

# 12 Distribution: suppliers' policies and practices

## Contents

	<i>Page</i>
Background .....	153
Channels of distribution .....	154
Suppliers' distribution policies .....	154
Suppliers' selection criteria .....	155
Geographic coverage .....	155
Sony .....	158
Aiwa .....	159
Panasonic .....	160
JVC .....	161
Sanyo .....	162
Toshiba .....	163
Canon .....	163
Hitachi .....	164
Kenwood .....	165
Philips .....	165
Pioneer .....	166
Mitsubishi .....	166
Samsung .....	167
Sharp .....	167
Thomson .....	168
Alba .....	168
LG .....	168
Denon .....	168
Other suppliers .....	168
CIH .....	170
Extent of suppliers' conditions for supply to small retailers .....	170
Withholding of supply .....	171
Wholesalers .....	172
CIH .....	173
Warehouse clubs .....	173
Multiple retailers .....	177
Small retailers .....	178
Retailers' pressure on suppliers .....	178
The legal position on selective distribution .....	179
EC aspects .....	179

## Background

12.1. This chapter describes the distribution policies and practices of the suppliers of reference brown goods and, in particular, sets out our findings on the matter specified within our terms of reference regarding withholding supplies from dealers. The chapter chiefly covers withholding supply from would-be dealers seeking initial supplies. Difficulties experienced by dealers who had been receiving supplies (ie difficulties

relevant to our inquiries) are dealt with in Chapter 10 save for one case, in respect of three of the reference goods, which we thought more appropriately recorded here (see Appendix 12.2).<sup>1</sup> Unless otherwise stated, the text in this chapter refers to all four reference brown goods.

12.2. In his press release announcing the references, the DGFT specifically mentioned information indicating that manufacturers had refused to supply 'retailers who sold the goods below the manufacturers' recommended retail price (MRRP) and outlets such as discount warehouse clubs'.

## **Channels of distribution**

12.3. Most of the reference brown goods are sold directly by suppliers to retailers. Wholesalers do not play a major part in the supply of reference brown goods other than in Northern Ireland where they appear to be the chief or only source of supply of certain brands. In Great Britain retailers largely buy reference goods from wholesalers only when volume requirements are low or when they are obtaining brands not normally stocked. We were informed, however, that photographic retailers commonly obtain reference goods from wholesalers, or other specialist retailers acting as wholesalers. Two hundred and seventy-two respondents (58 per cent of those who sold reference brown goods) to our survey of small retailers said that they bought some reference goods from wholesalers (Table 11, Appendix 9.1).<sup>2</sup> Most suppliers told us that they supplied CIH, either as a buying agent or as a wholesaler (in CIH's terminology, its central stock operation). CIH supplies only retailers which are members of one of its local groups. In 1995 five of its local groups also purchased reference goods direct on behalf of their members.

12.4. Some suppliers told us that they had no objection to wholesalers reselling on their brands to other dealers, whether or not those dealers had been authorized to sell the goods of the supplier concerned. Others prohibited resale other than to their authorized dealers. But we were also informed that some dealers obtain supplies through the grey market, usually through a diverter (see also paragraph 9.138). This service may be provided by a wholesaler, a retailer acting in a wholesaling capacity, or an agent working on his own account with suppliers to move goods that suppliers are unable to sell through the normal channels (most commonly because of over-capacity). We were told by a dealer's buyer that suppliers with surplus reference goods may sell them to 'stock traders', ie businesses that are not concerned with the normal supplier/dealer relationships. The stock trader may then resell the goods to dealers at prices cheaper than a dealer could himself obtain from the supplier. We were also told that some authorized dealers ordered reference goods ostensibly for their own use, and then sold them on to other dealers without the approval of the supplier concerned.

## **Suppliers' distribution policies**

12.5. To a varying extent most of the suppliers of reference brown goods seek to impose some controls or restraints on the supply of their brands, although not all suppliers accept that they operate formal selective distribution systems. We have used the term 'selective distribution' to mean a distribution system adopted by a supplier under which it selects dealers to be supplied with one or more of the reference brown goods by taking into account such criteria as it deems appropriate, but for our purposes we have disregarded creditworthiness and minimum turnover. This differs from the European Commission's concept of a system of selective distribution which involves essentially two elements. First, the goods are not supplied to every dealer, retailer or wholesaler who is willing to sell the products in question. Only those who meet certain criteria are appointed as authorized retailers or wholesalers. Secondly, authorized dealers may sell only to other authorized dealers (whether at the same level or at the retail level), and in the case of retailers, to users.

12.6. Not all suppliers of reference brown goods issue formal dealer agreements. But most publish standard terms and conditions.

---

<sup>1</sup>Cases A2, B4 and C4.

<sup>2</sup>Respondents did not specify which reference goods they bought from wholesalers. Some respondents who sold brown and white goods may have included one or more of the white goods which are the subject of our concurrent inquiries.

## Suppliers' selection criteria

12.7. Following the responses we received to our postal questionnaires, we prepared a list of selection criteria which one or more of the suppliers appeared to use in whole or part and sent it to suppliers of each of the reference brown goods with 2 per cent or more of the UK market by value in 1995; a definition of the criteria we listed is at Appendix 12.1. We asked suppliers to state which, if any, of the criteria they adopted. We analysed their responses to identify the extent to which each criterion was used and enclosed our analysis with the 'issues letters' (see Appendix 6.1, Annex A). In some cases the responses conflicted with suppliers' earlier evidence. Where this happened we informed those concerned and gave them the opportunity to comment.

## Geographic coverage

12.8. One such conflict arose over the criterion we had identified as 'area already supplied' (see Appendix 12.1, paragraph 4). Only about one-third of suppliers of televisions, and rather smaller proportions of suppliers of VCRs, hi-fi systems and camcorders, listed this criterion, including Mitsubishi which said (in relation to televisions and VCRs) that the adoption of this quantitative criterion was integral to its 'open' distribution system (see paragraph 12.67). But evidence we received from our survey of small retailers suggested that it was not uncommon for suppliers which had not identified this criterion as one they adopted to be named among those who allegedly refused supply on these grounds (see paragraph 12.154). When we asked certain suppliers about the practice we were told that their sales representatives might choose to tell retailers that the area had sufficient coverage to mask other reasons for not supplying, for example the premises not meeting the required standard. Some suppliers added that they would grant any new dealerships only if they expected to gain extra business as a result.

12.9. We asked Panasonic, which had not listed this criterion as one it adopted (see paragraph 12.31), why it believed several respondents to our survey of small retailers had told us that they had been refused supply of Panasonic reference goods on the grounds that the locality was already supplied. Panasonic said that the responses to the relevant question in the survey should be interpreted with caution; in the multiple choice options given to them, respondents might have used this option as a 'catch-all' rather than having to explain another reason. Panasonic noted that very few respondents had admitted that creditworthiness had been the reason for being refused supply. This was contrary to Panasonic's experience. Panasonic said that it would supply new dealers in any area if the effect were to increase Panasonic's volume of sales. There were cases, however, particularly in areas of low consumer density, where the appointment of a new dealer would reduce the sales of existing dealers to a level where their commitment to marketing Panasonic products would be significantly damaged. As a consequence the sales of Panasonic products in the locality would fall.

12.10. We asked Kenwood (in respect of its supply of hi-fi systems) whether the proximity of other authorized Kenwood dealers was a consideration in deciding whether to appoint new dealers in an area. It had not listed this criterion in its response to us (see paragraph 12.60) but we had received several observations from retailers that Kenwood had refused to supply them on these grounds. Kenwood told us that these observations indicated to it that its sales staff might have acted in a way inconsistent with its policy on appointing authorized dealers. It had since implemented a compliance training programme to ensure that its staff were aware of its policy. It was probable, however, that in some instances its sales staff had told applicants that no additional outlets were needed in an area to cover the fact that the dealers were not considered suitable for some other reason, for example poor premises. Kenwood said that this approach caused less friction. Kenwood told us that it consulted its existing dealers in an area when considering a new applicant as a matter of courtesy. It added that the dealer would often raise objections but Kenwood did not enter into further discussion on the point; it would never refuse to admit a prospective account based on objections from existing dealers.

12.11. Sony told us that until the introduction of its PEDAs (see paragraph 12.20) its retailers were also selected on the basis of geographic locations. A standard refusal to supply would have been, 'Unfortunately I have to advise you that we already have adequate dealer coverage in your area and are therefore unable to offer you our Dealership Agreement at this time'. We received some observations from small retailers who alleged that they had been refused supply by Sony on the grounds of their location. As a result of these

observations Sony told us that it had offered to carry out a review of the premises of all these dealers; those who had responded, and who met the PEDDA selection criteria, had been offered an account.

12.12. Pioneer (which supplies hi-fi systems and televisions) told us that too great a geographical concentration of dealers would suppress sales to unacceptable levels and render Pioneer's support to those dealers uneconomic. Within limits, therefore, the over-representation of dealers in a geographical area was a criterion that it took into account to ensure that its distribution system and, in particular its support, was to remain viable. It added that it favoured an extensive dealer base which it had no interest in constraining provided that expansion led to increased sales and covered the cost of support.

12.13. Denon (in relation to hi-fi systems) and Hitachi said that they took into account a dealer's proximity to their existing dealers and the likely effect on their businesses.

12.14. Observations from retailers who told us that they had been refused supply on geographic grounds and suppliers' responses are at Appendix 12.2.

12.15. In the issues letters we identified a wide range of practices relating to withholding of supply. These were:

- (a) the number, type or location of suppliers' existing dealerships;
- (b) the nature of the business (for example, that the dealer's premises are open to all members of the public, that it was a recognized retailer of the reference good(s), or the appearance of the premises);
- (c) the conduct of the business, including the level and type of pre- or post-sales service to be provided by the dealer (for example, with regard to staff calibre and training, stockholding, display, demonstration, delivery, installation or repair facilities);
- (d) the acceptance by the dealer of restrictions on how the supplier's goods are to be advertised or promoted (for example, by the supplier requiring the dealer to submit advertising material for approval or to use material provided by the supplier);
- (e) the acceptance by the dealer of restrictions on onward sale of the supplier's goods to unauthorized dealers;
- (f) the dealer's pricing policies; and
- (g) refusing to supply reference brown goods to retailers who were not so selected.

12.16. Drawing on information provided by suppliers in the lists (see paragraph 12.7) and from other evidence gathered during the course of our inquiries, we compiled a table (Table 12.1) which shows the proportions of suppliers (weighted by sales) that appeared to us to have adopted one or more of the criteria described at Appendix 12.1 during all or part of the period we were investigating.

