordance with the criteria set-out in Schedule 5.

3. The Exiting Party will provide a certificate (in a form acceptable to the Society) at the Second Stage Completion from the Secretary to the Society".

32. Legislative Provisions

Before outlining the submissions which were made on behalf of the respective parties, it would I think be helpful, in order to fully understand the issues in this case, to set out the relevant legislative provisions, as well as the main body of case law relied upon. Article 81 of the EC Treaty reads as follows:-

"1. The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market,

and in particular those which:-
(a) directly or indirectly fix purchase or selling prices or any other trading conditions;
(b) limit or control production, markets, technical development or investment;
(c) share markets or sources of supply;
(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.
2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:-
• any agreement or category of agreements between undertakings;
• any decision or category of decisions by associations of undertakings;
• any concerted practice or category of concerted practices,

which contributes to improving the production of distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:-

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

33. Council Regulation (EC) No. 1 – 2003 which is designed to implement the rules of competition as laid down in Articles 81 and 82 of the EC Treaty, provides, that under Article 81(1) the onus of proof is on the party asserting a violation thereof, whereas under Article 81(3), the onus of proof is on the undertaking or association of undertakings which is claiming the benefit thereof. (Article 2 of the Regulation). See also *The Competition Authority v. O'Regan* (Unreported, High Court, Kearns J., 22nd October, 2004).
Article 3 then reads as follows:-
"Article 3
Relationship between Articles 81 and 82 of the Treaty and National Competition Laws
1. Where the competition authorities of the Member States or national courts apply national competition law to agreements, decisions by associations of undertakings or concerted practices within the meaning of Article 81(1) of the Treaty which may affect trade between Member States within the meaning of that provision, they shall also apply Article 81 of the Treaty to such agreements, decisions or concerted practices. Where the competition authorities of the Member States or national courts apply national competition law to any abuse prohibited by Article 82 of the Treaty, they shall also apply Article 82 of the Treaty".

Notwithstanding the manner in which the relief sought by the Competition Authority is framed in the statement of claim, it is clear that given the concession contained in paragraph 35(a) of the amended defence and counterclaim, whereby it is admitted that the "BIDS arrangements" were "liable to have an appreciable effect" on trade between member states, this case is truly an Article 81 case and not one requiring independent consideration under s. 4 of the 2002 Act. Consequently the alleged anti-competitive nature of the arrangements must be considered under Article 81 (1), of the Treaty.
<u>Commission Guidelines:</u>
34. Although strictly speaking the following are not legislative provisions, it would nevertheless be convenient at this stage to deal with two notices from the Commission, the first on the applicability of Article 81 to horizontal cooperation agreements (OJ 2001/C3/02) and the second, on the application of Article 81(3) of the Treaty (OJ 2004/C 101/08). These guidelines are of course not binding on this Court but there are nevertheless both useful and helpful in setting out the Commission's approach to the subject matter of such notices.

35. The following are the more relevant statements drawn from the Guidelines on the interaction between Article 81 and horizontal cooperation agreements.

"1.1 <u>Introduction:</u>
2) Horizontal cooperation may lead to competition problems. This is for example the case if the parties to a cooperation agree to fix prices or output, to share markets, or if the cooperation enables the parties to maintain, gain or increase market power and thereby causes negative market effects with respect to prices, output, innovation or the variety and quality of products.
3) On the other hand, horizontal cooperation can lead to substantial economic benefits. Companies need to respond to increasing competitive pressure and a changing market place driven by globalisation, the speed of technological progress and the generally more dynamic nature of markets. Cooperation can be a means to share risk, save costs, pool know-how and launch innovation faster. In particular for small and medium-sized enterprises cooperation is an important means to adapt to the changing market place.
7) The purpose of these guidelines is to provide an analytical framework for the most common types of horizontal

cooperation. This framework is primarily based on criteria that help to analyse the economic context of a cooperation agreement. Economic criteria such as the market power of the parties and other factors relating to the market structure, form a key element of the assessment of the market impact likely to be caused by a cooperation and therefore for the assessment under Article 81 …"

" **1.3 <u>Basic Principles for the assessment under Article 81</u>**
1.3.1
18) In some cases the nature of a cooperation indicates from the outset the applicability of Article 81(1). This is the case for agreements that have as their object a restriction of competition by means of price fixing, output limitation or sharing of markets or customers. These agreements are presumed to have negative market effects. It is therefore not necessary to examine their actual effects on competition and the market in order to establish that they fall within Article 81(1).
19) Many horizontal cooperation agreements, however, do not have as their object a restriction of competition. Therefore, an analysis of the effects of the agreement is necessary. For this analysis it is not sufficient that the agreement limits competition between the parties. It must also be likely to affect competition in the market to such an extent that negative market effects as to prices, output, innovation or the variety or quality of goods and services can be expected…

<u>Agreements that almost always fall under Article 81(1)</u>
25). Another category of agreements can be assessed from the outset as normally falling under Article 81(1). This concerns cooperation agreements that have the object to restrict competition by means of price fixing, output limitation or sharing of markets or customers. These restrictions are considered to be the most harmful, because they directly interfere with the outcome of the competitive process. Price fixing and output limitation directly lead to customers paying higher prices or not receiving the desired quantities. The sharing of markets or customers reduce the choice available to customers and therefore also leads to higher prices or reduced output. It can therefore be presumed that these restrictions have negative market effects. They are therefore almost always prohibited".

"**<u>Economic Benefits</u>**
32. The first condition [(under Article 81(3)] requires that the agreement contributes to improving the production or distribution of products or to promoting technical or economic progress. As these benefits relate to static or dynamic efficiencies, they can be referred to as 'economic benefits'. Economic benefits may outweigh restrictive effects on competition. For instance, a cooperation may enable firms to offer goods or services at lower prices, better quality or to launch innovation more quickly. Most efficiencies stem from the combination and integration of different skills or resources. The parties must demonstrate that the efficiencies are likely to be caused by the cooperation and cannot be achieved by less restrictive means. Efficiency claims must be substantiated. Speculation or general statements on cost savings are not sufficient."

"**<u>Fair Share for the Consumers:</u>**
34. Economic benefits [must also favour] "the consumers. Generally, the transmission of the benefits … will depend on the intensity of competition within the relevant market. Competitive pressures will normally ensure that cost savings are passed on by way of lower prices … Therefore, if sufficient competition which effectively constrains the parties to the agreement is maintained on the market, the competitive process will normally ensure that the consumers receive its fair share of the economic benefits".

<u>Indispensability:</u>
35. This third requirement of Article 81(3) means that they are no less restrictive means available in order to achieve the benefits identified.

<u>No elimination of competition:-</u>
36. This last requirement of Article 81(3) relates, according to this notice, to the question of dominance "where an undertaking is dominant or becoming dominant as a consequence of a horizontal agreement, an agreement which produces anti competitive effects in the meaning of Article 81 can in principle not be exempted".

<u>Notice 2004/C 101/08:</u>
36. The extracts referred to and relied upon from the Commission document on the application of Article 81(3) were much more extensive than those from the Guidelines on horizontal cooperation. Some of the more relevant passages from the former are as follows:-

2.2: <u>The Prohibition rule of Article 81(1)</u>
"14. … a general principle underlying Article 81(1) which is expressed the case law of the Community Courts is that each economic operator must determine independently the policy which he intends to adopt on the market… a distinction is to be made between the unilateral conduct of an undertaking and co-ordination of behaviour between

undertakings …"
"15. The type of coordination of behaviour or collusion … falling within the scope of Article 81(1) is that where at least one undertaking *vis-à-vis* another undertaking undertakes to adopt a certain conduct on the market or that as a result of contacts between them uncertainty as to their conduct on the market is eliminated or at least substantially reduced …
16. Agreements between undertakings are caught by the prohibition rule of Article 81(1) when they are likely to have an appreciable adverse impact on the parameters of competition on the market, such as price, output, product quality, product variety and innovation. Agreements can have this effect by appreciably reducing rivalry between the parties to the agreement or between them and third parties."

2.2.2 <u>The basic principles for assessing agreements under Article 81(1):</u>
"17. The assessment of whether an agreement is restrictive of competition must be made within the actual context in which competition would occur in the absence of the agreement with its alleged restrictions …
18. For the purpose of assessing whether an agreement … may restrict inter-brand competition and/or intra-brand competition, it needs to be considered how and to what extent the agreement affects or is likely to affect competition on the market. …
(1) Does the agreement restrict actual or potential competition that would have existed without the agreement? If so, the agreement may be caught by Article 81(1). In making this assessment it is necessary to take into account competition between the parties and competition from third parties …
21. Restrictions of competition by object are those that by their very nature have the potential of restricting competition. These are restrictions which in light of the objectives pursued by the Community competition rules have such a high potential of negative effects on competition that it is unnecessary for the purposes of applying Article 81(1) to demonstrate any actual effects on the market …
Restrictions by object such as price fixing and market sharing reduce output and raise prices, leading to a misallocation of resources because goods and services demanded by customers are not produced. They also lead to a reduction in consumer welfare, because consumers have to pay higher prices for the goods and services in question.
22. The assessment of whether or not an agreement has as its object the restriction of competition is based on a number of factors. These factors include, in particular, the content of the agreement and the objective aims pursued by it. It may also be necessary to consider the context in which it is (to be) applied and the actual conduct and behaviour of the parties on the market. In other words, an examination of the facts underlying the agreement and the specific circumstances in which it operates may be required before it can be concluded whether a particular restriction constitutes a restriction of competition by object.
23. … In the case of horizontal agreements restrictions of competition by object include price fixing, output limitation and sharing of markets and customers …
24. If an agreement is not restricting of competition by object, it must be examined whether it has restrictive effects on competition. Account must be taken of both actual and potential effects. In other words, the agreement must have likely anti-competitive effects. In the case of restrictions of competition by effect there is no presumption of anti competitive effects. For an agreement to be restrictive by effect it must affect actual or potential competition to such an extent that on the relevant market negative effects in prices, output, innovation or the variety of quality of goods and services can be expected with a reasonable degree of probability. Such negative effects must be appreciable. The prohibition of Article 81(1) only applies where on the basis of proper market analysis it can be concluded that the agreement has likely anti-competitive effects on the market. Individual assessment of the likely effects produced by the agreement is required."

3. <u>The Application of the Four Conditions of Article 81(3)</u>
"44. The assessment of restrictive agreements under Article 81(3) is made within the actual context in which they occur and on the basis of the facts existing at any given point in time … When applying Article 81(3) in accordance with these principles it is necessary to take into account the initial sunk investments made by any of the parties and the time needed and the restraints required to commit and recoup an efficiency enhancing investment.

3.2 <u>First Condition of Article 81(3): Efficiency gains</u>
50. The purpose of the first condition of Article 81(3) is to define the types of efficiency gains that can be taken into account and subject to the further tests of the second and third conditions of Article 81(3). The aim of the analysis is to ascertain what are the objective benefits created by the agreement and what is the economic importance of such efficiencies.
55. … Given that Article 81(1) only applies in cases where the agreement has likely negative effects on competition and consumer (in the case of hardcore restrictions such effects are presumed) efficiency claims must be substantiated so that they can be verified. Unsubstantiated claims are rejected."
"3.2.2 <u>The Different categories of efficiencies</u>
59. The types of efficiencies listed in Article 81(3) are broad categories which are intended to cover all objective economic efficiencies.

3.2.2.1: <u>Cost Efficiencies</u>
66. Cost efficiencies may also result from economies of scale, i.e. the declining cost per unit of output as output increases
68. Efficiencies in the form of cost reductions can also follow from agreements that allow for better planning of production, reducing the need to hold expensive inventory and allowing for better capacity utilisation. … Cost savings may also result from agreements that allow the parties to rationalise production across their facilities."

3.3 <u>Third condition of Article 81(3): Indispensability of the restrictions</u>
73 … This condition implies a two-fold test. First, the restrictive agreement as such must be reasonably necessary in order to achieve the efficiencies. Secondly, the individual restrictions of competition that flow from the agreement must also be reasonably necessary for the attainment of the efficiencies.
74. … The question [of indispensability] is not whether in the absence of the restriction the agreement would not have been concluded, but whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction.
79. A restriction is indispensable if its absence would eliminate or significantly reduce the efficiencies that follow from the agreement or make it significantly less likely that they will materialise."

