

7 Views of BEW

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Response to the reference

Introduction

7.1. BEW said that in May 1993 the DGFT had made a monopoly reference, asking the MMC to investigate 'the supply to retailers of refrigerated cabinets on terms which prevent the retailer from using the cabinet to stock for sale ice cream supplied by other suppliers'. In the course of the resulting inquiry the MMC had scrutinized BEW's wholesale distribution system because it was an issue raised by other parties. The MMC had concluded that wholesale distribution fell outside their terms of reference and observed that BEW's concessionaire¹ network was: 'a highly efficient method of distribution for BEW, and has contributed to BEW's strong competitive position. It is a development of BEW's own previous in-house distribution system, to which BEW would be free to revert although at some cost, and against which some of BEW's competitors acknowledged they would have fewer grounds to object'.

¹BEW's 'concessionaires' were subsequently restyled 'dedicated distributors'; BEW told us that in March 1998 there were 29 of them, operating in 35 territories.

7.2. In 1996 the OFT began an inquiry into BEW's wholesale distribution arrangements. This led BEW to offer various undertakings, including detailed proposals for new terms for distributors that followed, and reflected, work done for it by KPMG. The OFT did not accept these undertakings, but BEW decided to implement them to put an end to the uncertainty that its dedicated distributors had undergone while the inquiry proceeded. The new terms were introduced on 29 March 1998.

7.3. BEW said that subsequently, in exchanges with it on the scope of our inquiry, the OFT had confirmed that it had not been its intention to include mobilising terms within the scope of the reference, but had chosen to include refusal to supply ice cream to non-dedicated wholesalers (although BEW had made it clear that it had no policy not to supply non-dedicated wholesalers and had offered an undertaking to this effect).

7.4. BEW said that on 22 December 1997 the DGFT, when making the reference, had stated that 'other [non-dedicated] wholesalers, where they are supplied, get ice cream on what the [OFT] considers to be less favourable terms'. BEW said that this was incorrect: the vast majority of distributors received comparable terms to those of dedicated distributors, and some received substantially better terms.

7.5. The DGFT had also said that the retailers' end-of-year bonus was available only on purchases from dedicated distributors. But BEW said that it had already offered an undertaking to take into account all verifiable purchases of its products for the calculation of retailer bonuses. This was being implemented, so BEW suggested that the matter was not an issue for our inquiry.

7.6. The DGFT, too, had suggested that, if wholesalers did not receive the same terms as dedicated distributors, then many retailers would continue to buy from those distributors, even if that meant those retailers could not obtain other popular brands of ice cream. This implied that, for many retailers, the only potential source of other brands was dedicated distributors. BEW said that this was unfounded: retailers who bought BEW's ice cream from dedicated distributors were free to purchase other brands from wholesalers, and the OFT had produced no evidence to the contrary. Research commissioned by BEW confirmed that over one-third of retailers used wholesalers.

7.7. Finally, the DGFT had suggested that BEW's distribution system restricted consumer choice and hindered market entry. BEW said that its distribution arrangements had negligible impact on consumer choice and none on market entry.

7.8. BEW said that the OFT had asked it to look at whether the costs to the dedicated distributors of providing the extra services which it had from them were justifiable. BEW agreed to do so, but its position remained that it was looking at an integrated marketing, selling and distribution system, and it was not prepared in any sense to compromise on that. BEW would have liked the OFT to accept its argument, but it did not. BEW said that it had asked the OFT: 'What is it in our attempted costs justification that you find it difficult to accept? Is it the figures or are there particular elements in the distribution service that you have difficulty in differentiating, for example, from what a general wholesaler could supply?' BEW said that the OFT was reluctant to allow differential terms of possibly up to 7 per cent of list price for dedicated distributors, but gave no reasons for that view: the OFT appeared to think this was a payment for exclusivity and nothing more.