12.17. All the major suppliers stipulated creditworthiness as a condition for supply. For suppliers of televisions, VCRs and camcorders other important criteria were post-sales service, suitable premises and demonstration facilities. Suppliers of hi-fi systems cited premises and minimum turnover as most important. Brand promotion and product knowledge were stressed by camcorder suppliers. Some suppliers required dealers to show commitment to the brand.

12.18. The distribution policies and practices of all suppliers of one or more of the reference brown goods with 2 per cent or more of the market in 1995, some smaller suppliers, CIH and its local groups are set out in paragraphs 12.19 to 12.99. In a few cases, where a supplier entered or withdrew from the market subsequently, that fact is recorded.

TABLE 12.1 Suppliers' adoption\* of selection criteria

	<i>Reference good</i>	<i>B1 Credit-worthiness</i>	<i>B2 Minimum turnover</i>	<i>B3 Suitable premises</i>	<i>B4 Area already supplied</i>	<i>B5 Stock requirement</i>	<i>B6 Supplier's range display</i>	<i>B7 Others range display</i>	
Aggregate market shares of suppliers adopting criteria listed in headings (all responding suppliers= 100)	TV	99.4	43.7	80.8	47.7	38.5	43.3	3.9	
	VCR	100.0	59.8	69.4	46.2	34.7	46.4	5.6	
	Hi-fi	97.3	72.2	90.2	46.1	30.8	51.8	0.0	
	Cam	100.0	44.2	77.0	42.6	57.7	69.4	16.2	
	<i>Reference good</i>	<i>B8 Display ambience</i>	<i>B9 Staff calibre</i>	<i>B10 Product knowledge</i>	<i>B11 Pre-sales advice</i>	<i>B12 Demonstration facilities</i>	<i>B13 Home delivery/installation</i>	<i>B14 Old machine removal</i>	
Aggregate market shares of suppliers adopting criteria listed in headings (all responding suppliers= 100)	TV	60.0	43.3	43.3	43.3	65.8	2.2	0.0	
	VCR	46.4	46.4	46.4	44.3	64.0	0.0	0.0	
	Hi-fi	59.5	59.5	59.5	59.5	59.5	0.0	0.0	
	Cam	69.4	69.4	83.7	69.4	69.4	0.0	0.0	
	<i>Reference good</i>	<i>B15 Post-sales service</i>	<i>B16 Brand promotion</i>	<i>B17 Advertising constraints</i>	<i>B18 Commitment to brand</i>	<i>B19 Specialist retailer</i>	<i>B20 Sales restraints to other dealers</i>	<i>B21 Dealer profile</i>	<i>B22 Recognized retailer</i>
Aggregate market shares of suppliers adopting criteria listed in headings (all responding suppliers= 100)	TV	88.2	49.9	40.3	24.6	58.5	29.8	14.5	28.7
	VCR	88.0	52.5	33.0	29.9	49.4	26.5	16.7	35.2
	Hi-fi	59.5	51.8	28.6	26.7	44.1	41.4	18.3	29.4
	Cam	72.2	86.5	58.5	43.9	62.4	54.9	2.8	37.1

Source: MMC.

\*See paragraph 12.16.

Note: Listed suppliers are those with 2 per cent or more of the UK reference brown goods markets by value, 1995. Suppliers with less than 2 per cent of the market, and market shares of retailers' own brands (Dixons' Matsui brand and Comet's Goodmans brand) are omitted.

## **Sony**

12.19. Sony, a major supplier of all four reference brown goods, whose brand accounted for the highest market shares by value in televisions and camcorders in 1995, operates a selective distribution system. It told us that the system was designed to ensure a common European approach to its dealers; high standards of pre- and post-sales service and support for consumers; and to maintain the image of Sony's brand and its position in the market.

12.20. Sony first notified the European Commission of a formal selective distribution system for the supply of certain of its products in the UK in 1980; this system was superseded by its PEDAs which were notified to the European Commission in February 1993. The European Commission deemed that some aspects of the agreements were anti-competitive and Sony entered into negotiations with the European Commission which resulted in four changes being made, three of which were applicable to Sony's operations in the UK. These concerned:

- (a) the establishment of a two-tier distribution agreement to preserve the wholesaler level (wholesalers themselves have to undertake to supply only Sony authorized dealers);
- (b) a clause added to the agreements to the effect that Sony may not refuse to supply authorized dealers without written justification;
- (c) the introduction of an internal arbitration procedure. The arbitration has to be conducted by one arbitrator, jointly appointed by both parties or, if the parties fail to agree on a nomination, by an arbitration tribunal. The arbitration determination has, in addition to deciding whether the dealer meets the relevant PEDAs criteria, to fix the costs of the arbitration and determine which of the parties shall bear them, or in what proportions they shall be borne. The arbitration determination is binding on both parties; and
- (d) the fourth change, concerning delivery and the right to return goods ordered by mail order, involved no changes to current practices in the UK.

Sony told us that it had written to its dealers notifying them of these changes to its PEDAs.

12.21. Subject to the changes, the European Commission gave Sony a comfort letter (see paragraph 12.175) in July 1995 to the effect that there were no further grounds for action by the European Commission in respect of the PEDAs.

12.22. Sony told us that, subject to satisfactory creditworthiness,<sup>1</sup> any dealer that satisfied its selection criteria under the relevant PEDAs agreement<sup>2</sup> would be authorized. Dealers were obliged to accept Sony's standard terms and conditions of business and:

- (a) be willing to promote the sale of Sony's products;
- (b) have at least one authorized outlet or department specializing in the sale of quality consumer electronics equipment (such outlets must 'maintain an attractive appearance and have adequate display and demonstration facilities');
- (c) provide pre-sales advice and assistance in technically satisfactory conditions;
- (d) provide post-sales service (or access to post-sales service) including repair facilities;
- (e) employ qualified personnel who specialized in the sale and service of 'high-quality consumer electronics equipment'; and
- (f) agree not to resell Sony's products outside its authorized dealer network.

---

<sup>1</sup>And other legal considerations, for example Sony being satisfied about the accuracy of a dealer's statements.

<sup>2</sup>Under the PEDAs, Sony operates five standard agreements: the Authorised Dealer Agreement; the Mail Order Dealer Addendum; the Prestige Products Addendum; the Buying Organization Agreement; and the Authorised Distributor Agreement.

12.23. Certain models of television, VCR and camcorder (but not hi-fi systems) are classified by Sony as 'Prestige Products', only to be sold by 'Prestige Products Dealers'. Such dealers are required to meet additional criteria, for example the provision of a technically satisfactory listening room or area; the ability to demonstrate and explain product features, comparative performance and potential use. (The Prestige Products Addendum of the PEDAs supplements the Authorized Dealer Agreement.) Some Sony retailers are solus dealers. They are bound by an agreement which is supplemental to the PEDAs, the 'Sony Centre Agreement', which prohibits them from selling, or offering to supply, any competing products from any Sony Centre retail outlets.

12.24. Sony supplies members of CIH's local groups under CIH's buying group arrangements but not, for most of period we were investigating, CIH's central stock. However, in 1995 Sony supplied CIH's central stock with reference brown goods on a trial basis on the condition that the goods would be resold only to those members of CIH who were Sony authorized dealers. At CIH's request, Sony carried out reviews of several CIH members to determine whether or not they met the PEDAs criteria. We received an observation from a CIH member who believed Sony's policy was unfair. His observation, and the responses of Sony and CIH, are at Appendix 12.2.<sup>1</sup> At the time of our report it was not certain whether this arrangement would be repeated.

12.25. Sony supplied mail order companies, and four wholesalers for the resale of Sony's reference goods to authorized specialist photographic retailers. It supplied Makro and told us that Makro was significantly different in its style of operations from PriceCostco. Makro had made a real effort to upgrade its stores in the past few years. Sony had discussed its criteria for supply with Makro in 1994. As a result of those discussions, Makro had made a proper investment in the quality of its presentation and in dedicated staff who had attended Sony's training courses. Makro fulfilled the requirements of Sony's PEDAs.

12.26. Sony provided us with a document entitled 'The Economic Case for Selective Distribution in Consumer Electronics' which it had commissioned from Lexecon in 1994 for presentation to the OFT. The paper argued that selective distribution reduced free riding, increased the speed at which innovation was brought to the market and gave manufacturers an incentive to build reputations for quality and reliability. Sony's views on the findings of the Lexecon report are set out in Chapter 13.

## ***Aiwa***

12.27. Aiwa, whose brand had the highest UK market share in hi-fi systems by value in 1995 (it also supplied VCRs and combined televisions/VCRs) told us that it operated an open distribution system. It said that it imposed 'neither contractual nor practical restrictions upon its dealers other than those which required a basic minimum level of competence and commitment to the sale of its products, and creditworthiness'. Aiwa also stipulated a minimum turnover requirement.

12.28. Aiwa told us that 80 per cent of its sales were conducted through national accounts for which no written or standard agreements existed.<sup>2</sup> Large retailers (which accounted for less than 10 per cent of its sales) were usually supplied under Aiwa's 'Elite Dealer Agreement'. This took the form of a conventional written selective distribution agreement which specified that dealers should have:

- (a) 'adequate' standards for premises;
- (b) a department which specialized in the sale of products similar to those supplied by Aiwa, including demonstration and display facilities;
- (c) range-stocking requirements; and
- (d) trained personnel.

---

<sup>1</sup>Cases A36, B30, C37, D20.

<sup>2</sup>Other than Comet which was supplied under a standard Comet agreement.

Aiwa said that the terms of its Elite Agreement were a 'product of history (and inertia) and did not reflect the reality of the current relationship between Aiwa and its Elite dealers'. It was doubtful if many of its dealers either knew or cared about the terms of the agreement. The key requirement was that a prospective retailer should aim for sales of £70,000 or more. Aiwa said that it had never refused to supply an otherwise adequate non-specialist retailer. Aiwa's efforts had been directed towards obtaining new and broader distribution outlets, for example garages and supermarkets.

12.29. Aiwa said that retailers with an annual turnover of less than £70,000 were more efficiently supplied through wholesalers; it supplied four wholesalers and imposed no conditions on the resale of its goods. The wholesalers covered broad geographic regions. In Scotland and Northern Ireland most of Aiwa's dealers were supplied through wholesalers which had 'sole distribution agreements'. Aiwa said that it would not necessarily supply all wholesalers that applied. It took into consideration creditworthiness and its existing dealer base, weighing whether the additional cost of supply would be covered by sufficient increased sales of Aiwa products, or a contribution to the Aiwa brand. Aiwa supplied CIH's central stock; Makro; PriceCostco; Cargo Club; and mail order companies.