3.4 <u>Second Condition of Article 81(3): Fair Share for Consumers</u>
"84. The concept of 'consumers' encompasses all direct or indirect uses of the products covered by the agreement including producers that use the products as an input, wholesalers, retailers and final consumers …
85. The concept of 'fair share' implies that the pass-on benefits must at least compensate consumers for any actual or likely negative impact caused to them by the restriction of competition founded under Article 81(1). In line with the overall objective of Article 81 … the net effect of the agreement must at least be neutral from the point of view of those consumers directly or likely affected by the agreement. If such consumers are worse off following the agreement, the second condition of Article 81(3) is not fulfilled …moreover, society as a whole benefits where the efficiencies lead either to fewer resources being used to produce the output consumed, or to the production of more valuable products and thus to a more efficient allocation of resources.
86. It is not required that consumers receive a share of each and every efficiency gain identified under the first condition. It suffices that sufficient benefits are passed on to compensate for the negative effects of the restrictive agreement.
87. … In some cases a certain period of time may be required before the efficiencies materialise. Until such time the agreement may have only negative effects. The fact that pass-on to the consumer occurs with a certain time lag does not of itself exclude the application of Article 81(3). However, the greater the time lag, the greater must be the efficiencies to compensate also for the loss to consumers during the period preceding the pass-on.
88. In making this assessment it must be taken into account that the value of a gain for consumers in the future is not the same as a present gain for consumers …"
" **3.5 <u>Fourth Condition of Article 81(3): No Elimination of Competition</u>**
108. The application of the last condition of Article 81(3) requires a realistic analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties through the agreement and the impact of the agreement on this competitive constraint. Both actual and potential competition must be considered."

<u>Relevant Case Law:</u>
37. A significant number of cases were referred to but as in all proceedings some of the material was far more relevant than the remainder. The four most relevant cases relied upon were, The Commission Decision of 4th July, 1984, in the *Synthetic Fibres* case, OJ 1984 L 207/17 p. 0017 – 0025; its decision of the 29th April, 1994, in *Stichting Baksteen* (the "Dutch Bricks" case), OJ 1994 L 131/15 p. 0015 – 0022; Decision no. 273 of the Commerce Commission of New Zealand, dated the 2nd February, 1995, *Weddel New Zealand Limited;,* and finally *Weyl Beef Products B.V. and Others v. EC Commission*, 2001/C 134/34.

38. **<u>The Synthetics Fibre Case 1984</u>**

For several years prior to 1978 the synthetics fibre industry, within the community, had suffered from overcapacity, low utilisation and poor pricing, all of which negatively impacted on profitability. In that year, faced with the installation of even more capacity, an agreement was entered into, and pending a Commission decision was provisionally implemented, which, by 1981 had resulted in a capacity reduction of an amount even greater than that anticipated. However after a full reappraisal of the then and the likely future situation, the same producers concluded that given the static demand for their products, any further increase in capacity would be seriously damaging to the industry. Accordingly, they entered into an agreement on the 21st October, 1982, later amended, which was notified to the Commission in November of that year. That agreement which was based on a number of assumptions, called for an overall reduction in capacity; to be implemented by certain dates, by each participant committing itself to achieve a targeted figure, which they would individually determine. In addition, they undertook not to increase capacity during the currency of the agreement, the period of which was set to expire on the 31st December, 1985. An independent trustee body was established to supervise this regime with penalties being provided for, in the event of non-compliance with the obligations imposed thereunder. On the 4th July, 1984 the Commission notified its decision to the parties.

39. Under its "legal assessment" of the agreement, the Commission made a number of observations:-

a. That by both object and effect, the agreement was restrictive of competition with the reduction in capacity meaning the imposition of restrictions on the scale of production facilities and hence on investment;
b. That the purpose of the agreement was to reduce capacity so that the remaining capacity in the industry could be operated at a more economic level;
c. That the duration of the agreement was for a limited period and that the promoters saw collective action as a necessary means to remedy the structural defect;
d. That in a free market economy, the issue of overcapacity should be dealt with by individual undertakings but that had not occurred in the given circumstances. Market forces accordingly had failed to achieve the necessary reductions so as to re-establish and maintain an effective competitive structure within the market;
e. That without collective action, an individual producer would not undertake the unilateral action necessary to achieve the capacity cut.
40. At paragraphs 34 and following, the Commission in its decision then said:-

> "34. By reducing its capacity, the industry will shed the financial burden of keeping underutilized excess capacity open without incurring any loss of output, since the remaining capacity can be operated more intensely. The capacity reductions also provide the undertakings with an opportunity to develop their particular strengths,
>
> 35. …
>
> 36. The eventual result should be to raise the profitability and restore the competitiveness of each party. It is worth noting that the total losses of the European Synthetic-Fibres Industry are reported to have been down to DM 500 million in 1983 from an estimated DM 1 200 million in 1981.

38. It can be concluded then that the agreement contributes to improving production and promoting technical and economic progress.
39. Article 85 (3) also requires that an agreement afford consumers a fair share of the resulting benefit. In the present case, consumers stand to gain from the improvement in production, in that the industry which eventually emerges will be healthier and more competitive and able to offer them better products thanks to greater specialisation, whilst in the short term they will continue to enjoy the benefits of competition between the parties.
40. The number of producers remaining for each product… is big enough to leave users a choice of the supplier and security of supply and to preclude the danger of monopolies developing on national markets".

The Commission therefore declared inapplicable the provisions of Article 85 (1) [now 81 (1)] of the Treaty, to this agreement.
41. <u>The Dutch Bricks Case: (1994)</u>
Some 25 firms operated on the Dutch Bricks Market, with the parties to the notified agreement of the 25th August 1992 holding approximately 90% of the installed capacity and accounting for approximately 85% of brick sales. The products in question were of clay construction and were burned in kilns. These competed against a wide range of alternative building and finishing materials in the construction and other industries. Because of their weight, intrinsic low value, high transport costs etc., there was little trade in bricks within the Community. The geographical market was largely local, though in the case of the Netherlands, given its proximity to Germany, Belgium and Britain, the market was more of a regional one rather than purely a local or domestic one. In any event the Dutch Foundation Stichting Baksteen, which was comprised of seven Dutch Brick Manufacturers, notified to the Commission a series of agreements between it and 16 producers aimed at rationalising production so as to eliminate overcapacity. Faced with opposition from the Commission, the original plan was withdrawn but not before a series of closures had resulted in the removal of a total of 150 million bricks from the industry. Being of the view that further rationalisation was essential and that a coordinated plan reducing capacity was necessary, the agreement, the subject matter of its decision, was notified to the Commission on the 10th September, 1992.

The particular problems giving rise to this agreement can be summarised as follows. At the end of 1991 brick stocks in the Netherlands formed 32% of total brick sales which easily exceeded the critical threshold of an acceptable inventory at 20%. The carrying of this surplus resulted in high costs being incurred. For several reasons the industry noted a sharp drop in demand, structural in nature, which trend was predicted to continue. Faced with this and if the industry should continue to accumulate surplus stock, there would then exist an un-acceptable imbalance between stockpile and sales.

42. Utilisation of existing capacity dropped by about 10% between 1989 and 1991. The effective maximising of capacity utilisation was necessary in order to generate a normal rate of return. Therefore the parties to the agreement considered that it was essential to implement, by way of coordinated plan, a capacity-cut of between 200 and 220 million bricks so as to restore, in the medium term an acceptable balance between supply and demand, whilst at the same time gradually reducing the stockpile. Under the agreement four Dutch producers undertook the following:-
(a) To definitively and irreversibly close down seven production units which would remove from existing capacity 217 million brick or approximately 20%;
(b) To halt production of ceramic building materials for a period of 30 years; and

(c) To refrain, again for a period of 30 years, from selling the dismantled plant to other producers who might use it to increase capacity and who were located within a 500 kilometre radius of the Dutch frontier.

Monitoring and verification procedures were specified with fines or penalties being provided for non-compliance.
This plan was 70% financed by the 16 firms who had signed the agreement and would last for a period of five years (or possibly shorter).

There was a strict prohibition on the parties to the agreement from bringing on stream any new capacity during the financing period and there were also restrictions by members of the foundation on replacement investment. In particular none could be used by members of the foundation to increase production and in the case of other parties, any increase had to be limited to a maximum of 5% over the entire financing period.

43. The Commission in its legal assessment of the case dealt with the issues arising in the manner following:-
(a) Under Article 85 (1) (now 81 (1)), the Commission decided that the principal object of the agreement was to cut and limit capacity and reduce stockpiles by the closure of plants. This objective was backed by a system of fines and was financially supported by a compensation fund. It therefore had a direct effect on competition as it restricted the means of production and investment;
(b) Under its Article 85 (3) (now 81 (3)) assessment, the Commission acknowledged that the industry suffered from considerable overcapacity and mounting stockpiles and that the demand trend was in decline. The participants were therefore seeking by the agreement to achieve a greater utilisation of the retained capacity and were hoping eventually to bring supply and demand into a more acceptable equilibrium;

(c) The normal reaction of the free market, when faced with an overcapacity issue had not materialised, with the forces operating on this market not being sufficient to drive, by way of individual economic activity, the capacity reduction sought. The situation would therefore remain as it was, unless the leading manufacturers understood (and were guaranteed) that their competitors would likewise participate in collective action;

(d) Dealing specifically with efficiency gains, the Commission at para.26 of its decision said "By reducing capacity, firms throw off the financial burden of maintaining unused surplus capacities and, by increasing utilization of the capacity utilization of the capacity retained, (sic) did not have to reduce output. As the capacity closures concern production units that are the least suitable and least efficient because of obsolescence, limited size or outdated technology, production will in future be concentrated in the more modern plants which will then be able to operate at higher capacity and productivity levels. This will lead to a corresponding reduction in the incidence of fixed costs which form a large portion of net costs." As a result, profit would increase and a return to normal competitiveness should follow. In consequence the first requirement of Article 85 (3) (now 81(3)) was satisfied.

44. In addition, the Commission also accepted that consumers would obtain a fair share of the benefits and that there was a sufficient number of producers remaining "to give consumers a choice of supplier and security of supply while ruling out the risk of over concentrated supply" (para 30).

In this context however, the Commission also said at para 31 that "a capacity reduction agreement accompanied by a financing system is, however, liable to lead in the short term to higher prices for consumers. In the present case, however, such risks are largely offset by the fact that the high costs of financing stockpiles will diminish. The special nature of the market for bricks, where unit costs are very sensitive to capacity utilization rates, makes it possible to expect a favourable effect on prices. Consumers also have the option, if the prices charged by the parties to the agreement are unfair, of obtaining supplies from other available sources".

45. With regard to the indispensability requirement, the Commission had this to say:-
"33 The agreement relates only to the reduction of surplus capacities: To that end, it is necessary for the agreement to contain a detailed and binding closure plan which guarantees, firstly, that surplus capacity will be effectively and permanently dismantled and secondly, that throughout the period of its application no fresh capacity will be installed apart from the replacement capacity provided for in the restructuring plan. For the rest, the freedom of the parties in matters of production, pricing, conditions of sale, imports and exports, deliveries, mergers and acquisitions is not

affected by the agreement. The provisions of the first agreement which could have jeopardized those freedoms have been deleted. Nor does the agreement contain any provision aimed at coordinating the commercial conduct of the parties."

46. Finally the Commission also held that since the agreement was limited in time (with the obligations to expire no later than the 30th September, 1997) the system of compensatory payments must be regarding as indispensable to the attainment of the object in question.
Having also highlighted the continuing existence of competition, the Commission concluded that the agreement was saved by the provisions of Article 85 (3) (now 81 (3)) of the EC Treaty.

47. Weddel-New Zealand Ltd (in receivership and liquidation): Decision 273: Commerce Commissions 2/2/1995:
The first named defendant draws attention to this case by pointing out that the Commission held that the benefits to the public, following upon the rationalisation of the slaughtering services for sheep, lamb and beef, in New Zealand, outweighed any anti-competitive consequences of such plan. The majority on the Commission also held that post rationalisation there would still be effective competition despite the closure of two plants owned by two competitors. Moreover, it decided that this coordinated activity was a realistic means of spreading fixed costs and reducing overcapacity, rather than reducing capacity simpliciter. In addition, such concerted activity would bring success to the sector in the international markets and that in turn would feed back, positively, into the domestic farming industry.

48. The Competition Authority dismisses this case as having no direct relevance to present circumstances and in the process makes a number of distinguishing points. Firstly, the plants, the subject matter of the decision, had already closed following the appointment of a receiver. Secondly, the primary purpose of the restriction on members of the consortium from selling plants unless a purchaser became a party to the arrangements, was to ensure that the existing processors would continue to bear their share of the cost required for the Weddel plants. Accordingly, the objects of the proposal before the Commission were entirely different from the objects of the BIDS arrangements. In addition, quite unlike any requirement of the BIDS arrangements, the plants sought to be closed in the Weddel proposal were those which relatively speaking were inefficient with high fixed and variable costs. The Commission did however make a finding, equally applicable to this case, when it concluded that the proposals would lessen competition; principally by creating additional obstacles for new entrants to quickly and effectively enter the relevant markets. Further significant findings by the Commission, were that in a proposed closure situation the industry would not lack physical capacity and there would still remain a large number of players. Moreover, the cost of constructing a new plant or the cost of extending an existing plant was not hugely prohibitive. In addition it held that the processing industry could increase capacity to meet additional demands if the need arose. Overall the decision of the Commission was that any detriment suffered would be minor.