7.9. In the course of our inquiry BEW told us that it assessed dedicated distributors' costs, on the one hand, against those of its own operation at Barking (see paragraph 7.25) and general industry benchmark data, on the other hand. BEW was satisfied that the two were broadly comparable, even if each distributor had a different set of customers, often with a markedly different geographic territory with different circumstances.

BEW's commercial principles

7.10. It seemed to BEW that the OFT, in considering BEW's operations, had in mind a simplified model of cost-minimizing distribution appropriate to undifferentiated commodity products. Hence, the OFT was critical of BEW's distribution arrangements in part because they precluded other arrangements that could or would reduce the costs of physical distribution of the products, a contention with

which BEW did not agree. Much of the criticism was focused on BEW's arrangements for its dedicated distributors.

7.11. BEW said that as the OFT was thinking in terms of simplified cost-minimizing arrangements appropriate for undifferentiated commodity products, its approach was seriously misconceived when it applied that model, implicitly or explicitly, to the marketing of differentiated, branded, frozen consumer products, like impulse ice cream, affected by acute fluctuations in demand. Such an approach ignored the critical role of a manufacturer's marketing and promotion activities for branded products, and the important part that both wholesalers and retailers could play in a manufacturer's optimal marketing and promotional mix.

7.12. BEW said that special features affected the distribution of wrapped ice cream:

- (a) it was essential that the 'cold chain criteria' were observed, ie that the products were kept appropriately refrigerated at all stages of distribution, and kept in the most favourable condition, until they were bought by consumers;
- (b) flexible and adaptable delivery methods and practices were essential to ensure that the products were available in sales outlets; this reflected the impulse nature of purchases, the high degree of seasonality on the demand side, and unpredictable variations in weather (especially during the short period of peak demand);
- (c) the need for the availability of the products in as many sales outlets as were required to meet consumers' impulse demand, often in non-traditional retail sales outlets; and
- (d) the need for effective availability and visibility of the products in the sales outlets, displayed to appeal to each consumer age group.

7.13. BEW told us that its 'strategic vision', or 'triangle' concept, integrated these special features by concentrating on product innovation, advertising and promotion, and wide availability through effective distribution. It took a large-scale approach to planning, and a small-scale approach to production, sales and marketing. BEW believed it had been successful in the wrapped ice cream business by working within these key areas.

7.14. BEW's business relationship with each of its dedicated distributors was evolving towards a partnership; this system developed from one in which BEW itself carried out the distribution of its impulse ice cream to sales outlets. The partnership relationship had as its goal the motivation of both parties, enabling them to operate to their mutual advantage, and achieve better results.

7.15. Thus, the dedicated distributor was motivated to seek out new outlets for BEW's reference products; to ensure that they were effectively displayed in accessible locations within each retail outlet; to encourage outlet owners to carry a wide range of the products, particularly those that were new to the market; and to seek to maximize the impulse sales of BEW's wrapped ice cream. The dedicated distributor had an incentive to devote his enterprise, initiative and resources to achieving this end since it would maximize the profitability of his own ice cream distribution. His incentive was increased by his having the benefit of the protection he derived from being given a 'principal sales area' by BEW. This encouraged him to increase the number of sales outlets, improve their performance and reduce the impact of seasonality of demand, thereby making a wide choice of products available to consumers.

7.16. BEW, for its part, had a strong incentive to use its wide experience to improve the operating methods, procedures and systems of its dedicated distributors. It knew that competing manufacturers could not enjoy the improved physical distribution that would result, in part, from this application of BEW's efforts and expenditure. For that reason BEW had less incentive to use its resources to improve the distribution operations of general wholesalers for impulse ice cream.

7.17. The partnership nature of BEW's dedicated distributor system served to promote a commonality of commercial objectives which contributed to improvements in efficiency. It made possible the constructive review by BEW of each dedicated distributor's annual business plan. This review and the associated discussion gave BEW greater assurance that the dedicated distributor would be

commercially viable and assisted him to be more effective in reducing the impact of seasonality, and to set realistic business targets.