### ***Panasonic***

12.30. Panasonic is a major supplier of all four reference brown goods. Its Panasonic brand of VCRs was the market leader by value in 1995. It told us that it operated an 'open' selective distribution system: its authorized dealers were free to supply its products to non-authorized dealers.

12.31. In February 1997 Panasonic told us that during the course of our inquiries it had re-examined its contractual relations with its dealers. It would be introducing two new dealer agreements with effect from 1 April 1997. The first was an account holder agreement under which Panasonic would supply retailers who provided certain support for Panasonic products. The second was an authorized dealer agreement under which Panasonic would provide additional support to those retailers who were prepared to meet stricter criteria. An account holder would need to meet criteria relating to creditworthiness, after-sales service, and the standard of presentation of the retail premises. An authorized dealer would need to satisfy all the criteria which were applicable to account holders, and in addition satisfy additional requirements on after-sales service plus range stocking; display and demonstration facilities; product timing; and support of promotional activity. The draft agreements were, at that time, being discussed with dealers. Prior to the new agreements coming into force, Panasonic selected its authorized dealers on the basis of:

- (a) creditworthiness;
- (b) the standard of their premises;
- (c) willingness to stock a representative range of Panasonic products;
- (d) pre-sales service (dealers must be able to demonstrate and explain the technical complexities of the products);
- (e) after-sales service, including repair and maintenance (either directly provided or through a competent subcontractor); and
- (f) staff training.

Panasonic said that it would not normally open an account for a dealer whose potential turnover was less than £10,000 a year. Such applicants would be referred to the nearest suitable Panasonic dealer. In remote or non-populous areas of the country, the choices of retailer for both supplier and consumer could be more limited. In such cases, the standard of premises required by Panasonic might be less demanding than that applied elsewhere.

12.32. Panasonic told us that it operated a voluntary scheme named 'PanaService' under which dealers were given continuous advertising and training support in return for a commitment to provide an enhanced pre-sales and repair service. They were also required to have their own service department with minimum numbers of qualified technicians, and specialist test equipment. PanaService dealers could opt to establish solus centres known as 'Panasonic Technics Centres' in which only Panasonic and Technics brands were

displayed. Panasonic provided further support for these dealers, including a contribution to shop fittings, point-of-sale material and other advertising support.

12.33. Panasonic told us that if a retailer was refused supply he could complain to Panasonic's regional representative, or to Panasonic's Managing Director. Panasonic would then review the decision not to supply and discuss the outcome with the complainant.

12.34. Panasonic supplied mail order companies. It told us that it did not supply reference goods to outlets whose primary business was wholesaling, except in respect of Northern Ireland (where the wholesaler concerned assumed similar responsibility for the supply of the products as that assumed by Panasonic in Great Britain), and of the supply of camcorders (where Panasonic's distributor assumed service responsibility).

## **JVC**

12.35. JVC is a major supplier of all four reference brown goods; its market share by value in 1995 of hi-fi systems ranked third.

12.36. JVC said that its selective distribution policy was necessary to increase the awareness of its brand. It traded on the quality of its products, and had been at the forefront of technological developments at a time when some other suppliers were investing in marketing their brand names. JVC's parent company, Victor, had received a comfort letter from the European Commission in June 1988 in relation to its standard form distribution agreement with its European subsidiaries (including JVC) (see paragraph 12.177). JVC told us that it was obliged to include the criteria set out in the Victor Agreement in its own agreements with dealers in the UK.

12.37. JVC said that, in addition to creditworthiness, its criteria for supply were:

- (a) an initial order of £5,000 and thereafter maintenance of a regular turnover in JVC products;
- (b) dealer status as a specialist retailer of consumer electronics equipment;
- (c) the provision of suitable premises;
- (d) stocking and display of a representative range of JVC products;
- (e) qualified staff;
- (f) pre- and after-sales service;
- (g) a prohibition on resale to non-authorized dealers; and
- (h) commitment to maintaining the reputation of JVC's brand name.

12.38. JVC supplied mail order companies. It recommenced supply to CIH in April 1997 (see paragraph 12.117).

12.39. JVC opened an account with Makro's associate, Business to Business (see paragraph 9.144) in August 1996. JVC said Makro had realized that, in order to sell consumer electronic products successfully, it needed to have a certain profile which in the past it had not attained.

12.40. JVC appointed Savacentre as an authorized dealer in May 1996. JVC saw Savacentre as 'an innovative form of retailing ... effectively a cross between a supermarket and a department store'. It had taken the decision to supply Savacentre only because Savacentre had satisfied JVC that it would be able to meet, and maintain, compliance with JVC's dealership criteria.

12.41. JVC told us that, in October 1996, it had introduced a new dealership application form. From that date every applicant would be referred to JVC's local sales representative who would visit the applicant within one month of the initial contact. If JVC did not think the prospective retailer would be able to comply with its

criteria, it would inform the retailer in writing of the reasons and of his right to appeal against the decision to the appropriate JVC director.

## ***Sanyo***

12.42. Sanyo's market share of camcorders by value in 1995 ranked second. It also supplied televisions, VCRs and hi-fi systems. Sanyo told us that it had operated a selective distribution system since 1989. It notified the European Commission of its system in May 1995. At the time of our report the European Commission was still considering the notification (see paragraph 12.179).

12.43. Sanyo told us that it operated a formal system of selective 'dealership agreements'. In addition to creditworthiness, Sanyo published its approval criteria for retailers which included:

- (a) the nature and appearance of the premises;
- (b) display and demonstration of products;
- (c) the employment of trained staff; and
- (d) the offer of point-of-sale and after-sales service.

12.44. In addition, under the terms of its selective distribution dealership agreement Sanyo required approved dealers to:

- (a) correctly use the Sanyo trade mark;
- (b) meet minimum purchasing requirements (indicative only);
- (c) provide post-sales service including installation and repairs (by the dealer or through Sanyo's network of Approved Service Centres);
- (d) meet range-stocking expectations<sup>1</sup> (of Sanyo's and competing suppliers' brands);
- (e) have commitment to the promotion of the Sanyo brand;
- (f) meet reasonable requirements for the advertising and promotion of Sanyo's products (which Sanyo would match typically pound for pound);
- (g) not resell Sanyo's products to non-authorized dealers; and
- (h) continue to comply with Sanyo's approval criteria.

The agreements also stipulated that the dealer 'must not sell any Sanyo product as a loss leader, or otherwise at such a low price that it is not consistent with the brand and market positioning for Sanyo products'.

12.45. Sanyo said that it undertook a detailed and objective evaluation of applications from prospective dealers. The ultimate decision to admit or reject was taken by its Sales Director.

12.46. Sanyo supplied mail order companies and members of CIH's local groups who were authorized Sanyo dealers. Sanyo told us that it would be prepared to supply CIH's central stock, provided CIH agreed to supply only Sanyo's authorized dealers.

12.47. Sanyo sent us an analysis of a survey of consumer attitudes it had commissioned from SRU, an independent consultancy specializing in consumer and market research. The analysis, involving about 500 consumers, was dated September 1995. The findings indicated that consumers purchasing reference brown goods were interested in or motivated by:

---

<sup>1</sup>Unless otherwise agreed, for example in the case of specialist photographic retailers who purchase only camcorders from Sanyo.

- (a) assistance in making informed choices by knowledgeable and informative staff who were courteous and attentive;
- (b) a belief that different brands had genuine values and reputations-a reputable brand being a key factor in the decision-making process;
- (c) the desire to purchase at a competitive reasonable price but not necessarily the absolute cheapest price;
- (d) a retail environment which made the shopping experience more pleasant and informative;
- (e) the identity and strength of the brand (consumers' views differed with regard to what they thought about quality, reliability, innovation and aesthetics);
- (f) features and facilities and the benefits available in connection with them;
- (g) well-presented and -displayed products;
- (h) good after-sales and other service, including installation and delivery; and
- (i) repair facilities.

### ***Toshiba***

12.48. Toshiba supplied televisions and VCRs. Its brand of televisions ranked second by value in 1995, and VCRs fourth. It said that it did not have a selective distribution policy 'in a narrow sense' but did not supply all dealers who requested supply. Toshiba said that it had rejected approaches from prospective dealers where no incremental business could be expected. It added, 'It can be assumed that other suppliers adopt similar approaches and that these may even extend to using pricing policies' as a criterion.

12.49. Toshiba said that it operated guidelines which stated that new dealers must:

- (a) specialize in the retail sale of consumer electronics;
- (b) have premises of an appropriate appearance and trading style, including provision for product demonstration; and
- (c) provide after-sales and servicing facilities.

12.50. Toshiba told us that it did not generally supply wholesalers (but added that no wholesalers were currently known to want to stock Toshiba products). It supplied mail order companies, CIH's members of local groups through CIH's buying group arrangements and CIH's central stock. In September 1996 Toshiba began supplying Makro, and in October 1996, PriceCostco.

### ***Canon***

12.51. Of the four reference goods, Canon supplied only camcorders. In 1995 UK sales of its brand ranked fourth by value, over one-third of which were supplied to Dixons. Canon told us that it operated an 'open' distribution policy but reserved the right to introduce a selective distribution system if it became necessary as products became more technically complex.

12.52. Canon stated that the criteria specified in its 'Video Dealer Agreement' were internal guidelines of general application to all channels of distribution. It said that in common with all standard form dealership agreements, its Agreement consisted of a mixture of terms: some were central and legally precise and significant, for example the declaration that trade mark rights were to remain the exclusive property of Canon and that the marks should be reproduced unchanged from Canon's standard sales literature, and some which

were necessarily vague and legally imprecise. The provisions headed 'Obligations of the Dealer' were characterized by references to 'best endeavours'. This was a 'high legal obligation' as to *ends* but left the *means* to be worked out between the parties, and reflected the flexible nature of the long-term relationship between Canon and its dealers and the difficulties involved in pre-specifying the full extent of what Canon expected of its dealers. The formulation allowed Canon to create expectations of desirable dealer behaviour and performance. It was not the case that any lapse from such a standard would inevitably result in termination; Canon would seek to improve the dealer's performance. If a dealer's performance proved to be unacceptable, a clause in the Agreement provided the justification for dealer termination but, in fact, Canon had never terminated a dealership for any such breach.

12.53. Canon said that the Video Dealer Agreement was a product of its earlier thinking about the distribution of camcorders. About one-half of its sales were conducted on the basis of the Agreement. For the rest, either the dealer's own terms applied or no express terms had been agreed. For some dealers it was unclear whether Canon's terms or those of the dealer would apply. Canon thought that, in practice, the issue was largely irrelevant because the Agreement was of secondary importance to the underlying relationship between the parties, which should be motivated by mutual goodwill and the desire to resolve any differences without recourse either to the 'small print' of the Agreement or the Courts.