49. The plaintiff further submits that the relevant law as applying to the Commerce Commission decision, was different to that which this Court must apply. Under New Zealand law, regard could be had to "public benefits". These were identified as improvements in the industry's confidence and reputation. At para. 2.62 of its decision the Commission on this topic said the following:-

> "the Commission believes that there is a reasonable chance that the restructuring could succeed in making a very important difference to the future of the industry. In any event, the Commission considers that the prospects of the industry are measurably enhanced by the proposal. Accordingly, it has given weight to this factor in its public benefit assessment over and above the weight given to the improvement in production efficiencies arising from the proposal. The amount of the benefit attributable to this factor cannot be measured precisely but is considered to be significantly greater than the public benefit attributed to the productive efficiency gains as discussed above".

It is therefore claimed on behalf of the Authority that such factors are entirely irrelevant to the present case and accordingly that Weddel offers no support to the Society in this matter.

50. Weyl Beef Products BV and Others v. EC Commission (The Dutch Beef Case)
The first named defendant considers this case to have particular relevance to its position. In the Netherlands there had been a series of agreements which resulted in the large scale purchasing of cattle slaughtering capacity with the intention of permanently withdrawing that capacity, from the industry. The industry itself had experienced a sudden decrease due to a variety of reasons. Accordingly, in 1995 six plants representing approximately 25% of the entire slaughtering capacity, exited the market. Compensation to the owners of such plants was financed by a government levy imposed on all the remaining industry participants. In return for this buyout, the plants of those exiting could not be used for 30 years and associated equipment had to be destroyed or else sold at the distance of at least 1500 kilometres from the factory. A number of Dutch processors alleged that these provisions breached Article 85 (now 81), and other Articles of the EC Treaty. The Commission adopted two decisions effectively holding against the complainants. The latter appealed to the Court of First Instance. That appeal was also unsuccessful. The Society

submits that since the Court of First Instance found that the Commission had acted properly in deciding that the arrangements did not give rise to any appreciable anti-competitive effects, above and beyond the effects inherent in the scheme itself, (which had been evaluated for the purposes of Articles 92 and 93 of the Treaty (New Articles 87 and 88 – The State Aid provisions)), it must follow, that as the restrictions in the present case are considerably less onerous than those in the Dutch Beef case, these are also valid.

The Authorities' response is that the Dutch beef case is primarily a decision relating to state aid and accordingly has no direct application to this case.

51. Text Books
In addition to the legislative provisions outlined above, the parties, as well as reciting relevant case law, also relied upon a number of well known publications on the law of competition including in particular *Whish on Competition Law 5th Edition*, *Bellamy and Child, on European Community Law of Competition*, *5th Edition and Faull and Nikpay, the E.C. Law of Competition*. Several passages, commencing at page 90 of *Whish*, were opened as to the appropriate manner in which an allegation that an agreement or a decision had, as its object or effect, the prevention restriction or distortion of competition should be approached. Likewise at para.2.096, *et seq*., of *Bellamy and Child*, which again deals with the same subject matter. In addition, further sections from *Bellamy and Child*, at para.6 - 116 and following were relied upon when discussing the definition of the appropriate geographical market. See also paras. 6.17 – 6.24 of *Faull and Nikpay*. Since further reference will be made to some of these extracts when dealing with the various submissions, I do not propose to outline the relevant passages at this stage of the judgment.

52. Established Principles of Law
(1) Prior to outlining the submissions, the following principles of law, which have relevance to this case, are well established and are largely, if not totally un-controversial. These are as follows:-

(a) The Plaintiff Authority has the power to prosecute these proceedings under Section 14 (2) of the Competition Act 2002, which section reads:-

> "(2) The Authority shall have a right of action under this subsection in respect of an agreement, decision or concerted practice or an abuse which is prohibited under Section 4 or 5 or by Article 81 or 82 of the Treaty".

(b) As previously stated by virtue of Article 3 of Regulation 01/2003, this Court must apply Article 81 of the Treaty to this case and accordingly, it is not necessary to conduct a separate evaluation under or in the context of Section 4 of the Competition Act 2002.
(c) The onus of proof is on the plaintiff to establish an infringement of Article 81(1) and on the first named defendant to obtain the benefit of Article 81(3). The standard in both cases is the civil one.

(d) Each member of the first named Defendant Society is "an undertaking" for the purposes of Article 81 of the EC Treaty. See *Hofner and Elser v. MacRotron* GambH 1991 ECR 1-1979 and *Hemat v. Medical Council*, (Unreported, High Court, McKechnie J., 11th April, 2006). This includes the second named Defendant. In its own right, the first named Defendant is "an association of undertakings", again for the purposes of the Treaty. See the Opinion of Advocat General Leger in *Wouters* 2002 ECR 1-1577.

(e) The arrangements put in place by the Society, which collectively have been referred to as the "BIDS arrangements" constitute, agreements or decisions by an "association of undertakings" and accordingly are within the purview of Article 81.

(f) The agreement between BIDS and the second named Defendant is likewise an agreement within the provisions of Article 81 of the Treaty.

(g) The type of agreement, decision, or concerted practice, instanced at Article 81 (1) (d) and (e), are not relevant to this case with the Plaintiff Authority essentially relying on sub-paragraphs (b) and (c) and also, but to a lesser extent, on (a) of that Article.

(h) To establish an infringement of Article 81 (1) the Plaintiff must *inter alia* prove that the agreement or decision in question has as its "object or effect" the prevention, restriction or distortion of competition within the Common Market. The words "object" and "effect" are true alternatives and must be considered separately. See *Ferriere Nord v. Commission* 1997 ECR 1-4411. *Societe Technique Miniere in Maschuinen Bank* ULM [1966] E.C.R. 235 In addition that prevention, restriction or distortion (sometimes collectively referred to as "anti-competitive" or as having "anti-competitive effects") must be appreciable as must the impact of the impugned decision or agreement on inter-state trade. That latter ingredient of Article 81 is admitted in this case.

(i) Restrictions of competition by object are those which obviously or evidently or plainly or by their very nature have the potential to restrict competition. If such restrictions exist "there is no need to take account of the concrete effects of an agreement (or decisions)...". See *Consten and Grundig v. Commission* (1966) E.C.R. 299 and *BNIC Clair* [1985] E.C.R. 391. The evaluative process leading to any such conclusion is based on a number of factors including, the terms of the agreement, regard being had to the context in which the agreement is applied, and to the actual conduct and behaviour of the parties on the market. In this regard, the parties' subjective intent to restrict competition is a relevant factor but it is not a necessary condition. In *ANSEAU-NAVEWA* [1983] ECR 3369, the Court of Justice, in concluding that the agreement at issue was restrictive of competition by object, described the test in this way:-

> "the purpose of the agreement, regard being had to its terms, the legal and economic context in which it was concluded and the conduct of the parties, is appreciable to restrict competition within the Common Market ……..that finding is not invalidated by the fact that it has not been established that it was the intention of all the parties to the agreement to restrict competition." See paragraph 2.8 of *Van Bael and Bellis* on Competition Law in the European Community 4th Edition."

(j) Market definition, where such a finding is open, is not essential to establish an infringement of Article 81(1); so the European Court of Justice held in *Volkswagen v. Commission* 2000 ECR 11-2707, a variation on previous dicta from the Court of First Instance in the *Italian Flat Glass* case, [1990] 4 CMLR 535.
(k) In the absence of regulations or guidelines as to what decisions or agreements might be considered restrictive of competition by object, case law from the European Courts has held that horizontal agreements which fix prices, control output, share markets, and ban exports, are all *per se* infringements of the Article 81 (1); this, subject to the *De Minimis* rule and to the requirement of effecting inter-state trade. See *Tate & Lyle & Ors. v. Commission* 2001 ECR 11-2035 and *European Night Services* 1998 ECR 11-3141. Restrictions of this kind are also known as "hardcore restrictions".

(l) From time to time, an issue arises as to whether in applying Article 81(1) of the Treaty, the Commission and the courts must also take into account the pro-competitive effects of the agreement or decision in question. In other words, is there in existence a "rule of reason" under Article 81(1). In *Metropole Television (M6) v. EC Commission* [2001] E.C.R. 11-2459, the Court of First Instance, whilst acknowledging the existence of some *dicta* which might encourage a wider enquiry under Article 81(1) than that historically conducted, nevertheless pointed out that there was no case law supporting a "rule of reason" application under Article 81(1). This debate was rekindled by the judgment of the European Court of Justice in *Wouters v. Algemene* RNOA, etc. [2002] E.C.R. 1-1577. Nevertheless, some years later the Court of First Instance, in *Van den Berg Foods*, Case T-65/98 (23/10/2003) reaffirmed the absence of any such rule under Article 81(1). This also seems to be the position adopted by the Commission. See para. 30 of its Guidelines on the application of Article 81(3).
(m) I therefore do not accept the suggestion advanced on behalf of BIDS that the scope of the Court's enquiry in the context of an alleged restriction by object is wider than that as outlined herein. In particular, I don't believe that there is any established authority for the view that a "rule of reason" type inquiry should be conducted. On the contrary, there is substantive authority to the opposite effect. Accordingly, I do not think, that an appraisal under Article 81(1) of the issues in this case, should involve any detailed assessment of the pro-competitive nature of the agreements or decisions in questions. That remains a matter for consideration under Article 81(3).
(n) An agreement or decision may also be anti-competitive by effect. There is no negative presumption in this regard (para. 24 of Guidelines last mentioned). If such is the allegation made, then the agreement complained of must be capable of effecting competition to such an extent "that on the relevant market negative effects on prices, output, innovation or the variety of quality of goods and services can be expected with a reasonable degree of probability". See para. 24 of the Guidelines on the Application of Article 81 (3) of the Treaty. To make such an assessment "account should be taken of the actual conditions in which the agreement functions, in particular, the economic context in which the undertaking operates, the products or services covered by the agreement and the actual structure of the market concerned". See para. 136 of the Court's judgment in *European Night Services v. Commission* [1998] E.C.R. II-3141 and also para. 20 of *Delimitis v. Henninger Brau* [1991] ECR 1-935. As a result it is necessary when conducting this exercise to define the relevant market and to assess the parties position on that market. If appropriate (though not in this case) similar type agreements may also be considered in order to determine any effect of "parallel networks"'.
(o) It is clearly and definitively established that the agreements or decisions complained of must have "an appreciable effect on competition", being either actual or potential competition. The European Court of Justice so decided as far back as 1969 in *Volk v. Vervaecke* [1969] E.C.R. 295 where it ruled that "an agreement fails outside the prohibition of Article 81(1) when it only has an insignificant effect on the markets, taking into account the weak position which the persons concerned have on the market of the product in question". If relevant, though again it is not in this case, reference should be made to the Commissions *De Minimis* Notice of 2001 (OJ 2001 C368/13).
(p) And finally, I accept that in principle a contractual restriction, does not by itself necessarily restrict competition. See p. 99 of *Whish* Competition Law, 4th Ed.

(2) I consider the above propositions to be well established in European Competition Law and indeed cannot recall any dispute in substance between the parties regarding such provisions. In addition, where appropriate, I propose to have

regard to both sets of Guidelines issued by the Commission and in many respects where relevant to apply them. Moreover, the issue between the parties on the case law does not involve a dispute about the principles emerging therefrom but rather about how these should be applied to this case. Finally, much of what is contained in the relevant extracts from *Bellamy and Child*, *Whish*, and *Faull and Nikpay*, are in substantive terms very similar to each other, though the phraseology and sometimes the emphasis may be somewhat different. Overall, therefore I don't believe that there is any great dispute between the parties on the relevant principles of law.

53. Submissions of the Competition Authority:
Article 81(1)
The written submissions made on behalf of the Authority run to over one hundred pages with these being supplemented by oral presentations. Because of the breadth and scope of such submissions, it would neither be practicable nor useful to outline these in their entirety. The following therefore is only a summary of what the Plaintiff's position is.