7.18. BEW said that it aimed to reward its dedicated distributors at a level that enabled them to carry out their activities efficiently and effectively. It also recognized the need to ensure that they could afford, and had the incentive, to replace and modernize their assets. BEW had no incentive to exploit its dedicated distributors by under-rewarding them: that would be counter-productive. At the same time it was not in BEW's interest to remunerate them excessively. From the point of view of its profitability, there was no reason for it to give its dedicated distributors discounts and bonuses in excess of what it considered necessary for them to operate effectively, to maintain their viability and to reward demonstrated enterprise and performance appropriately. There was no risk that BEW would deliberately over-remunerate dedicated distributors so that otherwise eligible general wholesalers could not compete fairly with them in the supply of BEW's impulse ice cream products.

7.19. BEW said, however, that it had no information, other than what was on the public record, on whether dedicated distributors' margins were excessively, or insufficiently, profitable. BEW's concern was that the dedicated distributors should invest for the future: it needed to make sure that together they formed a viable distribution network for the bulk of its wrapped impulse ice cream. The prominence given to business planning in the new terms for dedicated distributors reflected this concern.

7.20. BEW said that no data were available to enable it to quantify the full financial benefits extended to the dedicated distributors, although it believed they would have varied from case to case. Among the benefits offered to the dedicated distributors when they were established were: free software and IT support; second-hand BEW office furniture at low prices; refrigerated vehicles at normally depreciated prices; references to banks; the provision of accounts to be serviced within the dedicated distributor's territory; assistance in setting up administrative procedures; training for sales staff; and deferred payments in the first year of business. BEW said that it was aware of having given only one bank guarantee and one loan (but also showed us evidence given to the 1994 inquiry in which a BEW witness, in response to the question: 'Did you give [dedicated distributors] some capital to start?' had said 'We gave them funding which they have paid back over a number of years').

7.21. If a general wholesaler were as efficient, in carrying out the physical distribution functions, as a dedicated distributor within the BEW system it did not follow that BEW would be indifferent in choosing between them. The crucial role of the dedicated distributor lay in the implementation of BEW's marketing and promotional policy. For that reason Unilever (BEW's parent company) had opted for dedicated or in-house distribution in virtually every other European market and in new markets such as China. The central part played by marketing and sales promotion distinguished the marketing and distribution of differentiated branded products from that of undifferentiated commodity products. For the manufacturer of branded consumer products, cost minimization in physical distribution was not the sole objective or criterion in the choice of distribution channels and methods. The manufacturer of unbranded, undifferentiated commodity products, on the other hand, had no need for a marketing and promotional policy.

7.22. BEW aimed, broadly, at maximizing the profitable sales of its wrapped ice cream products. To achieve this, it had to persuade consumers to choose its branded products in preference to the products of its competitors. This involved, among other things, advertising its brand to consumers, retailers and the owners of other sales outlets, so that more of its branded products were sold at any given price. (BEW told us that nonetheless the UK wrapped ice cream market in the years 1990 to 1997 had been 'flat': it estimated that sales, adjusted to take account of the weather, had been about 1 per cent greater in 1997 than in 1990, although with rather larger variations in the intervening years.)

7.23. BEW also said that ice cream sales probably accounted for about 1 per cent, or slightly less, of the turnover of CTN shops. It followed that it would not be true to say that the commercial success or failure of CTN shops would depend upon their sales of BEW's ice cream.

7.24. BEW sold directly to many large customers. These 'direct-account' sales proceeded side by side with those of dedicated distributors and of general wholesalers handling BEW's impulse ice cream. These sales reflected the importance of the retailers in question, their preferences, and the fact

that their outlets were widespread. A direct account customer could choose the source of its supply. In practice a majority had chosen to obtain supply from dedicated distributors. Dedicated distributors were rewarded specifically for servicing direct account customers, but at a lower rate than for 'indirect account' customers, which they sold to and invoiced as principals. But, acting through the dedicated distributor and his employees, BEW was virtually as close to the final sales outlets as it would be if it delivered its goods direct to them.