12.54. The terms in the Agreement include:

- (a) maintenance of a good reputation for Canon's products;
- (b) the requirement to advertise in a manner that did not detract from Canon's image;
- (c) promotional activity;
- (d) stocking requirements;
- (e) participation in Canon's sales training; and
- (f) a prohibition on resale to other than end-users or other authorized dealers.

12.55. Canon said that it had never terminated supply on the basis of non-compliance with the agreement, and had never enforced the provisions relating to 'selling on'. Neither did it insist on stocking requirements. It did have regard to the appearance of a dealer's premises 'in the sense that this indicates general retailing competence and commitment' but did not insist that its dealers should be 'recognized' electrical retailers. (It gave us examples of two major retailers trading in other retail sectors whom it had sought to supply, albeit unsuccessfully.)

12.56. Canon supplied mail order companies; three wholesalers; members of CIH's local groups through CIH's buying group arrangements, and PriceCostco.

## ***Hitachi***

12.57. The sales by value of Hitachi's brand of televisions ranked fourth in 1995. It also supplied VCRs, camcorders and small numbers of hi-fi systems. Hitachi told us that it maintained a nation-wide distribution system using all major retailing channels. In general, it supplied only its appointed dealers. Most of its conditions for appointment were set out in a 'Dealer Appointment Proposal' which stated that dealers must be creditworthy and satisfy the following requirements:

- (a) minimum turnover;
- (b) the display of Hitachi's products prominently in well-kept premises with good point-of-sale material;
- (c) sales staff with adequate product knowledge;
- (d) stocking of a representative range of products;
- (e) the provision of demonstration facilities; and

- (f) post-sales service, including delivery and installation (or an agreement with an authorized sub-contractor).

12.58. Hitachi told us that its criteria for dealer appointments were applied flexibly. For example, its minimum turnover requirement would be carefully reviewed before any applicant was rejected. All applications were dealt with on an individual basis; the final decision on whether to approve or reject was made by its Sales and Marketing Director. Hitachi said that some account was taken of a prospective dealer's geographic location (see paragraph 12.13).

12.59. Hitachi said that it did not generally distribute its goods through wholesalers, other than in Northern Ireland. It supplied camcorders to three specialist photographic retailers, and it believed that effectively they acted as wholesalers to other photographic retailers. Hitachi supplied mail order companies, and began supplying CIH's central stock in 1996.

### ***Kenwood***

12.60. Kenwood supplied hi-fi systems. The market share by value of its brand ranked fourth in 1995. Kenwood told us that its 'qualitative criteria' were contractual obligations in its Dealer Agreement' which stipulated that dealers must:

- (a) operate from a specialist outlet or department;
- (b) provide suitable premises for the presentation, display and demonstration of Kenwood's products;
- (c) provide a sufficient number of technically-trained staff able to give expert advice and customer service;
- (d) hold an adequate stock of the full range of Kenwood's products (the level of which Kenwood determined);
- (e) not resell Kenwood's products to non-authorized dealers;
- (f) promote Kenwood's products; and
- (g) provide after-sales service.

12.61. Kenwood began supplying Business to Business, the Makro associated company operating within Makro stores in 1996. Kenwood told us that it supplied Business to Business but not Makro itself since Makro outlets that Kenwood had reviewed had not met Kenwood's criteria. It supplied CIH's central stock with a selected range. In Kenwood's view CIH differed from other wholesalers in that its members were retailers who had specialist knowledge of home audio products at a technical and marketing level. Kenwood said it was satisfied that undertakings it had received from CIH to restrict the resale of its goods to retailers who were willing to conform to Kenwood's selection criteria had not, and would not, be compromised. Kenwood said that it would be ready to supply other wholesalers if they were prepared to meet the level of investment needed in technical competence and service.

### ***Philips***

12.62. Philips' brand had the fifth largest market share by value in televisions in 1995. It also supplied VCRs and hi-fi systems. It told us that the policy of operating selective distribution systems adopted by the leading suppliers indirectly affected other suppliers. Dealers that approached Philips for supply could broadly be classified into one of two categories. Either:

- (a) they had already passed the selective distribution test operated by other leading suppliers (in which case their premises were likely to be perfectly satisfactory to Philips); or

- (b) they had not passed this test (in which case there would be doubts about their viability, and they would be unlikely to meet Philips' minimum turnover threshold).

Philips told us that a fully selective distribution policy had some merit for sophisticated products, which often represented major purchases and required considerably more support from the retailer than commodity products. Selective distribution systems could be used to encourage retailers to bear the costs of providing pre- and after-sales service, provide suitable showrooms and employ trained staff, and to protect the retailers against 'free riding'. Philips said that it did not operate such a distribution system.

12.63. Philips said that its criteria for supply included:

- (a) financial viability;
- (b) minimum turnover of £25,000 (at invoiced costs); and
- (c) access to suitable service facilities, either directly or through a Philips appointed agent.

Philips' dealers were also expected to have product knowledge.

12.64. Philips supplied wholesalers and said that retailers which did not meet its criteria for direct supply were free to obtain unrestricted supplies through these channels. Philips supplied members of CIH's local group through CIH's buying group arrangements and CIH's central stock; mail order companies; and PriceCostco (since April 1995).

### ***Pioneer***

12.65. Pioneer supplied hi-fi systems and small quantities of televisions. Its brand of hi-fi systems ranked fifth by value in 1995. Pioneer told us that it operated an open distribution system, subject to certain criteria. It would supply dealers only if they were creditworthy, met certain minimum criteria in terms of outlet and sales staff, and were likely to achieve minimum sales of about £20,000 a year to justify the administrative burden and fixed costs involved in setting up and supporting the account. Pioneer said that maintaining the reputation of its brand required its products to be sold in an environment in which they were appropriately displayed, suitable after-sales service was provided, and consumers could make an informed choice. Pioneer also told us that it took some account of geographic coverage (see paragraph 12.12).

12.66. Pioneer supplied Makro, mail order companies, and CIH's central stock. Pioneer told us that dealers refused direct supply were able to obtain its reference goods from one of its authorized dealers. Pioneer said that it made no attempt to control the availability of its goods through these sources.

### ***Mitsubishi***

12.67. Mitsubishi supplied VCRs and televisions.<sup>1</sup> Sales of its brand of VCRs ranked sixth by value in 1995. Mitsubishi told us that it did not have a selective distribution policy. It had elected, instead, to operate an 'open' distribution system. Mitsubishi said that such a system meant that, as opposed to a selective distribution system, the supplier was not able to impose any qualitative restrictions on its dealers. It also had total discretion about which dealers to supply (subject only to any constraints imposed by Articles 85 and 86 of the EC Treaty, and UK competition law). Mitsubishi said that it had weighed up the advantages and disadvantages of a conventional 'open' system as against those of a conventional 'selective' system and adopted an open system on the basis that it was more advantageous to Mitsubishi, even though to do so meant that it could not take advantage of the restrictions permitted in selective distribution systems. The primary objective of its system was to retain the flexibility:

- (a) to sell to dealers in areas in which Mitsubishi was under-represented and who might not otherwise satisfy the requirements of a typical selective distribution system; and

---

<sup>1</sup>Mitsubishi also supplied insignificant quantities of hi-fi systems in the period August 1995 to July 1996.

(b) to refuse to sell to dealers, however well qualified, in areas in which Mitsubishi was already sufficiently represented.

12.68. Mitsubishi said that it aimed to achieve sales of its goods throughout the UK whilst giving its dealers the opportunity to sell in sufficient numbers to justify their promoting Mitsubishi's products. Mitsubishi would not, however, dilute the market by appointing an excess of dealers in areas where potential demand would not support them.

12.69. Mitsubishi said that it applied 'internal selection criteria'. It would assess potential dealers against a dealer profile, ie a combination of number and type, the respective geographical areas in which its products would be marketed and dealers' likely impact on the maintenance and improvement of Mitsubishi's share of the market.

12.70. Mitsubishi said that it did not enter into dealership agreements with any of its appointed dealers. They were asked to complete an application form as a means of credit control; the form also confirmed Mitsubishi's standard terms and conditions of sale and any negotiated variation of such terms, and asked whether dealers had any service facilities (to enable Mitsubishi to put in place separate financial arrangements for such servicing). The provision of after-sales service was not, however, a criterion for supply.

12.71. Mitsubishi said that it did not exercise any control over the resale of its reference goods by wholesalers. It supplied a 'core range' to CIH's central stock, and supplied approved Mitsubishi dealers through CIH's group buying arrangements.

12.72. Mitsubishi supplied mail order companies. In Northern Ireland it supplied reference goods exclusively through a single wholesaler.

### ***Samsung***

12.73. Samsung supplied all four reference brown goods. Its sales by value of camcorders trebled between 1992 and 1995; its brand ranked sixth in 1995. Samsung told us that its policy was to supply all creditworthy dealers although it tried to select dealers who would sell the greatest volume of its products. Dealers requesting minimal supplies would be referred to a wholesaler.

12.74. Samsung supplied wholesalers, members of CIH's local groups and CIH's central stock, and mail order companies.

### ***Sharp***

12.75. Sales of Sharp's brand of camcorders ranked seventh by value in 1995. It also supplied televisions, VCRs and hi-fi systems. Sharp told us that it would supply all reputable dealers who were creditworthy and who satisfied its minimum turnover requirement. Smaller orders were referred to one of its distributors.

12.76. Sharp said that it had considered adopting a selective distribution system to include a requirement for trained sales staff, display areas and after-sales service. It believed that selective distribution might well have considerable merits for high-value complex consumer electronic products, and it had followed with interest the outcome of Sony's notification of its PEDAs to the European Commission.

12.77. Sharp supplied six wholesalers which it believed gave good coverage of the UK. It supplied members of CIH's local groups and CIH's central stock, mail order companies, Makro and PriceCostco.

## ***Thomson***

12.78. Thomson, whose Ferguson brand had a market share by value of over 2 per cent in 1995 in televisions and VCRs, and which formerly supplied camcorders, told us that it did not have a selective distribution policy. It had no formal agreements with dealers beyond acceptance of its terms and conditions. It would supply all creditworthy retailers. Thomson added, however, that it required dealers to provide 'an adequate level of after-sales service, either directly or by sub-contracting'.

12.79. Thomson supplied all wholesalers who wished to stock its brands, mail order companies and CIH.

## ***Alba***

12.80. Alba's sales of televisions and hi-fi systems were over 2 per cent by value in 1995; it also supplied VCRs. Alba's brands are Alba, Bush, Hinari and Goodmans. Alba said that generally it placed no restrictions on the sale of its reference goods other than creditworthiness.