In applying Article 81 (1) of the Treaty, one must consider whether the BIDS arrangements infringe by way of their "object or effect" competition within the Common Market. It is the view of the Competition Authority that the agreement to reduce capacity, (by a throughput margin of 420,000 animals), to apply levies and to impose restrictions on the re-entry of the goers are, by their very nature, either individually or collectively, or in the words of the Article itself, by "their object", restrictive of competition. Relying on the Guidelines of the Commission on the applicability of Article 81 to horizontal co-operation agreements and in particular on paras. 18 and 25 thereof, it is said that these three aspects of the arrangements are matters which can be described as "hardcore restrictions" and thus fall within the object prohibition. In essence, it is claimed that by reason of factory closures, the capacity formally utilised by such plants will in fact be lost to the industry and accordingly, there will be output limitation. The Plaintiff Authority does not accept what Messrs. McAndrew and Breen suggest will occur, namely that over 95% of that capacity will be subsumed by the stayers. This expectation it is said is speculative, particularly in view of other evidence which suggests that in the coming years the volume of live exports could increase.
In further support of this position the Court was referred to paras.4.046 to 4.054 of *Bellamy and Child* which contain an overview of some of the case law involving so called "crisis cartels". From this survey it is suggested, that even if part of the arrangement is correctly described as a limitation of capacity only, it would still be logical, by analogy, to treat it in the same way as a limitation on output. This approach is also justified by the Commission's decision in the *Dutch Bricks* case and in the *Synthetic Fibres* case, where, in the former, the Commission regarded an agreement to reduce capacity as a restriction on the "means of production" and in the latter described a capacity reduction as a "restriction on the scale of their… production facilities". At para. 16 of the *Dutch Bricks* case the Commission said "the principal object of the agreement is to achieve a larger cut in capacity and stockpiles than could be obtained by a unilateral restructuring operation. The notified agreement constitutes concerted action between competitors aimed at closing plants and limiting capacity, backed by a system of fines in the event of failure to comply with obligations, and financially supported by a compensation fund. It therefore has a direct effect on competition in as much as it restricts the means of production, and therefore the investments and competitive strategies of the parties".

54. At paras. 25 and 26 of the *Synthetic Fibres* decision the Commission stated:

> "25 The notified agreement is an agreement between undertakings which has the object and effect of restricting competition within the Common Market.

26 By committing themselves to reduce capacity, the parties accept restrictions on the scale of their production facilities and hence on their investments. This commitment involves an obligation on each party to draw up and implement the capacity reduction plan showing by product and plant, the size and timetable of the cuts to be made by the parties."
Therefore, it is the Authority's position that these arrangements are captured by the object prohibition contained in Article 81(1).

55. If however the Court should take a contrary view the Plaintiff's position, as must inevitably follow, is that these arrangements also constitute restriction by effect. Once again the same three aspects of the plan have been highlighted in this regard, all of which it is claimed will have "negative market effects as to prices, output, innovation or the variety or quality of goods and services"… see para. 19 of the above Guidelines (2001/C 3/02). The three matters referred to, are of course, the reduction in capacity, the levies and the restrictive covenants in the Exit agreement. It is agreed that a proper market analysis must take place and that the arrangements must be shown to actually or potentially have an appreciable anti-competitive effect. See para. 24 of the Guideline of Article 81(3) of the Treaty. In addition this matter must be judged by reference to competition which would occur in the absence of the agreements in question, and, following *ENI –MONTEDISON* OJ 1987 L5/13/1989 4 44, it is claimed that there is no useful purpose in looking at the withdrawal of capacity by reference to what might occur, if there were mergers or acquisitions within the industry. This proposition is in my view correct and I readily accept it.

56. Relying upon the test as outlined by the European Court of Justice in the *Delimitis* case, 1991 ECR 1-95 it is submitted that entry to the beef processing market is difficult even at present, but that the restrictions in the BIDS arrangements, in particular the obligation to decommission, would significantly add to these problems and would further restrict entry.

57. It is claimed on behalf of the Authority that any reduction in capacity is likely to make supplies scarce and raise output prices. It is said that in both the *Synthetic Fibres* case and in the *Dutch Bricks* case, the Commission recognised this; even though it found in both, that this negative impact was outweighed by more beneficial considerations. So these cases afford a clear acknowledgement of the link between production and capacity and a price increase for consumers. Indeed, McKinsey also made this point where at page 15 of the report it said "When capacity is tight, the buy/sell spread can widen …" or to put it another way "the buy/sell spread depends in large part on the level of capacity in the factories relevant to throughput. If there is a lot of excess capacity in the factories, competition for supply should increase and the buy/sell spread should narrow, and vice versa, if capacity is tight".

In this context, there is some seasonality in the market though this is not as evident as previously. Accepting that the removal of 420,000 cattle represents approximately 25% of the entire kill of export approved plants, it was suggested that with a peak of 60% (or 66%) as against an average throughput utilisation of 50%, there would be insufficient capacity to cope with peak demand. This will result in shortages which would put significant pressure on prices. Finally, in this regard it is claimed that the figures given for peak and average throughput are probably understated, as since the 1995/1997 period, there has been an internal re-organisation within the AIBP group which has seen the number of factories reduced from ten to six. Therefore, a reasonable conclusion from the evidence is that at peak periods there will be a capacity shortage.

58. The proposal, to impose a levy of €2 and in particular a levy of €11 on every kill above a certain threshold, is most likely to have significant negative pressure on prices. Such prices are, according to the Authority, likely to rise. Those price rises will have an impact not only on the domestic upstream market but also on the downstream external markets, in particular the UK. Given the large volume of exports to that country, mostly taken up by the Food Services Sector, it is assumed that there are good commercial reasons why the UK favours Irish Beef over alternative sources, and accordingly, a significant increase in the price of Irish Beef would have an appreciable effect on prices in that country. Mr. McDowell it is said is simply wrong in his assertion that consumers will turn to beef from South America (or elsewhere) in the event of a price rise. With regard to the upstream market, an increase in marginal cost would mean that farmers would receive less for their cattle. This clearly constitutes a distortion of competition brought about by the exercise of collective power. There is no appropriate comparison between these levies and the position of a formal national tax imposed by legislative process.
This levy issue was again addressed by the Authority when dealing with the requirement under Article 81(3) of passing on "a fair share" of any efficiency gains to consumers.

59. The Plaintiff also submits that the decommissioning of plants is anti-competitive and will have a negative effect on prices. In accordance with the evidence given, the situation seems to be that whilst the ownership of factories have changed throughout the years, plants have very rarely, if ever, ceased to operate. Therefore at present, a would be new entrant has this method of entering the business and thus of competing with the existing players. This fact alone or even the threat of this entry method, is a restraint on existing players and a reminder that they are open to competition. If a goer has to decommission his plant as is now proposed, that is an entirely different situation than what presently prevails. There would not exist in a new situation, even the threat of entry, as the cost of establishing a green field site would be prohibitive. This and the other existing barriers to entry, for example, the requirement to obtain various regulatory consents and permissions, would have an obvious impact on competition within the industry.

60. <u>Article 81(3)</u>
Of the four conditions specified in Article 81(3), two being positive and two being negative, the first is a requirement on BIDS to demonstrate that the arrangements contribute to improving the "production or distribution of goods" or in promoting "technical or economic progress". In short, because such benefits "relate to static or dynamic efficiencies, they can be referred to as economic benefits". See para. 32 of the Guidelines on the applicability of Article 81 to horizontal co-operation agreements. Such benefits or gains must be substantiated with the obligation in this regard being on the first named Defendant.

61. <u>Article 81(3) – Economic Benefits</u>
The Competition Authority, in its submission, then addressed the individual requirements of Article 81(3). The first relate to the alleged efficiency gains resulting from the arrangements. The plaintiff claimed that the Society had failed to demonstrate any sustainable cost savings as a result of its plan, and in support of this view the Authority undertook a most detailed analysis of both the written and oral evidence. In the first instance it pointed out that during the course of the hearing several different figures were suggested by BIDS, with the source of each figure being incorrect and unsustainable. In his May 2005 report to this court, which was co-authored by Dr. Francis O'Toole, Mr. McDowell seemed to rely upon the productive efficiency figure, as given in McKinsey, which was then stated to be IR £18

million. This, he converted to a current value of approximately €34 million. During the course of his oral evidence however he disavowed for the purposes of this case, any reliance on all but IR £7.5 million of the original figure, with this being related solely to cost savings on the slaughtering side. Being somewhat uncertain as to what weight the Society was placing on this figure, Mr. McDowell suggested that from Mr. Scully's report and evidence, the figure ought to be €11 million. When Mr. Scully gave evidence he calculated the savings at €18 million and based this on an annual throughput of 39,111 cattle. This, it is claimed was unreliable and inaccurate and in any event failed to address the real question, which was, what is the gap between the costs which the goers could save by exiting the industry and the incremental cost to the stayers of slaughtering the additional 420,000 cattle per annum.

62. Crucial to Mr. Scully's assessment was the starting point which he took as being reflective of a representative plant. This point was not significant in a model showing a linear relationship between throughput and average costs, being the one adopted by Mr. Ridyard, as with such a model the average cost reduction, even with an increased throughput of about 11,000, was the same irrespective of one's starting figure. However, the econometric model used by Mr. Scully was a U shaped one and as a result the calculations obtained from it were heavily influenced by the actual starting point, as any increase above 35,000 cattle meant that the ATC savings were reduced.

63. Mr. Scully, it was suggested was incorrect in concluding that an annual throughput of 35,000 animals reflected the information contained in McKinsey; rather on a proper analysis of the material available, and allowing for the internal rationalisation within the AIBP Group, the average industry throughput was more likely to be in excess of 58,765 per annum. The effect of this, in a post-rationalisation regime, would be that a plant with an actual throughput higher than the average would achieve smaller costs savings than a plant with a lower actual throughput. The explanation for this, in terms of the resulting calculation, is that the latter plant would start on the U shaped curve at a point well above that of the former. Given that plants with a low throughput face higher costs, it is likely that those are the plants which would exit the industry. Moreover, this is what was envisaged by BIDS. See the minutes of several of their meetings including those held on 11th July, 2002 and on the 10th of October of that year. Therefore, by operating his model with a starting point of 35,000 animals, the calculations made by Mr. Scully grossly overestimated the actual costs which might be saved. Faced with this challenge, Mr. Scully re-calculated his model with a starting throughput of 58,766. That led to a ATC saving of €2.69 per head. Even on this basis, his resulting figure of €7.123 million could not be correct as it was based on a national kill of 2.64 million animals, which is in fact almost 1 million above that ever recorded in this country. Even however if one took a figure of €2.69 per head, and multiplied it by the national kill, the savings would be no more than €4.5 million.

64. Finally, it is claimed that the BIDS presentation was entirely silent on what costs could be saved by the goers exiting the market and secondly, that Mr. Scully was obviously incorrect in suggesting that depreciation was an avoidable cost. Overall therefore, the first named defendant had failed to discharge the onus of proof which is upon it under Article 81(3).

65. <u>Article 81(3) – Consumer Welfare</u>
The second requirement of Article 81(3) is that the consumer should obtain "a fair share" of the economic benefits. In this context it is claimed by the plaintiff that since there is no credible estimate of gains, it cannot be shown that the consumer will benefit. Even however, if one was to operate on the basis of Mr. Scully's ultimate financial position, namely a saving of €2.69 per head in the average total costs (which for reasons outlined above is in any event an overestimate), this figure is greatly exceeded by the proposed levy, in particular that of €11, and also by the other price enhancing effects of the arrangements. It is said that consumers will be worse off, after the rationalisation than they presently are.

66. The plaintiff also argues that a 25% capacity reduction will mean an insufficiency of capacity to cope with peak demand with the result that this capacity shortage will increase the buy/sell spread. Secondly, the levy of €11 will add to marginal costs which will feed through at the prices which consumers will have to pay for the finished product, and thirdly, the effect of the restrictive covenants will eliminate for all practical purposes the option currently available to a new entrant, namely that of acquiring an existing plant.

67. On a review of the evidence the Authority also submitted the following:-

(a) that marginal costs will increase as output exceeds a certain threshold and therefore such increase will push up output prices;
(b) that the levy of €11 will have an additional upward effect on both marginal costs and average costs;
(c) that Mr. McDowell was incorrect in assessing the levy in the context of the overall price of an animal: rather the correct comparative was the buy/sell spread;
(d) that in the absence of knowing what the contractual arrangements were, as between the beef processors and the multiples, it was purely speculative on Mr. McDowell's part, to suggest that the gains would be passed on by the supermarkets to consumers. Instead, given the increase in marginal costs it is likely that the processors will charge more and that such increases will be passed on to the end user;

(e) that the processors will not be able to absorb such increases, or even as economic theory might have it, part of such increases; this is evident from the very tight margins currently obtainable in the sector;
(f) that it is unrealistic to expect the domestic abattoirs, who are likely to be less efficient than the larger ones, to act as substitute suppliers, at acceptable prices to supermarkets, even if the latter were so interested: nor is it likely that a substantial number of consumers would switch their buying preference in beef from supermarkets to local butchers; and
(g) that in any event the practice of multiples would appear to suggest that they tend to select a small number of processors with whom they enter into long term contracts with regular discussions on price. There would therefore be serious functional and practical problems for supermarkets, to obtain their beef requirements either from other domestic sources or from imports.