7.25. BEW said that within the area enclosed by the M25 it used Exel, at Barking, to provide what was in effect a dedicated distributor service. Exel operated from a depot owned by BEW and was supported by separate teleselling and merchandising operations. The area within the M25 was a dense market with a large number of retail outlets, but it lacked the distribution resources on which the regime of dedicated distributorship had been based elsewhere in the UK; in particular, it would not have been practicable to divide the area into dedicated distributors' territories.

7.26. The general wholesaler, unlike the dedicated distributor, was not committed to the branded wrapped ice cream products of a particular manufacturer: the general wholesaler carried the branded products of competing manufacturers if there was a profitable demand from its customers for them; its business objectives were not harmonized with those of BEW; it was in no way an extension of any particular manufacturer, and did not have the same close interest in consumer benefits in terms of availability and choice: it was essentially a physical delivery function. It was clear, therefore, that a general wholesaler could not provide BEW with the specifically brand-orientated marketing and sales promotional services that a dedicated distributor provided, both actively and passively, and that in coping with the special features (see paragraph 7.12) that affected the distribution of wrapped ice cream a dedicated distributor might be expected to perform more effectively than a general wholesaler.

7.27. BEW told us that large retailers which might wish to hold direct BEW accounts could choose whether to be serviced by general wholesalers or dedicated distributors. By way of example, BEW identified seven large accounts which were with general wholesalers, and also identified several much smaller accounts involving regional wholesalers in a similar way.

7.28. In discussion of the new terms that BEW extended to its dedicated distributors with effect from 29 March 1998, BEW said it did not expect that their introduction would change the pattern of market shares handled by dedicated distributors and independent wholesalers.

7.29. The marketing and sales promotional services that a dedicated distributor provided were of considerable value to BEW, although it was extremely difficult for either party to measure, or even reliably estimate, the additional costs a dedicated distributor incurred in generating the marketing and sales promotional services. The difficulties of measurement reflected the provision of the services by the dedicated distributor's presence, by his physical distribution of the products, and by his discovery of new sales outlets for BEW's wrapped ice cream products in the course of the normal activities of his job.

7.30. BEW stated, however, that the means of distribution that it adopted in different national markets had no effect on the volume of consumption of its impulse ice cream products: the volume depended on BEW's promotional efforts, but was greatly influenced by cultural differences between the markets. (For example, consumption of ice cream products per capita in the Irish Republic was three times that in the UK, but in France it was less than one-third of the UK figure.)

Courses of conduct

Refusal to supply non-dedicated wholesalers

7.31. BEW said that it did not in general supply other manufacturers of wrapped impulse ice cream. It did not accept that it had refused to supply wrapped ice cream to wholesalers other than dedicated distributors in the period from 23 December 1996 to 22 December 1997. It did not have a policy of refusing supplies to national or regional wholesalers. It drew our attention to three cases in which UK wholesalers had sought supply from it during the reference period. In the first case the

wholesaler had not responded to BEW's request for a written outline of his proposals, and in the second case the wholesaler had not responded to BEW's offer of terms. BEW did not consider either of these wholesalers to have been refused supply. In the third case the wholesaler's premises did not meet BEW's cold chain criteria. BEW told us that its only restrictions on supply were that the wholesaler should be creditworthy, meet minimum order size requirements, and possess adequate storage and transport facilities to preserve the cold chain.

7.32. BEW also drew our attention to its regular *Mobiling Newsletter*. In Issue 9 of 1997 it had said, 'We continue to monitor the activities of all our agents [mobiler wholesalers] and, where necessary we have either reduced terms or ceased supplying 8 agents this year [1997]. This reflects the operation of a number of agents who wish to carry out activities other than mobiling', for example to undertake shop deliveries as a wholesaling activity.