12.81. Alba supplied wholesalers and mail order companies, which it said constituted some 50 per cent of its sales, and catalogue companies responsible for another 25 per cent.

## ***LG***

12.82. LG supplied televisions, VCRs and hi-fi systems under the brand name Goldstar; its UK sales of VCRs were above 2 per cent by value in 1995. LG told us that its only criteria for supply were minimum turnover (potential purchases of £15,000 a year) and creditworthiness. But retailers who did not meet its turnover stipulation could buy its products through wholesalers. LG supplied mail order companies, members of CIH's local groups and CIH's central stock.

## ***Denon***

12.83. Denon's market shares by value of hi-fi systems were over 2 per cent by value in 1995. It told us that it operated a selective distribution system. Its criteria for supply were:

- (a) suitable premises;
- (b) pre-sales service from knowledgeable staff;
- (c) after-sales service; and
- (d) a contribution to Denon's total sales in a geographic area (see paragraph 12.13).

## ***Other suppliers***

12.84. We received evidence from some smaller suppliers to the UK markets whose market shares in none of the reference goods reached 2 per cent by value in 1995. Two companies particularly interested us, B&O and Grundig, because their selective distribution systems had been considered by the European Commission under section 85 of the EC Treaty.

12.85. B&O, a niche supplier of hi-fi systems, televisions and VCRs, told us that it received a comfort letter from the European Commission in August 1989 (see paragraph 12.178). B&O said that it believed it was fully justified in operating such a selective distribution system to protect its brand image and the reputation of its products. The B&O brand was associated with high-quality, technically sophisticated products, the nature of which meant that consumers required expert advice.

12.86. B&O's 'EEC Distribution Agreement' stipulated that its dealers must provide:

- (a) a specialized outlet or department within a store, visually and spatially separated from other departments;
- (b) display areas of a style befitting the standard of the name of B&O;
- (c) qualified sales staff;
- (d) demonstration facilities, free from any disturbance;
- (e) pre- and post-sales service; and
- (f) range-stocking requirements.

The terms of B&O's Agreement required its authorized dealers to participate in B&O's promotional activities although B&O told us that, in practice, its dealers were given some discretion about whether to take part. B&O added that it encouraged dealers to run their own sales campaigns and provided assistance for them to do so. Its authorized dealers were prohibited from reselling B&O's products to non-authorized dealers.

12.87. B&O told us that it received many enquiries about supply but many retailers did not pursue their applications when they became aware of B&O's stringent requirements. For example, Dixons had been appointed a B&O authorized dealer but had declined B&O's products because it found that the technical training, sales environment and stocking requirements did not fit in with the rest of Dixons' business.

12.88. B&O told us that its parent company had limited manufacturing capacity; it would be impossible for it to supply large numbers of dealer outlets. And it did not have the manpower or procedures to administer a large-scale operation.

12.89. Grundig supplied televisions, VCRs and hi-fi systems. In 1993 Grundig obtained an extension of its exemption from the European Commission for its selective distribution system under Article 85(3) of the EC Treaty (see paragraph 12.174). Grundig's Dealer Agreement stipulated that its dealers should:

- (a) be a specialized retail business or normal retail outlet (that is, open to the public);
- (b) display Grundig products attractively and prominently;
- (c) employ sales staff who are trained in product knowledge to professional levels;
- (d) display a fully representative range;
- (e) offer pre- and post-sales service; and
- (f) have the facilities to check its products prior to supply to a consumer.

Grundig also prohibited its dealers from advertising 'self-service' or 'takeaway prices', or reselling to non-authorized dealers. Grundig's dealers were required to keep documentation to help Grundig track down unauthorized sales.

12.90. Orion is an important supplier of own-label reference goods. It also supplied VCRs and televisions under its own brand name. Orion told us that it supplied only by the container load to dealers' specific orders. Other than this requirement, it would supply to any dealer whose payments were made by irrevocable letter of credit.

12.91. Akai supplied televisions, VCRs and hi-fi systems under the brand name Akai, and since August 1996, under the Nokia brand (see paragraph 12.96). Akai said that it supplied all wholesalers and retailers who wished to stock its brands, either on credit or on a pro forma invoice basis.

12.92. Amstrad supplied televisions, VCRs and small quantities of hi-fi systems. It told us that it did not have a selective distribution policy. It preferred its retailers to stock as wide a range as possible but imposed no requirements. Its only criteria for supply were that a dealer should be creditworthy and purchase on

acceptable terms; in November 1994 it stopped selling in quantities of less than 50 pieces. Amstrad supplied wholesalers, including CIH's central stock, warehouse clubs and mail order companies.

12.93. Beko supplied televisions. It told us that it accepted all retailers who were prepared to accept its financial terms provided they were creditworthy. It chose wholesalers based on the geographic area and the customer base within it.

12.94. Daewoo, a recent entrant to the UK reference goods market, supplied televisions, VCRs and hi-fi systems. It said that it supplied all dealers who wished to stock its brand. It supplied wholesalers and mail order companies.

12.95. Marantz supplied hi-fi systems. It told us that its criteria for supply included range display (of its and other brands); staff calibre; product knowledge and training; pre-sales advice; demonstration facilities; and home delivery and installation. Marantz said that its normal policy was to encourage all dealership applications to be in writing so that Marantz could determine creditworthiness.

12.96. Nokia formerly supplied three of the reference brown goods but it withdrew from the UK hi-fi system market in 1994, and the television and VCR markets in 1996 (see paragraph 12.91). It told us that its principal criteria for supply had been creditworthiness, a level of turnover to warrant the costs of direct supply, and the provision of competent after-sales service.

12.97. Tatung supplied televisions and VCRs. It told us that its account opening procedure was primarily based on creditworthiness, the ability to provide after-sales service, and the ability to display its products and provide an acceptable level of product knowledge.

## ***CIH***

12.98. CIH told us that it had 'careful policies on admission [to membership]'. Normally, prospective retailers needed to satisfy the following criteria for admission to one of CIH's local groups:

- (a) the production of three years' audited accounts;
- (b) a minimum turnover of around £75,000 a year; and
- (c) status as bona fide electrical retailers.

CIH said that it would consider applications from public limited companies but only if the shareholding was family-based or held within a fairly small community. It said that in the past there had been more local discretion regarding the requirement for three years' audited accounts. But as CIH now took responsibility centrally for managing the risk of non-payment by its members, it insisted that its local groups should conform.

12.99. CIH said that three-quarters or more of the reference goods ordered by members of its local groups were supplied directly from suppliers through CIH's buying group arrangements; the remainder was ordered from CIH's central stock.

## **Extent of suppliers' conditions for supply to small retailers**

12.100. Over 40 per cent of respondents to our survey of small retailers said that suppliers imposed conditions on retailers' shop appearance, staff training or levels of service. Table 16 of Appendix 9.1 shows the numbers of respondents reporting alleged imposition of conditions; and Table 17 breaks these down by type of condition and reference good. (To determine the nature of the conditions, we grouped the responses, which were of a wide-ranging nature, into broad categories.) The most commonly cited conditions (expressed as a percentage of respondents who reported conditions) were:

			<i>per cent</i>	
	<i>Televisions</i>	<i>VCRs</i>	<i>Hi-fi systems</i>	<i>Camcorders</i>
(a) Competence in after-sales and servicing	64	64	60	68
(b) Quality of premises	29	30	29	30
(c) Quality and knowledge of staff	31	31	31	32

12.101. Over 90 per cent of respondents to the survey who bought reference goods from wholesalers said that the wholesalers imposed no conditions on supply (Table 12, Appendix 9.1). The remainder mentioned conditions which were not within our terms of reference.

### **Withholding of supply**

12.102. We obtained information on suppliers' behaviour and dealers' experiences in relation to withholding of supply from:

- (a) responses to questionnaires sent to suppliers, multiple retailers, mail order companies, wholesalers, warehouse clubs, CIH and its local groups;
- (b) responses to our issues letters (see Appendix 6.1, Annex A);
- (c) hearings with, and visits to, suppliers and dealers, followed up in some cases by further written representations;
- (d) our survey of small retailers (see Appendix 9.1);
- (e) observations from dealers and others;
- (f) examination of the trade press; and
- (g) media reports.

12.103. In all we received 408 observations from dealers and others about withholding of supply of one or more of the reference brown goods. We judged that 245 of these lacked sufficient detailed evidence for us to pursue them further, or were not within our terms of reference (see paragraph 6.6). The remaining observations (with eight exceptions), and suppliers' comments on them, are set out at Appendix 12.2. The exceptions are set out in paragraph 12.132 and paragraphs 12.138 and 12.139 (two cases, each in respect of all four reference goods). We accepted the dealer's account of events in 121 of these cases; these observations have been denoted by an asterisk against the name or code number of the dealer. In 34 cases there was a conflict of evidence between the accounts given by the dealer and the supplier which we were unable to resolve. In a further eight cases we were unable to reach a judgment because the retailer had asked to remain anonymous and the supplier declined to respond without being given more information. These cases, together with those in which there was an irreconcilable conflict of evidence, remain unmarked in the appendix and we have not relied upon them in reaching our conclusions.

12.104. We asked suppliers to list all dealers they had refused to supply since January 1993, citing the reasons for the refusal. Almost all referred to lack of creditworthiness. But many of the lists did not reflect the complete picture. It was common for dealers to be given an application form only once they had passed successfully through a series of steps (for example, telephone conversations and interviews with suppliers' sales staff) designed to filter out those dealers who were not expected to meet the particular supplier's criteria.

12.105. Panasonic told us that prospective dealers completed account application forms only when the relevant sales department expected an account to be opened. At that stage it was extremely unusual for an application to fail other than as a result of an unfavourable credit or service assessment. Mitsubishi said that potential dealers who approached it but did not satisfy its dealer profile might not even reach the stage in the

application procedure of completing the application form. PriceCostco and Broadbent Television came into this category' (see Appendix 12.2<sup>1</sup>).

12.106. All the suppliers denied that they had withheld supply from dealers because they had charged, or were expected to charge, prices below RRP. Sanyo told us, however, that if it were:

to supply cut-price retailers who did not meet [Sanyo's] present standards for service, and its other selection criteria, this could be expected to induce some of its existing approved dealers to stop buying Sanyo products and, instead, to concentrate on products of our competitors which are not supplied to free riders. The reduction in the number of our retail outlets providing service and meeting our approval criteria could be expected to reduce sales through those approved dealers.

### ***Wholesalers***

12.107. Most suppliers told us that they used wholesalers to a greater or lesser extent but some, including Sanyo, JVC, Kenwood and Pioneer, supplied none.