Consequently, for these reasons it is claimed that the increased cost to the processor would become an increased price for the consumer.

68. With regard to export markets, it is claimed by the Authority that the members of BIDS, following the implementation of the plan, would be in a position to negotiate better prices for their products on such markets.

Lastly, noting the absence of any commitment by the first named defendant not to increase its prices, and highlighting the location of the onus of proof, it is said that the costs increase will inevitably result in price increases for the end consumer.

69. Article 81(3) Indispensability
It is submitted that the attempt by the first named defendant to establish market failure as a basis for meeting this requirement has not been successful. On the contrary, the evidence is that the market is operating in a satisfactory manner. Significant profits have been earned by some firms, and plants have been sold and acquired within the industry. Despite an attempt to so do, Mr. McDowell has not established by any credible evidence that such plants are sold at a "knockdown price". Moreover, the investment decision by Dawn, who acquired Galtee Meats (Charleville) from the Dairygold Group, is entirely inconsistent with this proposition. The departure from the market of Glanbia and Dairygold, whilst remaining significant players in the general agri-food industry, can properly be explained as a strategic decision by these companies. It cannot be interpreted as indicative of market failure.

70. In addition, if the industry was in a crisis, one would have expected a major uptake under the BIDS arrangements which did not happen either in 1998 or in 2002. Moreover, the decision by Eurofarm to enter the market in 2003, via the upgrading of a domestic abattoir which involved a significant investment, would only have been undertaken by that firm in the belief of obtaining a realistic return. The overall picture which emerges from the evidence is that there is profit to be made in the processing sector.

Finally, McKinsey itself gives support to an operational market, admittedly in the context of a prediction that there would be a substantial drop in raw material (which has not yet happened) when it said that there would be processors exiting the market.

There is therefore no evidence to support the indispensability requirement.

Article 81(3): No Elimination of Competition:
71. The final point made on behalf of the Competition Authority, though one not ultimately pressed by it, was that under this heading, one should look at the competition within the market and should analyse the barriers to entry facing would-be new entrants. In that regard when one considered the regulatory framework presently operating within the sector, the effect of large scale sunk costs, the advantages of and need for minimum efficient scale and other factors, it was self evident that the BIDS proposals would increase obstacles to entry.
72. Submissions on behalf of the Society
The submissions made on behalf of the first named defendant by Mr. Maurice Collins S.C. were supported by Counsel on behalf of the second named defendant, Mr. James O'Leary S.C. and P.J. Breen, B.L. These, which again were very extensive and most detailed, can be summarised in the manner following.

By way of general observation it was forcibly stated that the true objective of the BIDS arrangement was to enable all the players in the industry, from the farmyard to the factory gate, to compete more effectively and be more competitive. If this should be achieved, Ireland plc (as it was titled) with all of its constituent parts, would gain. As Mr. Derek Breen put it in evidence, it would enable the processors, for example in the export markets, to significantly improve on their present fourth tier status. It would give them greater clout and bargaining power to become a recognised quality supplier with any increased benefits being purely incidental to this. The entire arrangements therefore have to be looked at in this light.

73. The second general comment was that the Competition Authority, had failed to carry out a proper market analysis so that the alleged anti-competitive consequences of the arrangements, either by object or effect, could be fully analysed. In every aspect of this case, there was insufficient evidence about the circumstances of the market, the conditions of competition within that market and the likely effect which the BIDS arrangements would have on those conditions. That and the "desk top" analysis carried out by Mr. Ridyard were fundamental flaws in the plaintiff's case.

74. Outlining, in considerable detail the evolution of the beef industry, see para.8 *et seq*. above, it was asserted on behalf of the Society that the evidence unquestionably shows the existence of overcapacity within the sector. Of equal significance were the cost factors which undoubtedly were associated with such gross under utilisation. The basis for this view emerged not only from the manner in which the industry had developed, particularly in the context of Ireland's access to the C.A.P., but also from the conclusions reached by every single major report into the sector. McKinsey was but one. The Beef Task Force was but another. In addition, there were several more all coming to the same view. When one looked at the identity and calibre of these who served on the reporting teams, it was evident that this view on overcapacity, was shared across a wide spectrum of interests in this community. Therefore, it can hardly be open to the Competition Authority to now credibly challenge such a conclusion.

75. Again, in general, it was said that the plaintiff had failed to give proper recognition to the limited duration of the agreement, to the fact that the stayers could at any time after rationalisation, decide to leave the industry or to stay and increase capacity, and to the absence of any market sharing on the supply side or collusion on the beef side. Moreover, Mr. Ridyard had failed to appreciate the lasting impact of the DSP (or even the fact that it had ended), and furthermore was evidently quite wrong in his treatment of the efficiency gains. Without however, even moving to an Article 81(3) appraisal, there was no evidence in this case, that the three objectionable aspects of the arrangements as identified by the authority, had or were capable of having an actual or potential negative impact on competition in the relevant market places.

76. Continuing with this issue of capacity, it was submitted that a reduction *per se*, could not be said to be anti-competitive unless the remaining capacity was insufficient and led to resulting shortages. The persons, most qualified to give evidence in this regard were Messrs. McAndrew and Breen. From there uncontradicted evidence, it was claimed that the remaining capacity, after rationalisation, would be sufficient to meet not only peak time demand but also any sudden or unexpected increase in demand. Plants could operate "flat out" for short periods. Factories could undoubtedly work longer than the three or four days for which many presently operate; they could increase that to a seven day period and of course could also operate double shifts and even utilise more than one line. So there was sufficient evidence of a credible nature to indicate that with a 25% reduction, the residue was still more than capable of meeting actual or potential future demand. In addition, Mr. Breen said that this surplus capacity operated as a "fundamental drain" on the sector.

77. The treatment by the Competition Authority of the levy was fundamentally wrong. Apart from its failure to provide a proper market analysis, it failed to appreciate that it had a two level imposition namely at €2 levy and at €11 levy. And that the latter would apply only above the traditional kill as expressed in percentage terms. In addition, the levy which should not be measured against short run costs, was for a maximum of three years and probably less. Being so short- term in nature, it could be argued that the processors would carry it themselves. According to the evidence, the way in which it would actually operate, would be that each company would average out the annual cost of the levy and would not be mindful that above a certain level of kill the amount would increase from €2 to €11. It would, according to Mr. McAndrew have no effect on purchasing and as it would account for only 18% of their profit margin, there was a realistic expectation that the industry itself would subsume it or at least a substantial part of it.

78. The short term nature of its imposition would also be favourably considered by the farmers, as it would coincide, at least approximately, with the cycle of production, that is from insemination to kill. Moreover insufficient weight was attached to the long-term and permanent gains which would follow rationalisation.

79. It was strongly denied that the consumer would have to pay more for the price of beef. It was said that the supermarkets, (which is a fact), are supplied by a small number of beef processors, thereby leaving several others available, who rationally would be interested in doing business with them. In addition, there were a number of export approved plants which were not members of BIDS and which therefore did not have to carry any part of the levy. Moreover, there were the domestic abattoirs, any and all of whom could act as substitute suppliers if that was required. Indeed it was pointed out that the supermarkets sell about 3% of the entire domestic supply and that there were a number of alternative processors who would have the capacity to meet these demands. (see para. 89 below). Finally, it was said that it is entirely unrealistic to believe that processors would refuse to supply or would discontinue supply, to for example Tesco, simply because the latter would not absorb or pass on the increase in marginal costs. Processors fully realise the desirability of selling locally as it avoids transport costs and as there is a national preference for local product. Given the substantial power of the multiples it was reasonable to argue that the consumer would not have to pay more. In any event, there was no reasonable attempt by the Competition Authority to produce realistic evidence upon which this court could determine, how much for example prices might increase by. Overall, on any analysis, the Plaintiff's case should be rejected.

80. As marginal revenue was still above marginal costs there would be no shortage on the production side.

81. On the third objection, namely the restrictive covenants, it was submitted that if it was justified to remove capacity it was equally justified to keep it out. That is unless the remaining capacity by itself, is or would be insufficient. There had been no evidence in this regard. The decommissioning of plants and the non-compete clause were both necessary and proportionate to the agreement. As the first named defendant saw it, the real objection of the Authority in this regard, was an allegation that such covenants constituted a restriction on entry. This view was not justified. Firstly, in the context of the existing barriers to entry, including the requirements to obtain planning permission, to get an integrated pollution control licence, as well as meeting the department's criteria for export approval, there was no evidence to support a finding that the decommissioning and the non-compete clause for five years and two years respectively, would make it impossible or indeed even more difficult for new entrants to enter the market. Moreover, those who would exit the industry could return after these brief periods had expired. In addition, of course, potential entrants could acquire domestic plants and upgrade, much as Eurofarm had done in 2003. The true obstacle to entry was the overcapacity issue and not the arrangements. This was borne out by the absence of any green field investment since Liffey Meats, at Ballyjamesduff in the mid 1980s. Therefore, what is suggested under the BIDS arrangements is not anti-competitive.

82. On the Article 81(3) argument, the only credible evidence on Requirement No. 1 was that given by Mr. McDowell and Mr. Scully, with both the model used by and the approach of Mr. Ridyard being demonstrably incorrect. Of these economic gains it is not suggested that consumers in the export markets will materially benefit, in specific financial terms, as a result of the rationalisation plan. However, farmers in this country will. Such farmers, who are well informed and well organised, realise that if the processors take costs out of the industry and thus sell at a lower price, then that would be a significant factor in underpinning both the product and price which they have on offer. Moreover, all the players within this sector will benefit from rationalisation, which benefits must be assessed not only at the beginning of the process but also over the long term. See paras. 44 and 50 of the Guidelines (2004/C 101/108). In addition the consumer will not be worse off: see para. 79 *supra* and section 3.4 of these Guidelines.

83. On the issue of market failure, which is relevant to the indispensability requirement, the true test is not whether normal attrition will ever achieve a rationalisation of the industry; if that was correct then the Commission could never have given its decisions in the *Dutch Bricks* case and in the *Synthetic Fibres* case. Rather it is whether a normal market can correct this excess in a timely manner. There is no evidence whatsoever that it can do so. This is again borne out by the absence of the substantial investment which is required in the industry. The fact that operating profits can cover marginal costs is no substitute for a proper economic return on such investment. Moreover, according to the evidence of Mr. Breen, plants with a throughput of between 50,000 and 60,000 animals per year can be acquired for between €3.5 and €4.5 million and it is only because of this reduced level of entry, that plants have been bought and sold throughout the years. If, as one would normally expect, such plants were valued on a replacement cost basis then this turnover in ownership would not have occurred. On a more general note, it is said that the entire arrangements are reasonably necessary to achieve the efficiency gains which have been targeted.
Finally as Condition No. 4 of Article 81(3) is not being relied upon by the plaintiff no submissions are required in that regard.

DECISION

Engagement with the Authority

84. At the outset of this section of the Judgment, it is convenient to deal with one point which, whilst not having a direct bearing on the case, was nevertheless raised during the course of the hearing. It is the Society's attempts to engage with the Competition Authority.

85. From its very inception the founding members of BIDS recognised that the initiative then proposed could have competition consequences which would have to be addressed with the Competition Authority and indeed perhaps with the EU Commission. This is clear from the minutes of a meeting which some members had with the Secretary General of the Department of Agriculture and Food on Thursday the 2nd May 2002, the day upon which the Society was established. Again, from the outset, it was stated in the "Proposed Operating Rules" of the Society, that competition legislation would have to be complied with. To this end the Society pro-activately took the initiative of personally meeting with the Authority on the 13th May, 2002. So from the very beginning there was an openness and transparency within the Society about the disclosure of their rationalisation plan, recognising as it did, the necessity of obtaining, if possible, the approval of the Competition Authority in respect thereof. This position should be noted and acknowledged.

86. As matters evolved and following the Authority's decision to commence an investigation into the plan, the Society cooperated fully with the Authority and in the process made available all required documentation and furnished all requested information. Whilst obviously arguing its case, the Society nevertheless made several submissions to the Authority and had a number of meetings with its personnel. It acted therefore in a manner which was totally the antithesis of how cartels usually operate, as shown and demonstrated by case law. There were no secret meetings, no coded messages, no failure to record and keep minutes, and no obfuscation in request compliance. Consequently, in its approach to processing the rationalisation plan and in terms of its engagement with the Competition Authority, one could not under any circumstances levy criticism against the Society, nor it should be said did the plaintiff seek to do so.