7.33. BEW told us that it had offered the OFT an undertaking on 11 September 1997 to supply all wholesalers fulfilling certain objective minimum criteria (excluding those wholesalers connected by common control with a competing manufacturer).

7.34. BEW invited us, in the absence of any direct evidence of refusal to supply, to find that it had not pursued this course of conduct in the relevant period. BEW said that, since it was unaware of any specific cases of refusal to supply, it could not comment on whether this would constitute a course of conduct or whether it would be anti-competitive or whether it would have any adverse public interest effects. As to the question of supplying wholesalers who were connected to competing manufacturers it could only comment hypothetically.

7.35. BEW said that the EC jurisprudence on this issue was quite clear. In *United Brands v Commission*,¹ United Brands had refused to supply Olesen following the latter's appointment as exclusive distributor of United Brands' main competitor. The Court held that 'the fact that an undertaking is in a dominant position cannot disentitle it from protecting its own commercial interests if they are attacked and ... such an undertaking must be conceded the right to take such reasonable steps as it deems appropriate to protect its said interest'. Likewise, in *BBI/Boosey & Hawkes*² the EC Commission had to consider whether Boosey & Hawkes was entitled to stop supplying a long-standing distributor when it set up competing manufacturing operations. The EC Commission held that, whilst Boosey & Hawkes was obliged to give a reasonable notice period before terminating supplies to the distributor in question, 'there is no obligation placed on a dominant producer to subsidise competition to itself'. BEW's situation was a fortiori in that it had had no long-standing supply arrangements with any substantial competing manufacturers.

Refusal to supply non-dedicated wholesalers except on terms, or with benefits, less favourable than those accorded to dedicated distributors

7.36. BEW said that the DGFT, in making the reference, appeared to proceed on the assumption that all non-dedicated wholesalers received poorer terms than dedicated distributors. This was incorrect, as had been shown in data supplied to the OFT in May 1996 and June 1997. These data had not been challenged by the OFT.

7.37. Major national wholesalers and cash-and-carry stores received terms which were more favourable than those given to dedicated distributors. These terms ranged from 25 to 28.8 per cent off GSV depending on the size of the retrospective bonus, compared with a discount of 20 per cent to dedicated distributors for their indirect accounts (ie accounts comparable to those served by general wholesalers). For direct accounts and buying groups the discounts of dedicated distributors were even lower, respectively 13 and 15 per cent off GSV. In addition they received a retrospective discount of up to 1.5 per cent. The vast majority of regional wholesalers had negotiated basic terms of 20 per cent off GSV; a handful in the catering category received terms ranging from 12.5 to 18 per cent; and a few in the non-catering category received a discount above 20 per cent but less than 25 per cent.

¹Case 27/76 [1978] ECR 207.

²OJ 1987 L286/35.

7.38. The turnover of those wholesalers receiving less than 20 per cent discount (ie less than the basic discount received by a dedicated distributor for indirect accounts) represented less than 2 per cent of BEW's wrapped impulse ice cream turnover. BEW said that, in view of the *de minimis* nature of such cases during the reference period, its practice in giving discounts below 20 per cent could not be characterized as a 'course of conduct'. That would imply that there was some systematic policy which had a given effect. But that was not the case here.

7.39. First, BEW submitted that, as a technical matter, the course of conduct as specified had not been pursued. As drafted, the course of conduct specified was the refusal to supply any non-dedicated wholesalers except on less favourable terms. That was not the case, because BEW has supplied major national wholesalers and a large number of regional wholesalers on better or equivalent terms.

7.40. Second, BEW said that it had been a consistent practice of the MMC since their 1981 report on *Discounts to Retailers*¹ not to interfere with freely negotiated prices, reflecting the volumes purchased and relative bargaining positions of buyers, unless they were set by an undertaking with market power and were deterring new entry or stunting the development of new brands. That was clearly not the case in the wrapped ice cream market in the reference period. The handful of wholesalers who had not received equivalent discounts to those obtained by dedicated distributors took substantially lower volumes. It was scarcely surprising, therefore, that their terms were rather less favourable.