12.108. Pioneer told us that it acknowledged that some of its authorized dealers also traded as wholesalers. Nevertheless it considered that it was more efficient and cost-effective to provide its own distribution facilities.

12.109. Sanyo told us that following a review of its selective distribution agreement, it had decided during 1994 not to supply wholesalers with effect from 1 April 1995 but to concentrate its sales on a network of approved dealers which met Sanyo's approval criteria. Sanyo said that it did not have the resources to evaluate wholesalers; it would not be cost-effective to monitor whether they would only sell to retailers which met Sanyo's supply criteria. JVC told us that its concern was that it would be difficult for wholesalers to ensure that they resold JVC's products only to authorized dealers; it would supply wholesalers if that could be guaranteed. Sony, which supplies those wholesalers who agree to be bound by the terms of either its Group Buying Agreement or Authorized Distributor Agreement (see paragraph 12.22), told us that it did not consider it needed a wider wholesaler network, particularly as Sony did not insist on minimum turnover as a criterion for supply.

12.110. Panasonic, which supplied only one specialist photographic wholesaler in Great Britain, told us that it did not attempt to control wholesaling by its dealers, many of which had substantial wholesale businesses in addition to their retailing interests. Panasonic, however, believed that a dealer whose sole wish was to wholesale products to the exclusion of any retail sales activity would probably not meet its criteria for appointment.

12.111. Kenwood told us that its 'qualitative criteria' effectively eliminated supplies to wholesalers, since these criteria focused exclusively on retail factors. It added that if wholesalers were prepared to invest in the level of technical competence and service necessary for the retail sale of Kenwood products, they would be supplied.

12.112. We received no evidence about wholesalers adopting selective distribution policies but we received two observations from Pact International Limited (Pact), one of the largest wholesalers of electrical goods, concerning difficulties it had experienced in attempting to become distributors of Aiwa's reference goods for distribution in Scotland and Northern Ireland, and LG's reference goods in Northern Ireland.

12.113. Aiwa told us that it had given sole distribution rights in Scotland and Northern Ireland to other wholesalers to maximize the cost-effectiveness of distributing Aiwa's products. It had not forbidden Pact to supply retailers in Scotland and Northern Ireland but did not want it to 'canvass actively'. LG told us that prior to its appointment of Pact as an authorized wholesaler of its reference goods, it had already appointed wholesalers in Northern Ireland.

---

<sup>1</sup>Cases A12, A13, B12 and B13.

12.114. A full account of Pact's observations and of the suppliers' responses is at Appendix 12.2.<sup>1</sup>

### ***CIH***

12.115. We received minutes of meetings of some of CIH's local groups indicating that they had, in recent years, rejected applications for membership from retailers of whose pricing they disapproved. CIH told us that it did not, at present, encourage its local groups to refuse membership on the grounds that there was sufficient coverage in an area. But the minutes of meetings of some CIH local groups indicated:

- (a) a reluctance to admit a prospective new member whose business was in close proximity to an existing member;
- (b) a requirement that new members should be admitted only if acceptable to existing members;
- (c) an objection to a prospective applicant 'with regard to location, pricing policy' (*sic*);
- (d) one local group which admitted a known discounter to its membership rather than him applying to, and possibly being accepted for membership by, another CIH local group, so that 'neighbours can keep an eye on his activities'; and
- (e) another group expressing concern about the pricing policy of a prospective member but deciding that he should be admitted as the prices he advertised and displayed in his store were acceptable.

12.116. At an early stage in our inquiries, we were told that CIH had reminded all the retailers it supplied that they should sell goods bought from CIH only to the general public or to CIH members. CIH later told us that it had fully revised its membership rules in consultation with the OFT. As a result it had no objection to being asked to give an undertaking that it would not make any recommendation to the members of its local groups that they should not resell goods to other dealers. CIH told us that it did not accept that its current practice of requiring three years' accounts as the best way of checking on a prospective member's creditworthiness was unreasonable (see paragraph 12.98). It said that personal guarantees of payment often turned out to be worthless, and to exact from members payment guarantees such as a bond or bank guarantee would be imposing an unreasonable burden on entry to membership.

12.117. Supply to CIH was not universal during the period of our investigation. For example, Panasonic told us that it dealt directly with the majority of CIH members who sold reference brown goods. These dealers were already entitled to the highest level of discounts offered by Panasonic and wished to remain in direct contact with Panasonic. At CIH's request, JVC ceased supplying its authorized dealers who were CIH members through CIH's group buying arrangements in 1995 after JVC refused to contribute towards a levy to cover CIH's bad-debt insurance arrangements. JVC recommenced supply from 1 April 1997. Sony, other than for a trial period (see paragraph 12.24), did not supply CIH's central stock.

### ***Warehouse clubs***

12.118. It is clear from the evidence we were given that warehouse clubs have rarely been successful in their efforts to obtain direct supply of many brands of reference brown goods, either from suppliers or other sources authorized by them. (But we were told that some suppliers 'turned a blind eye' to their products being supplied to warehouse clubs by diverters.)

12.119. PriceCostco, whose declared philosophy is to avoid costs typically associated with retail stores, for example 'elaborate sales fixtures, service personnel, advertising, credit and broad product selection', told us that it had been refused supply by:

- (a) Sony, Panasonic, JVC and Sanyo-all four reference brown goods;

---

<sup>1</sup>Cases A11, B1, B11, C1 and C18.

(b) Hitachi and Grundig-televisions, VCRs and hi-fi systems;

(c) Mitsubishi-televisions and VCRs; and

(d) Toshiba-televisions and VCRs.

12.120. PriceCostco stated that, since December 1995, it had provided a free three-year guarantee to purchasers of reference brown goods costing over £100. It had a contract with a third party maintenance company operating on a national basis. Purchasers were given a local telephone number through which they could contact this company. It would undertake whatever repairs were necessary and invoice PriceCostco. PriceCostco said that it was willing to buy out the guarantees of its brown goods suppliers. This guarantee was in addition to its normal 'no quibble' returns policy.

12.121. Toshiba told us that it had indicated to PriceCostco, when first approached, that it doubted there would be any incremental business for Toshiba were it to supply PriceCostco. Toshiba was experiencing some difficulty at that time in meeting demand for the products in which PriceCostco was primarily interested. Subsequently, in October 1996, Toshiba began supplying PriceCostco.

12.122. Sony told us that it had refused to supply PriceCostco with reference brown goods on the grounds that the interior of its premises and pre- and post-sales service standards did not meet the criteria of Sony's PEDDA. In particular: the interior, exterior, decoration, merchandising and layout of their premises conflicted with Sony's standards and high-quality image; the stores visited had no satisfactory demonstration facilities and provided no appropriate assistance with installation and service; the merchandising, layout, point-of-sale information and display facilities did not provide the consumer with a reasonable opportunity to evaluate the products' potential to meet their current and future requirements; and there were insufficient sales staff (and those staff were not trained to sell high-quality consumer electronics equipment). In addition neither the overall look and feel of the premises nor their operations were compatible with the retailing of specialist consumer electronic goods. Following site visits to PriceCostco in 1994, Sony had written to PriceCostco explaining what improvements would need to be made before Sony would supply it with any of the reference brown goods. Sony had expressed a willingness to review its refusal to supply if PriceCostco would agree to upgrade its premises and offered to supply it with non-reference goods.

12.123. Panasonic said that it would not supply PriceCostco with reference goods although it did supply non-reference goods which it said required little pre- or post-sales input on the part of the retailer. The reference goods were becoming increasingly sophisticated and many consumers needed guidance in their selection of products. PriceCostco had put no resources into recruiting and training suitable staff to give this guidance. Panasonic also required its dealers to offer satisfactory after-sales service. PriceCostco did not provide it. Panasonic had real concerns over the lack of service facilities available at PriceCostco. Offering to replace a product would not overcome problems which might have arisen, for example in identifying how a product became defective and what consequent advice to give the customer. Along similar lines Panasonic did not regard PriceCostco's offer to exchange faulty goods without question as a satisfactory alternative to its providing after-sales service since many of the goods in question were difficult for consumers to transport safely. Moreover, Panasonic had concerns about the subsequent disposal of products returned to PriceCostco. Suppliers were expected to accept back any product returned by the customer and to provide PriceCostco with a full credit. Panasonic was not prepared to trade on those terms.

12.124. Panasonic said that its sister company in the USA (MECA) did considerable business with PriceCostco's US affiliate. Panasonic understood that MECA supplied directly to consumers (as was common in the USA) and accordingly PriceCostco's service arrangements were not such an issue. If PriceCostco were to expand and develop a national service system, it might meet Panasonic's dealer criteria.

12.125. JVC told us that PriceCostco had first expressed an interest in purchasing reference goods in 1993. Discussions had taken place but PriceCostco had failed to meet the requirements of JVC's Dealer Agreement, including a refusal to supply JVC with any financial information to enable a credit analysis to be undertaken.

12.126. Sanyo said that one of the reasons it had refused to supply PriceCostco was that its premises were not open to all members of the public. Moreover, the whole ethos behind Sanyo's selective distribution system was to ensure that its products were supplied to the end customer in a professional manner. To achieve this, Sanyo had to be able to monitor the quality of the whole supply chain, including point-of-sale and after-sales

service. Consequently Sanyo was prepared to sell reference goods only to dealers who were willing and able to undertake the responsibilities detailed in its Dealership Agreement. PriceCostco had also declined to undertake that it would not resell Sanyo's products to non-authorized dealers. Sanyo had offered to undertake a formal evaluation of PriceCostco's premises, most recently in September 1995, but PriceCostco had not responded.

12.127. Hitachi told us that the likely volume of business that might have accrued had it traded with PriceCostco would have been small and might not have justified opening an account. Neither had it been under pressure from PriceCostco which seemed to be able to obtain Hitachi's reference goods through other channels. Hitachi was not enthusiastic to supply warehouse clubs because they were a new trading format and Hitachi had doubts about their compatibility with Hitachi's brand image. Hitachi said that it did not believe it was consistent with EC law to impose on it a blanket requirement to supply warehouse clubs. Exemptions had been obtained under Article 85(3) by some of Hitachi's competitors 'enabling them not to supply outlets advertising at cash and carry prices'.

12.128. Mitsubishi said that it had refused to supply PriceCostco with televisions and VCRs in July 1993 but had suggested that its decision should be reviewed after one year. In August 1994 the OFT had written to Mitsubishi asking for an explanation of its refusal to supply PriceCostco. Mitsubishi had told the OFT that PriceCostco did not suit the dealer profile Mitsubishi had established under its open distribution policy. PriceCostco had requested supply from Mitsubishi twice subsequently, in January 1995 and latterly in June 1995. But Mitsubishi had told PriceCostco that Mitsubishi's open distribution system operated 'entirely at its discretion' and was not conditional in any way upon meeting criteria as to presentation, point-of-sale staff or after-sales service as PriceCostco had suggested. Mitsubishi said that PriceCostco still failed to meet the requirements of Mitsubishi's dealer profile. However, it had told PriceCostco that Mitsubishi's reference goods were available from many of its appointed dealers or other resellers.