87. In May 2002 with the establishment of a vehicle for promoting the underlying project, it was felt by some members of the Society that competition compliance could be achieved by requesting the Authority to give clearing to its proposals. On making such a request however, the Authority, realising the imminence of a new legislative regime, declined to engage in this way. Thereafter, the Authority's position was that economic operators who interacted with competition law, had to self assess the agreement or decision in question and that no advice in that regard would be forthcoming from it. Whilst the Authority in my view was correct in this approach, and whilst there was good reason for the legislative change, I wonder nevertheless, if this action would ever have proceeded if a more fulfilling engagement was feasible. Particularly given the subject matter involved and the conduct of the first named Defendant. One will never know whether adjustments either requested or offered could have avoided this litigation.

Market Characteristics

88. The total number of animals slaughtered in this country amount to approximately 1.6 million – 1. 7 million annually which figure has held steady for a number of years. This kill is overwhelmingly carried out by abattoirs with export approved licences. For example, the original fifteen members of BIDS accounted for 93% of the commercial kill. The rest is essentially taken up by non-BIDS members with export licences, and by about 280 local abattoirs whose slaughter figures range from 100 to 1000 per annum (see para. 2.15 of Merger Decision). These smaller slaughter houses supply the domestic market only with an export licence being required for any level of kill in excess of 1000 cattle per annum. 90% of the resulting beef is exported, mostly to the EU and within that, predominately to the United Kingdom. There is some export to third countries, including Russia and Egypt. Domestic consumption of beef represents just 12.5% of total beef production. About 25% of domestic consumption is satisfied by imports. There is also trade in live cattle with approximately 117,000 being exported to the EU in 2004. This figure has significantly increased for 2005. Whilst the available information is dated, that which had been obtained as part of the Mc Kinsey study shows, that the capacity and throughout of export approved plants vary considerably. Utilisation can range between 18% and 91% (1997) and 8% and 81% (2000). As do revenue and profit, though such figures, without placing a relative value on them, must be looked at with caution. Some factories bone as well as slaughter. Some do beef and lamb, others beef only. Other variables are also evident.

89. Following the Merger Decision in which the Competition Authority authorised the acquisition by Dawn Meats Limited, of Galtee Meats (Charleville) Limited from Dairygold Co-Operative Society Limited, (20/11/2003) the share of the national kill held by the major Irish beef processors was as follows:-

Beef Processors Share of the National Kill

Dawn 20%
AIBP 18%
Kepak 15%
Kildare Chilling 6%
Liffey Meats 5%
Exel Meats 5%
Fair Oaks 4%
Slaney Meats 3%
Ashbourne Meats 3%
DMP 3%
Bergin Meats 3%

90. As part of market characteristics see also para. 96 of this judgment dealing with capacity/overcapacity.

91. On the retail side there is a strong national preference for Irish beef. About 50% of domestic use goes to retail with the balance to the food services sector. Of the percentage sold to the end consumer, the multiples account for between 60/70% with the balance being distributed through the 600 or so local butchers and also through some grocery shops. There are four major retailers in this country, namely Superquinn, the Supervalu/Centra chain, Tesco and Dunnes Stores. Two of the four have appointed a single beef processor as their sole source of supply. Tesco Ireland uses four processors and Dunnes Stores source up to 95% of its beef from an intermediary subsidiary called Tender Meats Limited. See the above Merger Determination M/03/092. The general practice of such companies is to enter into long term contracts with their suppliers but with regular negotiations on prices. Prices generally are not transparent and information is difficult to obtain.

92. On the producing side there could be anything up to 100,000 farmers in this country. Virtually all of the cattle which are slaughtered go directly to the factory and are not acquired in marts. This is because the processor does not pay the farmer on a live weight basis. Cattle are bought "spot", though there may be some long term contracts between certain producers and processors. A 3% differential in price would not induce a farmer to move from a regular plant, but a 5% might. See para. 2.12 of the Merger Decision.

The Relevant Markets:

93. There is no dispute in this case about the relevant product market either upstream or downstream. The former comprise the procurement of cattle for slaughter and de-boning and the latter is for the sale of processed beef. Equally so there is no argument on the relevant geographical market upstream. It is "at least national" which I am taking as meaning national.

There is however, a difference between the parties on what constitutes the downstream market. This, rather surprisingly, emerged only on day six of the hearing, because up to then it was assumed by the Competition Authority and also by the Court, that the first named Defendant was in agreement with the position of the former, which had argued for a national market. Or at least it so appeared from both the Society's written submissions (previously exchanged between the parties) and from the written report dated the 10th day of May, 2005 of Mr. McDowell and Dr. O'Toole. (see pages 24 – 25 thereof). In any event on day six Mr. McDowell sought to enlarge upon the scope of this market.

94. From the outset of his evidence both written and oral, Mr. Derek Ridyard, on behalf of the Competition Authority, had argued that the downstream market for the sale of processed beef comprised a series of national markets. He supported this view by referring to evidence "on the differing price levels for the sale of processed beef as between Ireland and other EU countries"… This in his opinion indicated the existence of such separate national markets. He went on to support this, by analogy with the upstream market, when he said that the evidence "strongly suggests the market in which cattle farmers sell live animals to slaughterhouses, is also a national market, since levels of trade in live animals into and out of Ireland is small, and the option for Irish cattle farmers to sell live animals abroad is limited by transport costs and other impediments". (See page 7 of his May 2005 report as confirmed by his oral testimony). It was never suggested to him that instead of this market being comprised of a series of national markets, it was in fact, and ought to be considered as, a "Pan European Market".

95. In addition to this curious omission, and noting the written submissions made on behalf of the Society and its economist's précis of evidence, I do not accept the contention made by Mr. McDowell as in my view it was advanced without any sustainable support from any reliable source. Firstly, Table 2 of Mr. Ridyard's report, which is headed "Relative market prices for Beef – (Ireland = 100)" shows that in fact there is a wide variation in price throughout Europe. Even if I am to assume that the special position of Italy can be explained by its heavy reliance on veal, the data shows a price variation of up 38% between other countries. Therefore, this in itself is indicative evidence of separate national markets. Secondly, there is undoubtedly a domestic preference in each country for home produced produce. Thirdly, Mr. McDowell did not appear to have any basis for suggesting, when attempting to explain this price difference, that the available figures for individual EU countries, may include both domestic and imported beef. Fourthly, the fact that such beef can be traded quite easily within the EU is not counter-indicative of national markets. Given these circumstances and the fact that Mr. McDowell himself could see a difference between the UK market and the other EU markets, I am of the view that on the credible evidence adduced, including that from the non-economic witnesses as well as the reports referred to at para. 28 above (see, for example para.3.2 of the December '98 report) the export market for Irish beef comprises a series of individual EU markets. Finally this conclusion is not I believe either disturbed by or inconsistent with the undoubted fact that 90% of Irish beef is exported.

Over Capacity

96. The de-seasonalisation premium (D.S.P.), which I have referred to above, certainly so far as Ireland is concerned, achieved its objective. In 1998, this country received about £26.4 million under the scheme, that figure had dropped to £14 million in 1999, by 2000 it was down to £165,000 and thereafter it ceased. Effectively, therefore the premium for all practicable purposes had no impact on farmer activity after 1999. The results which had been achieved by the time of the McKinsey report, have with very little variation, been retained to the present day. It will be recalled that in 1997 the average throughput was 32,000 animals per week with the peak being only 44,000 per week. This was in stark contrast to previous ratios which were as high as 1:5. Despite the absence of any comprehensive updating of the McKinsey material, there are figures available from IBEC which show what the slaughtering pattern has been, at export approved premises, for the years 2003 up to November 2005. In 2003 the lowest weekly throughput was about 26,000 with the highest, peaking at 44,000. In 2004 the comparable figures were 22,583 and 43,943. Up to November

2005 throughput had not exceeded 40,000 and much of it ranged in the 20,000 bracket. It therefore seems to me on this evidence alone, that the relationship between average and peak throughput, is likely to remain at or about the level which these figures represent. If however there should be a reduction in the availability of raw material, then of course the national kill figures will drop and as a matter of probability the relationship between average and maximum will be even closer. The Competition Authority is largely sceptical of this happening, particularly in view of a similar prediction by McKinsey not materialising. However, a most likely explanation for this was the major shocks which the industry suffered at the turn of the century namely the BSE and the Foot and Mouth crisis. Live exports as a result virtually ceased but the trend has steadily been reversed and the figures for 2005 should show a 50% increase over 2004. Therefore, whatever about the issue of capacity shortage, it seems to me that as a matter of probability both the average and maximum throughput will not increase above current levels for the foreseeable future and may in fact decrease. On this basis, in respect of which see also paras. 8 – 12, above and 105 and 106 below, and consistent with all of the major studies referred to above, I am satisfied beyond question that there is overcapacity in the industry and that it is not a short term or cyclical feature of the business but rather is structural and therefore long term in nature.

Article 81(1) – Restriction by Object:

97. As appears from the legislative provisions, the Guidelines and the case law, (some of which is outlined above), this Court should under Article 81(1) of the Treaty firstly consider whether the three aspects of the BIDS arrangements, as identified by the Competition Authority, constitute an appreciable restriction on competition by way of object. In the Guidelines, on the applicability of Article 81 of the Treaty to horizontal cooperation agreements, three examples are given, at para. 25, of what would normally be considered as infringements *per se* of Article 81(1). These are agreements which result in price fixing, in output limitation, or in the sharing of markets or customers. Much the same examples were given by the court in the *European Night Services* case. *Whish*, on Competition Law, 4th ed. (at pg. 96) adds to this list, by including agreements under which price information is exchanged and those which are used for collective exclusive dealing. As a comment the author describes these type of agreements or decisions as being of a "pernicious" nature. Such agreements are so described because they are considered particularly harmful to and directly interfere with the competitive process. The first question therefore is whether any or all of the three features of the bids arrangements, which call for a reduction in capacity, the imposition of the levy and the restrictive covenants in the exit agreement, fall foul of the object restriction.

98. As appears from its rules, and as minuted in many of its meetings held throughout 2002, the fundamental purpose for establishing the society was to implement the conclusions and recommendations of both the McKinsey report and the report of the Beef Task Force. Having carefully considered its proposals to achieve this end, I cannot see any provision or clause which could be said to fix prices or share customers. Nor do I believe that the arrangements can in any way be described as plainly or evidently limiting output, sharing markets or prohibiting investment. In addition, there is no injunction on those who might remain in the industry to reduce output or indeed even to freeze it at a certain level. There is no question of production quotas. Such players and each one of them, would be entirely free to increase production within their plants if they so wished. Unless therefore, a reduction *per se* in capacity must necessarily be equated with a limitation on output, which in my view is unlikely, (see p. 99 of *Whish* on Competition Law 4th Ed.) then I cannot see how the arrangement is objectionable in this regard; which is of course the major suggested violation by object restriction. Equally so, there is no question of the agreement resulting in market sharing, as if the excess capacity is removed, the destination of the resulting cattle will be subject to ordinary market forces. Even though the society may believe that the vast proportion of this will be subsumed by its members, nevertheless there is nothing preventing domestic abattoirs or export approved plants who are not members of BIDS, or indeed new entrants, from competing for this raw material. In consequence, I do not believe that these arrangements restrict competition by object. See *Bellamy & Child* at para. 2.098.
In this regard I do not think that the decisions of the Commission in the *Synthetic Fibres* case, and in the *Dutch Bricks* case, or the court's judgment in the *Dutch Beef* case require a contrary conclusion. In the former the Commission seems to have grouped object and effect together without giving any analysis of their disjunctive existence and in any event the objectionable provisions in all such cases, including the scope and duration of the restrictive covenants, the prohibition on capacity increases, and the penalties for non-compliance, are substantially different from those complained of in the present proceedings. I therefore do not believe that one can say, on the balance of probability that the arrangements under discussion, are so objectionable as to restrict competition by object.

Restriction by Effect

99. In conducting this analysis I propose to apply the relevant principles of law as are set out at para. 52 of this judgment, as well as the cases last mentioned, and to do so in the context of the relevant markets as above determined, and of the conditions of competition pertaining therein.

100. As previously stated, Mr. Derek Ridyard, economist, gave evidence on behalf of the Authority and Messrs. Moore McDowell and Derek Scully gave the economic evidence on behalf of the Society. In addition Mr. McAndrews, Mr. Breen and Mr. Malone also gave evidence on behalf of BIDS.

It was asserted by Mr. Ridyard in evidence that the capacity restrictions as envisaged, the imposition of the levy, and the restrictions on re-entry, were either collectively or individually restrictive of competition by effect. Each of these has to be considered separately.

101. Under the rationalisation plan it is clear that the proposals involve the closure of plants which presently process a maximum of 420,000 cattle per year. This is approximately 25% of total throughput. According to Mr. Ridyard, when seasonal output is combined with the information available from the McKinsey report, capacity utilisation in a peak demand month may range between 62% and 75%. He felt that the deseasonalisation premium, introduced as part of the 1992 CAP reforms, had achieved its objective, but believed, in arriving at his conclusion, that it was still influential in 2005; accordingly, he expressed concern that the cyclical pattern of killing might re-emerge (with an even greater range) when the incentive had totally ceased. In his considered view, the suggested reduction in capacity would cause shortages at peak demand periods and consequently would result in price increases.