7.41. Third, as to new entry and expansion, BEW said that it had been suggested that its dedicated distribution system was an essential facility for market participants. But BEW thought this a misconception. Mars had been successful initially, but had failed to invest sufficiently in new products, marketing and brand assurances, availability, visibility and distribution and as a result had failed to capitalize on the opportunities of the short summer season which could make all the difference to business performance. Treats had succeeded in increasing its market share in wrapped ice cream from 5.6 per cent in 1995 to 6.4 per cent (by volume) in 1997, and it had introduced major new brands, including the Ribena brand under licence. Nestlé, too, had successfully introduced several new brands in the reference period. Other examples of successful new entry or new brands were the German producer, Mövenpick, and in 1998 Frederick's new launches under the Cadbury brand. Furthermore, the weighted and nominal distribution penetration of several of BEW's competitors had risen since 1993.

7.42. BEW then addressed the effects this course of conduct might have on the public interest, if we were to find it anti-competitive.

7.43. BEW said that there was no evidence showing that retailers were paying higher prices either for BEW products or for other manufacturers' products as a result of BEW according slightly lower discounts to a few wholesalers than to its dedicated distributors. There was no reason why retailers should be paying higher prices: they could always obtain supplies of BEW's products from those dedicated distributors or national wholesalers that were best placed to offer them the most competitive prices. Fewer than 2 per cent of BEW's sales to wholesalers were on terms less favourable than those given to dedicated distributors. Further, the price of competing brands was unaffected by the prices BEW offered to dedicated distributors and other wholesalers. The suggestion that the cost of distribution for competing brands would be lower if they could be supplied by BEW's dedicated distributors concerned the exclusive purchasing obligation on those distributors. But this was not a practice within the terms of reference of our inquiry.

7.44. As to the level of distribution service, BEW said that it was a public interest benefit which retailers enjoyed. This was corroborated by repeated surveys (1993, 1995, 1996 and 1998) of retailers, demonstrating that satisfaction with BEW's distribution was particularly high in the area of speed of delivery and replenishment of stocks. Whether competitors' products were unable to benefit from the high levels of service achieved through dedicated distribution was a matter that concerned exclusivity: it was not a matter for our inquiry. BEW did not think the issue of a single delivery was strictly about ice cream: it tended to be an issue only for those outlets selling many other food and drink products, for whom it was convenient to receive all these products in a single delivery.

¹*Discounts to Retailers: a report on the general effect on the public interest of the practice of charging some retailers lower prices than others or providing special benefits to some retailers where the difference cannot be attributed to savings in the supplier's costs*, HMSO, HC 311, May 1981.

7.45. BEW said that it had seen no evidence to suggest that differential terms for wholesalers led to consumers paying higher prices or having a restricted choice of products. In BEW's experience retailers very rarely sold at below the RRP but frequently sold above it. In 1994 the MMC had concluded (in paragraph 3.81 of their report):

We were told that RRPs are generally observed in independent CTNs but this is not the case in leisure centres, petrol forecourts, motorway service stations and some convenience stores, where actual retail prices can be significantly higher than those recommended. BEW told us that one of the larger CTN chains does not adhere to RRPs in selling impulse ice cream in its outlets but adds 2p to the RRP on all lines stocked. It is not usual for retailers to charge prices below RRP.

BEW saw no cause for revising that conclusion. Indeed, it had been overwhelmingly endorsed by a recent survey.

7.46. The same argument applied to consumer choice. In their 1994 report the MMC had concluded that there was 'wide availability of the main brands' and no substantial restriction on consumer choice as a result of freezer exclusivity. It was unsustainable to suggest that discount differences to wholesalers affecting less than 2 per cent of BEW's wrapped ice cream turnover were having an appreciable effect on consumer choice.