12.129. Grundig told us that PriceCostco was unable to comply with the conditions in Grundig's Dealer Agreement.

12.130. PriceCostco's observations, and suppliers' responses to them, are set out in Appendix 12.2.

12.131. N&P told us that it had been refused supply for its Cargo Club business by:

(a) Panasonic, of televisions, hi-fi systems and camcorders;

(b) JVC, of televisions, VCRs, hi-fi systems and camcorders; and

(c) Toshiba, of televisions and VCRs.

12.132. Sony told us that it had refused to supply Cargo Club on similar grounds to those relating to PriceCostco (see paragraph 12.122). Sony had written to Cargo Club in July 1994 explaining the areas in which it would need to upgrade conditions before Sony could consider supplying it with any of the reference brown goods. Meetings between Sony and Cargo Club had followed but Sony had remained dissatisfied with Cargo Club's standards and had requested written plans for substantial alterations and operational changes it considered necessary. Discussions ceased when Cargo Club was sold in March 1995.

12.133. Toshiba told that us it had refused to supply Cargo Club on the grounds that to supply would not provide Toshiba with any incremental business.

12.134. JVC said that Cargo Club had applied to open an account in 1993; JVC had deferred making a decision until Cargo Club's proposed premises were available for inspection. In August 1994, following an article in *ERT* which said that Cargo Club had been unable to meet JVC's criteria for supply, JVC had suggested that Cargo Club should renew its application. But it had not done so and shortly afterwards closed for business.

12.135. Panasonic told us that it had offered to supply Cargo Club with non-reference goods which required minimal or no investment in pre- or post-sales service by the retailer.

12.136. N&P's observations, and suppliers' comments on them, are at Appendix 12.2.

12.137. Makro told us of the difficulties it had experienced in obtaining direct supply of reference brown goods. It had sold some brands for several years but had not been able to obtain leading brands, other than through diverters. In 1995 Makro had made a decision to upgrade the image of its brown goods range by stocking better-known brands. It appointed Business to Business as its associate (see paragraph 9.144) to improve its chances of obtaining supply: Makro believed suppliers which were reluctant to deal with Makro as a known discounter would supply Business to Business operating within Makro stores more readily.

12.138. Makro said that it had been involved in protracted discussions with Panasonic to obtain supply of reference goods since June 1994. In mid-1995, acting through Business to Business, Makro had reopened negotiations with Panasonic. (Panasonic had supplied Business to Business with office equipment for sale in Makro stores for eight years.) Panasonic had suggested a slowly developing step-by-step approach, starting with supply to a few of Makro's stores, whereas Makro wanted supplies for 12 stores. During this period (of six months or so) Panasonic had often missed or cancelled meetings, not answered letters and declared the sudden non-availability of key personnel. Panasonic, too, had ruled out supply of Technics hi-fi systems, on the grounds that Makro did not have sufficient technical expertise. Eventually, however, discussions on the Panasonic brand had proved fruitful and, with effect from September 1996, Business to Business had begun receiving supply of Panasonic reference goods.

12.139. Panasonic told us that there had never been any question of it refusing supply of reference goods to Business to Business. Following an initial presentation in June 1994, Panasonic had 'supported the notion'. The delay had occurred because of a change in concept by Business to Business. Panasonic had begun to supply Business to Business with hi-fi systems and audio products in May 1996, and televisions in September.

12.140. Makro told us that the only supplier which still refused to supply it was Sanyo. Other major suppliers had, at one time, refused it supply of reference brown goods. But in the months which had elapsed between Business to Business's involvement in the negotiation process and the time of our report, the position had changed. Makro, in those parts of its stores identified as Business to Business, was now selling a wide range of reference brown goods from leading suppliers.

12.141. Sanyo told us that it formerly supplied Makro but had ceased to do so in 1994 in accordance with its policy of not supplying wholesalers.

12.142. We asked suppliers which did not supply warehouse clubs whether their reluctance showed that they wished to discourage price discounting by retailers. All denied that there was any association between their refusal to supply and the warehouse clubs' discounting policies.

12.143. We asked some of the suppliers which supplied reference brown goods to mail order companies but not to warehouse clubs to explain the rationale for selling to the former and not the latter. We had in mind the fact that mail order companies are not able to exhibit the goods, nor provide advice by knowledgeable staff.

12.144. Sony told us that its criteria for mail order companies were equivalent to those it set for other retailers. A mail order catalogue was a substitute for a store and Sony applied the same criteria to it. Its standards were embodied in Sony's Mail Order Dealer Addendum (the Addendum) (see paragraph 12.22), which mail order retailers were required to sign if they were to be admitted to Sony's PEDANA network. Sony told us that the Addendum imposed various obligations including sale of the products through approved catalogues only and submission of the catalogues to Sony for approval prior to publication (although the dealer did not have to indicate prices or other sale terms in the proofs submitted). Sony also said that it required all catalogues to be well presented, on good-quality paper and with an overall quality image. They had to be issued on a seasonal basis or at other regular intervals, have good exposure and provide comprehensive and clear information and to offer delivery and the right to return.

12.145. Sony said that it reserved the right to decline to supply products which, in its opinion, were not suitable for sale through mail order. It added that mail order retailers had invested heavily in customer enquiry centres which customers could telephone for information about the goods. Mail order companies did not overreach themselves; they knew how to sell the products which were in their catalogues.

12.146. Panasonic shared Sony's view. It said that the mail order catalogues carried explanations of the benefits and features of products and the technology employed. Mail order companies provided installation services (where needed) and technical helplines, none of which were available at warehouse clubs. The ethos

of warehouse clubs was different, ie to keep the business lean and not to spend money on point-of-sale information, demonstration facilities, home installation, technical helplines and approval periods.

12.147. JVC said that it would only sell its products to a mail order company which operated a free home repair service during the manufacturer's normal guarantee period. Unlike the warehouse clubs, mail order companies had established telephone enquiry points. Some mail order companies also offered free installation of reference brown goods.

12.148. Sanyo said that it had specific approval criteria in its Dealership Agreement for catalogue and mail order houses, which included a requirement to use full colour pictures and comprehensive descriptions of the features and facilities of Sanyo's products in the catalogue. Provided these points were satisfied, Sanyo said:

The Catalogue, whether in a Catalogue shop or Mail-Order House, has substantially the same function and serves substantially the same purpose as the display and demonstration by trained staff. It may be that the information imparted is sometimes slightly less extensive than that available for example, from an independent dealer and the customer, therefore, will not have an opportunity for having his or her question answered. That however is a matter for the personal choice of the consumer in selecting to purchase by mail order/catalogue.

12.149. Sanyo told us that it expected mail order and catalogue companies to offer the same guarantee and after-sales service for its goods as any other authorized dealer. Since Argos met Sanyo's approval criteria, Sanyo supplied Argos with goods sold through its catalogue. Conversely, Sanyo had refused a request from Argos to supply goods to Argos's new venture, First Stop (see paragraph 9.70). This decision had been taken on the grounds that First Stop did not meet Sanyo's approval criteria for catalogue and mail order companies and, in particular, it did not issue a catalogue, did not offer pre- or post-sales service, and had no trained staff.

12.150. Kenwood said that mail order catalogues had always displayed a good range of hi-fi systems, including useful technical specifications. Mail order customers were a captive audience, loyal to that form of purchasing. Kenwood rejected a suggestion that it had been willing to supply mail order companies and not Makro because Makro offered discounted prices. Kenwood said that, in its experience, Makro charged standard high street prices.

### ***Multiple retailers***

12.151. Asda, which sells Sharp, Amstrad and Samsung televisions, VCRs and hi-fi systems obtained through a wholesaler, and the same reference goods directly from Alba and Bush, told us that it did not aim to sell the more expensive brands. It believed that, in practice, suppliers of premium brands would not supply it because of its low-margin, high-volume discount price strategy. Asda added that 'buying discussions are entertained but are not encouraged by the suppliers involved and in one way or another never reach a conclusion. A lack of supplier flexibility on cost price was cited as the primary reason'.

12.152. JLP told us that it was unable to reach an agreement with B&O for the supply of reference goods since it was not prepared to accept B&O's requirements in respect of stocking its full range and using a particular style of presentation. B&O withdrew supply of its reference goods from Sevenoaks Hi-Fi when it moved its Tunbridge Wells shop further along the same street. B&O said that its contract with the Tunbridge Wells branch of Sevenoaks Hi-Fi had been premises-specific. B&O also told us that Dixons had not felt able to continue with its application for supply of B&O products because agreement could not be reached on B&O's supply criteria.

12.153. Multiple retailers' observations and suppliers' comments on them are at Appendix 12.2.

## ***Small retailers***

12.154. Between 12 and 16 per cent of respondents to our survey of small retailers alleged that they had been refused supply of reference brown goods<sup>1</sup> (Table 19, Appendix 9.1). The grounds cited are shown in Table 20(e), Appendix 9.1. Twenty-seven observations from retailers of televisions; 25 VCRs; 31 hi-fi systems; and 13 camcorders concerned alleged refusal to supply because the location was already supplied (see paragraph 12.8). Some respondents alleged that they had been refused supply by more than one supplier. In all, 88 instances of alleged refusal to supply televisions were cited; 85 VCRs; 104 hi-fi systems; and 50 camcorders (Table 20(f), Appendix 9.1). In all cases in which a supplier was named, we followed up the retailer's observation. Those about which we were able to obtain sufficiently detailed information are shown, with the suppliers' responses, at Appendix 12.2.

## **Retailers' pressure on suppliers**

12.155. At a dinner which Dixons gave for its suppliers in September 1993, Dixons' Chairman said:

You will face the dilemma of whether or not you supply the warehouse clubs. Some here may succumb and try and ride two horses simultaneously—a fairly dangerous exercise. Others will try and fudge by supplying them only with special merchandise. There will be those who will claim colour blindness when confronted with grey shipments; those who suffer from cholesterol will at least have the advantage of knowing which side of the bread has the butter. But the far-sighted suppliers should be sensibly resolute. I believe there is a fundamental conflict with parallel distribution and you will have to consider which offers the most attractive option—cut-price or value-added retailers.

12.156. At the first hearing with Dixons in July 1995, we asked whether this speech had constituted an invitation to suppliers to infringe the RPA by refusing to supply a price-cutter.