As appears from other parts of this judgment, this witness was incorrect in his belief about the continuing existence of the DSP. In fact it produced no revenue for the farmers of this country after the year 2000, (see para. 96). When, being informed of this for the first time during the course of his evidence, he maintained his position about shortages. Nevertheless, it was quite clear that his original view was influenced, perhaps a good deal, by his mistaken belief in this regard.

102. Mr. McDowell on behalf of the society did not substantially address this issue in his written report but during the course of his evidence, did suggest that 75% of existing capacity, (that is the level which would remain in the market after the proposed rationalisation), should be sufficient to serve peak demand and indeed even to cover any sudden increase in demand. He did not however support these allegations with any updated quantitative evidence.

103. As a general comment it would not I think be unfair to point out, that in this particular regard the evidence of both economists lacked solid foundation. Rather both sides relied a good deal on theoretical and qualitative arguments without being in a position to advance quantitative evidence in support of their respective positions. Perhaps this can be explained, and therefore understood, in that a great deal of the evidence given on this point, indeed on the entirety of the case, was based on data which largely ended in 1997. Be that as it may and despite the obvious limitations which that causes, it is nevertheless necessary to determine the issue as to whether the planned reduction in capacity would cause capacity shortage in the peak demand months.

104. A reduction in capacity, *per se* may not necessarily have the effect as suggested by Mr. Ridyard. For capacity to matter in the present context it must have a moderating effect in keeping prices low. It is because of this that a shortage in capacity may impact upon prices. This may occur even without a plant reaching full capacity, because a tightening alone may put pressure on the buy/sell spread.

105. In this regard the evidence of Mr. McAndrew, who has been in this business for approximately 30 years and that of Mr. Derek Breen who likewise has been involved on the State side for at least that period, was helpful. Mr. McAndrews' experience on the ground, tells him that the weekly capacity is somewhere between 60,000 and 65,000 animals and that the average utilisation is less than 60% approx. He feels that the existing throughput figures, both average and peak, are likely to decrease in the years ahead. He is of the opinion that even with a 25% reduction, the remaining capacity would be more than sufficient to cater for existing and future predictive needs. Working on the basis of 52 weeks per year, there should be no shortage in capacity and in any event some plants could operate to capacity for short periods with other underutilised facilities being also available. It is the industry as a whole that one must look at and not simply individual plants. Local abattoirs, non BIDS export plants and dormant facilities could also be used. The net effect therefore in his opinion is that all cattle produced for slaughter would in fact be slaughtered with no change occurring from a producer's point of view.

106. Mr. Derek Breen fully supported this view and points out that currently not even one factory operates on a full five day week for 52 weeks of the year. He said that typically a working week was somewhere between three and four days. In addition there is no shift work which was a common practice in several European countries. He also made a point, which I believe in principle has considerable validity to it, that in the coming years the national kill is likely to decrease by 300,000 or 400,000 animals. There are three reasons for this. The first is the removal of price supports by virtue of this country now operating full decoupling. Secondly, there is a widespread attempt at the world trade negotiations to achieve equalisation of farm prices and thirdly, the ever increasing live export of cattle from this country. On the latter point he indicated that in the year 2000 they were 500,000 animals exported. That trade collapsed virtually over night because of the B.S.E. and the Foot and Mouth disease. It was now in the recovery stage and at the end of 2005, he expected 170,000 cattle to be exported, an increase of almost 50% over the previous year. Overall therefore, his view was that even by removing the suggested figure there would be no capacity shortage.

107. In addition to these reasons which I accept, there are other grounds for believing that the suggested reduction would not lead to capacity shortages. Firstly, the Irish beef industry is open to foreign competition and indeed 25% of domestic consumption is imported. There is therefore no reason why such imports would not rise to the challenge, if prices so compelled. Secondly, given that 90% of Irish beef is exported, some of that, if necessary, could be redirected into the domestic market in order to meet any excess demand. To do so in my view would pose no difficulty for the processors who in fact would most likely welcome such a move. In addition, any redirection would have no negative impact on foreign markets given the relatively small market share which the Irish beef industry has on such markets.

Given the circumstances, I do not believe that Mr. Ridyard's evidence was sufficiently conclusive to demonstrate to a reasonable degree of probability that capacity shortage would occur in the event of the rationalisation plan proceeding. I note a number of concessions which he made during cross-examination, including his mistaken belief about the D.S.P. as well as agreeing that he could not say at what figure, below full utilisation, there would be capacity restrictions. In my view he did not prove the likelihood of such shortages and did not satisfy the court that market prices would be appreciably affected.

108. The second aspect of the proposal which is claimed to be restrictive of competition, is the funding arrangement. That is the obligation on each stayer to pay a levy of €2 per head for volumes up to their "traditional kill" threshold, as determined in percentage terms, and a levy of €11 per head on incremental slaughter volumes about this level.

According to the evidence of Mr. Ridyard, this levy will cause an increase in the incremental cost of the stayers of €11 at the margin, that is, at the new level of production. This witness however was not in a position to offer any evidence, even by way of estimate, of the likely price impact of the levy nor did he suggest what in his opinion would be the likely output reduction caused as a result. He did claim, and in this regard I accept his evidence, that in economic theory any increase in marginal costs is likely to impact negatively on prices and on output. This is because competitors may pass on the increase in the cost base to their customers by incorporating in the price charged, that increase.

109. In his evidence Mr. McDowell points to a number of reasons why in his opinion it is most unlikely that this levy could have an adverse impact on prices. He adverted to the following:-

(a). That beef processors will not know until the years end, or at least will be uncertain until then, as to what point in time they will have reached their traditional kill level. Consequently until then there will be that uncertainty as to whether (and at what point) the increase in their marginal costs will go from €2 to €11;

(b). That the increase in marginal costs due to the levy, whatever that might be, will be offset by the reduction in marginal costs caused by the increase in capacity utilisation, which is an essential economic driver of the BIDS arrangements;

(c). That any serious attempt by the processors to raise prices in the downstream domestic market would lead to an increase of imports into this country. Moreover any such attempted increase would most likely mean that some of the product now exported would be reallocated for home consumption;

(d). That beef processors face significant buyer power in both the domestic and foreign markets. These powerful buyers for example multiples, would be a prohibiting or at least a significantly restraining or moderating force in any attempt to raise prices after the implementation of the plan;

(e). That those processors who export to foreign markets would be unable to raise prices because in such markets they face an infinitely elastic supply curve, that is, they are price takers. If they should attempt to force the issue their sales will drop with alternative sources from other exporting countries taking their place;

(f). That the levy is temporary. This is of significance because of the cyclical duration of output. Typically the period from insemination to commercialisation involves a period of between three and four years with the result that production cannot be adjusted from one year to the other; and

(g). That output in any event will not decease because slaughterhouses have an incentive to maintain high utilisation so as to achieve economies of scale and thus to minimise their production costs.

110. There is little doubt but that the levy will have an impact on the marginal costs of the stayers and that such impact, at least to a some extent, may equal €11. That however in itself does not guarantee that the levy will lead to a price increase for beef either in the domestic or foreign markets. In my view there are many reasons why such an increase in marginal costs may not lead to a significant price increase in either of these market. These reasons are largely those as enumerated in the previous para, which I accept. In addition, Mr. Ridyard at page 22 of his report,

recognises at least by implication, that the relationship between an increase in marginal costs and an increase in market price, depends on the elasticity of demand. That witness however has provided no reliable evidence on this phenomenon. He has not considered what would be the impact on the demand faced by each and every one of the member of BIDS of an increase in price. If such an impact was large then the increase in marginal costs would not translate into an increase in prices. As the beef industry in this country is quite fragmented, a situation recognised in the Competition Authorities' Merger Decision and given that Irish beef is homogeneous, it is likely that the impact on demand would be large and accordingly it is also likely that any increase in prices resulting from the levy would be quite small.
111. With regard to the foreign markets I am quite satisfied from the evidence (in particular because of market share and a national preference for domestic produce) that Irish Beef Processors are "price takers" and that the evidence of Mr. McAndrew does not suggest the contrary. The core of what he said (see page 103/104 of Transcript, Day 4) was referable to making the processors more acceptable suppliers in those markets rather than affecting their ability to set prices. It therefore follows that being price takers, any attempt by them to affect these markets would most likely be defeated by competitors from other exporting countries.

112. In respect of the upstream market, I do not believe that the processes will be able to distort competition by passing off some of the increased costs to the producers. The former have no readily available alternative sources of supply. The farmers, in their own right are well organised and whilst many in numerical terms, they operate for the purpose of this case in a single product and geographical market. They could increase exports and are well acquainted with the consumers national preference, as indeed the processors are. Given the limited duration of the levy I do not believe that anything more than insignificant concessions can be obtained from the farmers.
In conclusion, whilst the levy may have an impact on prices and output, these most likely would be small. In any event, and of crucial importance, I do not believe that Mr. Ridyard has established that the levy will result in any significant price increase and/or output reduction. It therefore cannot be said that the arrangement is restrictive in this regard.

113. The third issue under Article 81(1) centre on the restrictions in the Exit Agreement. In particular the non-compete clause the requirement to decommission the plant and to refrain, for a period of five years, from the future use of the associated land for the purposes of beef processing.
According to the evidence of Mr. Ridyard the presence of these restrictions are likely to remove a "safety valve" that could prevent a price rise resulting from the implementation of the rationalisation scheme. In addition he said that the ban on re-entry could give rise to a coordinated effects concern. This in two ways. Firstly as a result of a number of competitors leaving the market, this will increase the concentration in the industry and make collusion, or at least tacit collusion, much easier. Secondly, it will also be easier for those who remain within the industry, to set their sights on higher prices, to be achieved by way of coordinated action, as they have no fear that those who leave, might re-enter the industry.

114. On the other hand Mr. McDowell argued that the restrictive covenants will have no anti-competitive effect as these are limited in time and as potential new entrants can otherwise enter the market in response to a price rise. Moreover he points to the increasing influence of beef imports from South America and indeed closer to home from Northern Ireland, Britain and other EU Countries as potential sources for beef imports.
This witness strongly disagreed with the suggestion of tacit collusion. He points out that the industry is highly fragmented and that the BIDS proposal does not create any structural link between its members. Hence it is most unlikely that coordination would take place. Moreover he refers to a frequent change in plant ownership, to the absence of market share symmetry and to the lack of price transparency, as all being strong indicators of the existence of a competitive environment. In addition, the scheme should have no impact on the strength of competition in the domestic market and certainly none in foreign markets, where, because of its limited market share and in light of national preference, Ireland was not a significant player on any of these markets.

115. There is no doubt but that the BIDS scheme will reduce the number of competitors in the domestic market but the true question which remains is whether or not that will have any clear adverse effect on domestic competition. The market, as previously indicated, is fragmented with changes of ownership occurring regularly if not frequently. Whilst I accept that the identity of, the expenditure necessary for and the time taken to develop a green field site, are, under current circumstances prohibitive, nonetheless there remains other avenues for potential competitors to enter this market. The most obvious and likely, is the acquisition of domestic plants and their development to export approved standards and capacity. This is what happened with Exel Meats Limited in 2000 and with Eurofarms Limited in 2003, which firm is now killing between 60 and 70 thousand animals per year. This manner of entry has been recognised by the Competition Authority, in its Merger Decision, (at para. 2.39) as having competitive restraints on existing players. Moreover, those who remain within the industry would have unrestricted commercial freedom after rationalisation. They can determine production levels, pricing, conditions of sale, imports and exports, deliveries, and all other commercial activities. Whilst for the period of the restriction it would not be possible to acquire the plant of a goer, nevertheless it would be possible thereafter and during the transient period competition in my view would remain

vibrant within the industry.
116. In this context one must also note that imports represent about 25% of domestic consumption which is indicative of the absence of barriers or prohibitive barriers to entry.
Finally, I don't believe that the economic evidence given by Mr. Ridyard bears out the suggestion that the "goers" would be the only credible entrants into the market. This has not been established as a matter of fact and neither has his allegation that the re-entry prohibition will facilitate co-ordination between the remaining players. Indeed, the evidence of fragmentation and imports are inconsistent with this suggestion.

I therefore cannot accept that his economic analysis of this issue is sufficient to discharge the onus of proof which is the Plaintiff Authority.

117. Accordingly, as the Competition Authority has failed to demonstrate by credible evidence, that the objectionable features of the arrangements are likely, as a matter of probability to have appreciable anti-competitive effects, this action must fail. In such circumstances it is not strictly necessary to proceed and consider the arguments advanced under Article 81(3). However as the parties have made submissions in this regard I propose to set out in brief terms, my views on the four requirements under that Article of the Treaty. In so doing it must be appreciated that there is a certain degree of artificiality about this exercise as I have previously found that the agreements and decisions in question do not have anti-competitive effects.