7.47. The third issue was whether any wholesalers had been unfairly disadvantaged in the development of their businesses. There had been few complaints of this. Several factors might account for that fact. First, wholesalers receiving terms less favourable than dedicated distributors accounted for less than 2 per cent of BEW's wrapped ice cream turnover. Second, between 70 and 80 per cent of regional wholesalers' turnover was accounted for by frozen food. By contrast wrapped ice cream was a small portion of the remainder. Consequently, the terms on which these wholesalers bought wrapped ice cream were unlikely to affect their profitability. Third, regional wholesalers which obtained less favourable terms than dedicated distributors were likely to be smaller businesses buying much smaller quantities of ice cream and other frozen foods. It was hardly surprising, therefore, that they received less favourable terms. Fourth, regional wholesalers' difficulties, in maintaining or expanding their businesses, reflected competition from national wholesalers which offered retailers better terms.

7.48. Finally, there was the question of whether other manufacturers of wrapped ice cream had found entry or expansion more difficult as a result of BEW's wholesale discount structure in the reference period. BEW said that Mars argued that if BEW's distribution system were available to all manufacturers everyone's unit costs of distribution would be reduced. But this argument focused entirely on the cost of physical distribution, notably delivery. That might be appropriate for undifferentiated commodities but was entirely inappropriate for strongly branded goods, like wrapped ice cream, which also posed acute problems for distribution. The argument also exaggerated the impact of a small reduction in delivery costs on retail sales. At retail level the popularity of the brand and its availability at the right moment counted for far more than a small potential variation in wholesale price.

7.49. BEW said that its distribution channels were considerably wider and more diverse than would be the case with in-house distribution or total reliance on dedicated distributors. Furthermore, the practice referred for investigation was not exclusivity as such but the much narrower issue of allegedly less favourable discounts to a limited number of wholesalers. BEW thought it inconceivable that these had operated as a barrier to entry for other manufacturers.

Retailers' discounts on purchases from dedicated distributors but not on purchases from other suppliers

7.50. BEW initially identified two practices relevant to this course of conduct. These were:

- (a) the annual differential bonus set out on the back of its price list; and
- (b) a bonus granted to certain seasonal accounts to assist them in the short summer selling season.

BEW accepted that it had engaged in these practices in the 12 months preceding the reference. The description of the practice in the terms of reference, however, was not entirely accurate. The bonuses were paid on all purchases of BEW products from its dedicated distributors. The fact that a retailer might also have purchased BEW products from other sources did not disqualify him from obtaining the bonuses on purchases from a dedicated distributor.

7.51. BEW did not accept that either of these practices had or was intended to have or was likely to have the effect of restricting, distorting or preventing competition within the meaning of section 2(1) of the Competition Act. The reason for the way in which the bonuses were calculated had been discussed in the course of the 1994 inquiry. BEW's dedicated distributors were the only wholesalers with details of sales to retailers which could be passed on to BEW and so enable it to apply the correct bonus scale and make the payment. It had not been thought until recently that other wholesalers had the systems to be able to produce verifiable data on their sales of BEW's products which could be taken into account by BEW in calculating the retailer and seasonal bonuses.

7.52. BEW submitted that its practice had been dictated by logistical considerations. It could be seen to have had no significant effect. There were four reasons for this:

- (a) the volume of BEW's products going through general wholesalers had varied quite substantially over the years; the percentage of BEW's wrapped ice cream sales through wholesalers and cash-and-carry stores was estimated to have risen by some four percentage points between 1993 and 1995;
- (b) it was clear that retailers had been willing to change their sources of supply, which suggested that general wholesalers had been well placed to compete with dedicated distributors;
- (c) general wholesalers representing 87 per cent of BEW's wrapped ice cream sales through the wholesale/cash-and-carry channel received substantially better terms from BEW than did the dedicated distributors: this had enabled general wholesalers to offer retailers terms which were at least as favourable as those offered by dedicated distributors; and
- (d) the fact that so few general wholesalers had applied to BEW to benefit indirectly from the annual or seasonal bonuses suggested that the issue was trivial.