12.157. In response, Dixons said that the speech had been a reflection of its concern about the planning constraints and higher rates that bore on retailers but not on wholesalers, with resulting advantages to the latter. In particular, discount warehouses sought to obtain an unfair competitive advantage by purporting to trade as wholesalers whilst intending to trade as retailers. If the net effect was to drive down prices on a broad front, this was not a sustainable proposition as far as Dixons, or any of the retail trades, were concerned. Dixons had seen from its experience in the USA where this development could lead; it wanted suppliers to consider the consequences.

12.158. In further evidence at the hearing Dixons said, in the context of the Chairman's speech:

we have a responsibility to seek to protect our business and not to be other than straightforward with our suppliers. We had to let our suppliers know that we would not just sit on the sideline and allow this to go on. We at no stage ever, directly or I would suggest by implication, said 'You should not supply them'. What we did say was 'If you go ahead with this, do understand that there will be a competitive reaction from us, and this *may* have an effect on your business'.

12.159. In September 1995, following up points raised at the July hearing, Dixons let us have a note on this matter, together with a copy of a letter written by its Chairman to the DGFT in December 1993 and a copy of the DGFT's reply. In the note Dixons said that the speech had reminded suppliers of Dixons' objective of selling at competitive prices, and with the appropriate degree of service, in an environment which purchasers found exciting. Dixons had added value to the products it sold by introducing new standards of service. To enhance customer satisfaction it had invested heavily in systems enabling it to monitor product performance. Manufacturers had enjoyed increased sales, so both they and Dixons had benefited from Dixons' initiatives. Manufacturers should reflect on the advantages to be derived by them from distribution systems which benefited from value-added services, such as those Dixons provided, compared with the returns manufacturers could expect from cut-price retailers. It was for manufacturers to decide for themselves, and

---

<sup>1</sup>The numbers varied slightly between retailers of each of the reference goods.

the Chairman neither suggested nor invited any supplier to refuse to supply PriceCostco or any other price cutter.

12.160. In October 1996 Dixons asked that in our report the quotation from the Chairman's speech should be introduced by the words:

In his speech, the Chairman noted that the cost of creating and developing Dixons' retailing environment was very considerable, and that manufacturers would benefit from gaining a much better understanding of the retail business generally, and of the issues which were of particular concern to consumers. In the context of the many services Dixons provided to customers, which included an extensive after sales service, the Chairman stated: ...

12.161. In February 1997, Dixons told us that its Chairman's speech:

was not an implicit invitation to refuse supply. [He] had spoken of the benefits to be had from distribution through a supply chain which assured customers of a full level of service: the cost of creating and developing Dixons' retailing environment was very considerable. Dixons regarded warehouse clubs as legitimate competitors, but deplored the fact that consumers could have a demonstration of the product they wanted at a Dixons' store with a view to buying it at a lower price from a warehouse club.

A supplier of electrical goods who was in the audience told us that he had gained the clear impression from the speech that suppliers which decided to deal with 'discount companies such as [Price]Costco and Cargo Club' would not receive custom from Dixons.

12.162. Dixons told us on a separate occasion that outlets such as warehouse clubs which provided minimal pre-sales information were 'free riding' on the service available at other retailers who offered a high level of competent pre-sales service and incurred costs accordingly. Several small retailers made the same point.

12.163. Sony told us that suggestions and requests from retailers that Sony should not supply certain dealers were not uncommon; Sony did not regard itself as being put under any pressure by these requests. Panasonic said that it could identify only one case in the period since 1 January 1993 where it had kept a written record of a dealer expressing concern at the prospect of Panasonic supplying a new dealer in the same area.

## **The legal position on selective distribution**

12.164. In the UK, selective distribution systems do not normally require registration under the RTPA. However, provision exists under the FTA and the Competition Act 1980 for the MMC and the OFT to investigate the effects on the public interest of such systems.

12.165. In addition, the provisions of the RPA make it illegal for a supplier to refuse to supply goods to a dealer on the basis that the dealer has sold or is likely to sell such goods below the RRP set by the supplier (see Appendix 6.2).

## **EC aspects**

12.166. We were mindful of the fact that our terms of reference require us to consider the questions which had been referred to us by the DGFT from the point of view of the effect on the UK public interest, and did not require us to decide whether a particular matter was in breach of EC law. Nonetheless we thought it important to have the advice of DGIV of the European Commission.

12.167. We noted that the ECJ has recognized that competition concerns are not the exclusive preserve of EC law. The ECJ has said<sup>1</sup> that EC and national competition legal regimes may consider anti-competitive practices from rather different points of view. Whereas Articles 85 and 86 of the EC Treaty are designed to deal with competition issues which affect trade between member states, national law arises from and may involve considerations particular to the relevant individual member state. Given these different types of concerns at the EU and national levels, it therefore follows that, where appropriate, national competition law authorities may take action with regard to situations that infringe their regulatory systems subject, however, to the condition that the application of national law may not prejudice the full and uniform application of EC law or the effects of measures taken or to be taken to implement it.<sup>2</sup>

12.168. Article 85(1) states, *inter alia*, that the following shall be prohibited as incompatible within 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 ....

12.169. It has been put to us by several parties that as the European Commission and the ECJ have accepted that certain selective distribution systems for consumer electronics products are not caught by Article 85(1) or are suitable for exemption under Article 85(3), the MMC should not make recommendations which would restrict the ability of suppliers to operate such distribution systems.

12.170. We were advised that in past cases the European Commission and the ECJ have been inclined to accept selective distribution systems in certain circumstances, with each case having been considered on its own merits. Their view appears to be that such systems fall outside Article 85(1) in some circumstances, and even if they come within Article 85(1) they may fulfil the requirements for exemption under Article 85(3). Benefits which may be taken into account include the maintenance of a specialist trade capable of providing specific services in the context of transactions concerning high-quality and high-technology products. In general terms, for a selective distribution system to fall outside Article 85(1):

- (a) dealers should be selected solely on the basis of non-discriminatory qualitative criteria relating to their technical ability to handle the goods and the suitability of their premises and staff;<sup>3</sup>
- (b) the nature of the product(s) in question must justify the application of a system of selective distribution;
- (c) the qualitative criteria applied should be necessary to ensure an adequate distribution of the goods;
- (d) all suitably qualified dealers, if they so wish, should be admitted to the supplier's selective distribution system;
- (e) the dealers must not be subject to any restrictions on competition other than a ban on sales to unauthorized resellers; and
- (f) weaknesses in inter-brand competition should not be reinforced as a result of competing manufacturers applying selective distribution.

---

<sup>1</sup>*Procureur de la Republique v Giry & Guerlain SA* [1980] ECR 2327.

<sup>2</sup>*Walt Wilhelm v Bundeskartellamt* [1969] ECR 1.

<sup>3</sup>This is what is sometimes referred to as a 'simple' selective distribution system: see *Metro v Commission* [1977] ECR 1875.

12.171. Article 85(1) may apply if the supplier seeks to impose additional or quantitative requirements which, for example, set turnover or sales targets for the dealers to achieve; stipulate minimum stock levels to be held by dealers; and impose other obligations on dealers to promote the supplier's goods.

12.172. In particular Article 85(1) is likely to apply if the additional or quantitative requirements either in form or effect seek to limit the number of dealers to be appointed in any given area.

12.173. Consequently, in assessing whether or not Article 85(1) is applicable in any particular case, the European Commission (and, where relevant, the ECJ) will take into account the nature of the product and whether it merits the supplier's requirements. Furthermore the features of the relevant product market will be considered and in particular whether effective competition exists in that market. It could be the case that even if the selective distribution system satisfies the conditions stated above (in that it contains only non-discriminatory qualitative requirements and is open to all suitably qualified dealers), it may still be caught by Article 85(1) in that it is detrimental to competition in the particular product market. If an agreement is within Article 85(1), the question whether it fulfils the requirements for exemption under Article 85(3) arises.<sup>1</sup> Conditions may change from time to time. Any exemption can be revoked, amended or not renewed.

12.174. The European Commission examined the market for consumer electronics products within the EU as a whole when considering the application by Grundig AG for an extension of the exemption for its selective distribution system. In its decision of 21 December 1993<sup>2</sup> approving the extension of Grundig's individual exemption, the European Commission noted the following features of the market for consumer electronics products and of the operation of Grundig's distribution system:

- (a) the market was keenly competitive;
- (b) Grundig dealers were free to set their own prices;
- (c) there was a sufficient number of comparable competitive products from other manufacturers being distributed via different distribution channels, in particular discount stores and cash-and-carry outlets, to ensure that consumers had sufficient choice between more service and more price-oriented ways of distribution; and
- (d) Grundig's selection criteria were applied in a non-discriminatory fashion.

12.175. Sony notified its PEDAs, ie its selective distribution system (see paragraph 12.20), to the European Commission and received a comfort letter in July 1995 to the effect that there were no further grounds for action by the European Commission in respect of the PEDAs. Sony put it to us that (based on the EC rules and policy considerations underlying them) the MMC should refrain from interfering with the full and proper application by Sony of the PEDAs in the UK. Sony said that the PEDAs had been held to be compatible with EC law following an extensive and thorough review by the European Commission including publication in the *Official Journal*, inviting interested parties to make comments, and the PEDAs ought not to be held to prejudice the public interest in the UK. In Sony's view an essential element of the European Commission decision approving a pan-European dealer agreement was the European Commission's positive finding that distribution was improved by the application of a uniform distribution policy throughout the EU. Sony said that the uniform application of EC law would clearly be impeded if an exempted pan-European agreement were to be prohibited in some member states by the operation of stricter national law.

12.176. We put Sony's view to the European Commission. It told us that it did not believe that a comfort letter or decision by the European Commission had the effect of preventing the UK competition authorities from pursuing their investigation in a related matter under national law. However, it would wish to be informed before any action was taken on the basis of any recommendations which we might wish to make.

12.177. JVC's parent company, Victor, notified its standard form of distribution agreement to the European Commission in 1980 and received a comfort letter from it in June 1988.

---

<sup>1</sup>We understand that an exception is not likely to be granted in respect of a selective distribution system containing requirements which seek to impose territorial restrictions on the resale of products, restrict parallel imports or which can be used by the supplier to control the level of prices.

<sup>2</sup>OJ No L.20, 25.1.94, p15.

12.178. B&O told us that it had notified its current 'EEC Distribution Agreement' to the European Commission for negative clearance/exemption on 19 June 1989. It received a comfort letter from the European Commission dated 10 August 1989.

12.179. Sanyo told us that on 31 May 1995 it had notified the European Commission of its selective distribution system with a view to obtaining a comfort letter. The European Commission was still considering Sanyo's case when we completed our report.