Article 81(3)
118. Unlike where the onus of proof lay under Article 81(1) of the Treaty, the obligation to satisfy the four cumulative conditions of Article 81(3) is on the first named defendant. On behalf of the society both Mr. McDowell and Mr. Derek Scully asserted that all four conditions have been satisfied whereas Mr. Ridyard on behalf of the Competition Authority took the opposite view.

The first of these conditions is that "The agreement must contribute to improving the production or distribution of goods or contribute to promoting technical or economic progress". In other words, it must be shown that the arrangements offer economic benefits or economic gains.

119. In his evidence Mr. Ridyard accepts that the proposals are likely to reduce the industry's variable processing costs by re-allocating existing processing volumes through a smaller number of processing plants. In other words, greater utilisation of existing capacity. He estimates the resulting savings as involving a reduction in unit costs of €1.41 which when applied to the yearly kill figures gives a total of €2.482 million per annum.
This witness arrived at this figure by the use of an econometric model where the slaughtering average variable cost of a slaughtering plant was a linear function of the annual kill of that plant. Even however with this modest figure of €2.482 million, Mr. Ridyard went on to suggest that this overstates the true efficiencies, because the BIDS scheme is likely to result in a reduction in overall output, which would limit the economies of scale enjoyed by the plants which remain in the market. He can find no evidence that the scheme would reduce the industry's total processing costs with the only savings being those achieved in the slaughtering area.

120. The evidence offered on behalf of the first named defendant suggested a variable number of figures in this regard. Firstly, it appeared that Mr. McDowell was initially basing his efficiency gains on the McKinsey report, where it was stated that IR£18 million, as of 1997 was available in respect of slaughtering, boning, and fifth quarter returns. Adjusting that for inflation and converting it to Euro, the 2004 figure was about €34 million. It should be noted that this data from McKinsey did not indicate what part or parts of the IR£18 figure related to avoidable costs. This omission makes the useful interpolation of this figure much more difficult.

During the course of his evidence Mr. McDowell then suggested that based on a saving of €7 per head, Mr. Scully would indicate that the total savings might be €11 million. Apart from this information he could not otherwise assist with the composition of this figure.

121. Mr. Scully, in his estimate of the cost functions for the Irish beef processing industry, used quite a different specification than that employed by Mr. Ridyard. It will be recalled that the latter had used a linear specification in his econometric model whereas Mr. Scully used a quadratic cost specification. This took into account the degree of excess capacity in the industry as well as other variables including local differences between individual plants and also the year effects. When using this model Mr. Scully confirmed the existence of economies of scale in the slaughtering process (to which McKinsey had attributed £7.5 million) but had not been able to do so, either in the follow on de-boning process or with fifth quarter realisations (to which McKinsey had in total attributed £10.5 million).

122. This regression model as used by Mr. Scully, suggested that the impact of a reduction in capacity on average total costs was much larger (at £18.2 million, see p. 17 of the report of 10/05/05 and Transcript, Day 8, p. 253) than that estimated by Mr. Ridyard. However, the results of these two studies are difficult to compare because, *inter alia*, the model used by Mr. Scully focuses more on the average total cost of slaughtering whereas the model used by Mr. Ridyard concentrates on the average variable costs of slaughtering. In addition the results of both are of course quite dependent on a number of assumptions, in particular in the case of Mr. Scully on what level of throughput, both before and after rationalisation, he inputted into his model.

In the course of the hearing Mr. Scully produced further reports which predicted a cost reduction (average variable costs) of €7.417 million per annum, and (average total cost) of €8.8 million; both achieved by increasing the average throughput figure to 50,286. When the latter was increased to 58,776 the saving in ATC per unit was calculated at €2.69, giving a total saving of $7.123 million.

123. It can immediately be stated that the econometric model used by Mr. Ridyard was by reason of its linear specification, incorrect. It failed to have regard to a number of variables which it was essential to have regard to. That this was so, was ultimately acknowledged by him in evidence. The explanation given by Mr. Ridyard was that the obligation was on the Society to conduct this exercise in order to prove the existence of efficiency gains. Whatever about the wisdom of that approach, he was also not quite right in believing that condition No. 1 of Article 81(3) could not be satisfied unless the aggregate gains exceeded the levy of €11 per head. In this regard he had not taken into account several matters put to him in cross examination which would affect this conclusion. However since his evidence on efficiency gains cannot be really accepted because of the incorrect basis of his approach, it is not necessary to further detail these matters.

124. At the outset it must be said that quite surprisingly the Society had not arrived at its ultimate figure for economic gains before the economists reports were exchanged; indeed this had not been done before the commencement of the action. Instead, such a figure was arrived at only at the very end of the case. This evidently is quite an unsatisfactory way for any party to approach its obligations under condition No. 1 of Article 81(3).

125. Despite this and quite independently of it, I accept many of the criticisms levelled against this segment of the Society’s evidence. In particular there was no justification for taking as a starting point, to reflect a representative plant after rationalisation, a throughput level of 35,000 animals per annum. This greatly over estimated the gains in the model used by Mr. Scully. I accept that a figure closer to 59,000 would be much more reflective. Eventually Mr. Scully recalculated his figures using a starting throughput in this range. His resulting estimate of over €7 million (being €2.69 x 2.64 million animals) was also over stated as he used an incorrect figure for the annual national kill. Taking the latter, at approximately 1.7 million the ultimate evidence might suggest a saving, in average total costs, of about €4.5 million per annum.

126. The question which I have to decide in this context is whether the arrangement is likely to produce economic benefits or economic gains. Despite the unsatisfactory nature of the economic and econometric evidence and notwithstanding the clear imperfections in it, some of which I have above mentioned, I believe nevertheless that the preponderance of evidence (including McKinsey) is in favour of the arrangements resulting in cost efficiencies. That conclusion is in my view justified by the tenor of the overall evidence including even that of Mr. Ridyard whose model most likely would have under estimated the savings. On the balance of probability I am therefore inclined to the view there will be cost savings.

127. What is much more problematic however is the magnitude or quantum of these gains. On the part of the Society, the figures range from €4.5 million up to €34 million at 2004 prices. No serious attempt has been made by either Mr. McDowell or by Mr. Scully to reconcile these figures. However and notwithstanding this, I believe as I have said, that technically the Society has satisfied the first condition of Article 81(3) as in my view some significant, though not scientifically quantified, economic gains have been shown to exist.

128. <u>Consumer Welfare</u>
The second requirement of Article 81(3) is that the consumer must receive a “fair share” of these benefits. Mr. Ridyard concludes that the marginal cost savings are likely to be less than the prices increases caused by the reduction in capacity and the imposition of the levy; accordingly this condition in his view cannot be satisfied.

129. The opposite conclusion is arrived at by Mr. McDowell who states that the processors will be forced to pass on some of these gains to foreign customers, as they are price takers in those markets and also to domestic consumers given both the domestic and foreign competition operating within Ireland as well as the significant power of the multiples in that market. In addition he says the levy is temporary. In its submissions to the court the Society does not argue for a direct cost saving for foreign purchasers whereas it does in respect of the domestic market. With regard to all markets, a gain in competitiveness is also highlighted.

130. In considering this issue there are a number of reasons which might point to an affirmative answer to this question. Economic theory suggests that a reduction in variable costs is more likely to result in a reduction of prices than a reduction in fixed costs. Whilst McKinsey's treatment of its estimated savings is deficient, in that it does not clearly state which share of these cost reductions correspond to a reduction in variable costs, the evidence of the economists however tend to suggest that there will be a reduction in the variable costs of slaughtering. Secondly, both the domestic and foreign markets are fragmented, with the processors facing competitive pressures both at home and in the foreign markets, with a capability if necessary, of both the multiples and end users of switching suppliers if prices so demand.

131. On the other hand for this Court to accept that the second condition of Article 81(3), is satisfied there must be acceptable evidence that the consumer will receive "a fair share" of the resulting benefits; this to compensate for the negative effect on competition (see the *caveat* at para. 117 above and para. 85 of Guidelines 2004/C 101/08). In my view, before one could arrive at such a conclusion it would be necessary to know with precision the size of the efficiency gains generated by this scheme as otherwise it is impossible to know, or even to conduct an evaluation or review as to whether what is proposed to be passed on, is or is not "fair" to consumers. That when measured against anti-competitive effects. I therefore do not believe that the evidence given on behalf of the Society under this heading, when looked at in the context of the evidence furnished with regard to efficiency gains, is sufficient to discharge the onus of proof which is upon it in this regard.

132. Indispensability
The third requirement of Article 81(3) is that the restrictions complained of must be "indispensable" to the attainment of pursued objectives. It is the Authority's position, in claiming that this requirement has not been satisfied, that the natural process of competition between plants should be able to eliminate any excess capacity in the industry. The fact that normal market forces have not, as yet, produced the required degree of rationalisation does not contradict this position; as so asserted by Mr. Ridyard. He says that firms, whilst not been able to cover their entire fixed costs, will nevertheless stay in the market if they can cover the avoidable component of such costs. In addition he asserts that competition in the market may somehow be distorted by operators with market power and he also claims that many less efficient plants have decided, in the short term, to remain in the industry and to exit, with compensation, in the event of this scheme obtaining court approval.

133. On behalf of the first named defendant, it is asserted as a fact, that to date market forces have not been able to achieve the desired rationalisation and that the appropriate level of capacity reduction will not take place in a timely manner. This is because some processing plants, even though productively inefficient, are able to recover their short run avoidable costs, and secondly, because no individual processor has an incentive to act unilaterally and acquire, and thereafter dismantle, the plants of his competitors. Why should such a processor bear the cost of achieving capacity reduction within the industry and yet have to share the benefit with others who have not contributed to that rationalisation? In addition it is claimed there is no rational basis for suggesting that processors will incur short term profit losses in order to bid up the price of cattle so as to exclude inefficient processors. Moreover it is said that the restrictive covenants will not harm competition because they reflect nothing more than what is normal commercial practice and in any event these provisions have a limited duration of two and five years.

134. In my opinion this third objective of Article 81(3) is satisfied and in that regard I accept the above evidence of Mr. McDowell. It is an undoubted fact that the market itself has not been able within a reasonable time, to achieve capacity reduction up to now, even though all industry participants feel the necessity for it. This is most likely to result from operators being satisfied to continue in business, covering part only of their cost, rather than closing down and permanently having to suffer the loss of their sunk costs. Once revenue exceeds short term avoidable costs then most players, in the absence of a greater return through some alternative use or shut down, seems to be satisfied to remain in the industry. This is not to say that the industry as a whole is getting any real economic return on its business. True, many are making an accounting profit, indeed without reference to a return from a comparable investment, some figures seem high. This however is not a true reflection of what is needed. A return of 3% or more is what is required in order to deliver real investment in new plant, products and people. (See Mr. Breens evidence at Transcript, Day 5, p. 114 – 116). There has been no Greenfield investment since the mid 1980s. Largely therefore the industry in my view, though with some exceptions, is in survival mode. In addition I accept the proposition that no individual processor will take it upon itself to either bid up the price of cattle (and thus increase its raw material costs) in the hope of eliminating the more inefficient plants, or to expend the capital required to purchase plants and close them down. There is undoubtedly a "free rider" problem in this regard. Why should individuals suffer even a short term profit drop so as to confer benefit on others? This is not likely to occur. I therefore think that there is a market failure and that ownership changes occur only because of the relatively cheap cost of entry. This requirement of Article 81(3) is in my view satisfied.

135. Elimination of Competition
The final requirement of Article 81(3) is that the arrangement must not afford the undertakings involved the possibility of eliminating competition in respect of a substantial part of the products in question. Mr. Ridyard, on behalf of the Competition Authority (which ultimately did not press this particular issue) believed that a reduction of 25% of total

throughput represents a substantial part of the market. He considers, as is evident from above, that this reduction will lead to capacity restrictions and hence to an increase in price.

136. On the other hand, Mr. McDowell disagrees with this conclusion. In his opinion the industry will retain sufficient capacity to deal with peaks in demand time. Moreover, he highlights the fact that in a post rationalisation scheme the market will remain highly fragmented which should eliminate any concerns regarding tacit collusion. Finally, the competitive constraint exercised by imports should keep prices in check.

137. As appears from the section of this judgment dealing with the alleged infringement of Article 81(1) by reason of capacity reduction and thus capacity shortage, I have come to the conclusion that no such shortage will result from this proposal. Consequently I am satisfied that if the plan is implemented there will be a sufficient level of competition remaining within the industry.

138. I will therefore refuse the relief sought.