BEW therefore invited us to conclude that, even if the practice amounted to a course of conduct, it was not anti-competitive.

7.53. BEW did not believe that the specified practices had had any adverse public interest effects. In the case of large national wholesalers their highly favourable overall terms amply compensated them for the fact that they did not benefit indirectly from the bonuses. National wholesalers tended to focus their efforts on large national retail accounts, which BEW negotiated direct. Those negotiations usually led to a package of terms which made any annual or seasonal bonus unnecessary. In such cases it was hard to see how the practices could disadvantage general wholesalers in any way in relation to dedicated distributors. In the case of regional wholesalers their main area of activity had tended to be in the catering channel where the bonuses did not apply. This probably accounted for the general lack of interest shown by regional wholesalers in participating in these bonus arrangements.

7.54. BEW said that for these arrangements to constitute substantial barriers to entry for other manufacturers at least two conditions would have to be met:

- (a) They would need to operate as a powerful incentive for retailers to purchase their requirements of BEW ice cream products from dedicated distributors rather than from general wholesalers. But the ability of general wholesalers to negotiate better terms than many dedicated distributors, and to pass on part of the benefit of those terms to retailers, suggested that the impact of the annual and seasonal bonuses was often neutralized. The shifts in the pattern of procurement over the last few years tended to confirm this.

- (b) Retailers would have to find it impossible, or prohibitively more expensive, to obtain supplies of competing products elsewhere. That this was not the case was confirmed by a recent survey. Retailers could obtain competing products easily from general wholesalers and cash-and-carry stores regardless of where they obtained BEW brands. Moreover, wholesalers and cash-and-carry stores that handled competing brands had every incentive to make it profitable for retailers to stock them if local market conditions were favourable.

In short, BEW believed the bonus arrangements during the reference period had had no perceptible effect on entry.

7.55. Nor had the bonus arrangements had any effect on price levels. At the retail level the bonus was paid annually and retrospectively. It was unlikely therefore that retailers would take it into account in setting their prices to consumers. In any event retailers tended to price at RRP or above. At the wholesale level the bonus had no effect either. It was paid directly to retailers and so did not affect the prices which a retailer was able to negotiate with his dedicated distributor or wholesale supplier.

7.56. BEW said that the bonuses could affect consumer choice only if they persuaded a retailer not to stock non-BEW products. But they could not act as such a deterrent where the retailer had other sources of supply for non-BEW products. The administrative inconvenience of having two sources of supply was trivial. Moreover, a large national wholesaler would probably be able to supply BEW products to such a retailer on terms which fully compensated him for the loss of any bonus.

7.57. BEW said that, as to retailers' profitability, it estimated that ice cream represented on average only 1 per cent of the turnover of CTN and other small retail outlets. The bonus accounted on average for less than 0.5 per cent of turnover. By comparison confectionery, tobacco and publications accounted for 14, 25 and 23 per cent respectively. The effect therefore of ice cream bonuses on retailers' profitability was insignificant.

7.58. In conclusion, BEW said that the fact that it had offered the DGFT an undertaking on this head could not have any bearing on the substantive competition or public interest issues, which should be considered on their merits. The undertakings were offered in an attempt to avoid a reference, to close an investigation which had lasted nearly two years following a monopoly inquiry in 1994, and to avoid further disruption to the management of the business. Indeed, BEW had offered similar undertakings in relation to dedicated distributors' exclusive territories and terms to wholesalers in the mobilising channel. Neither was accepted, but both practices were excluded from the terms of reference. BEW found it anomalous that the issues of retailer bonuses and of supply of wholesalers should nonetheless have been referred, particularly as BEW had confirmed explicitly in a letter of 28 November 1997 to the DGFT that it would be implementing the undertakings offered as soon as possible.

Issues letter

7.59. In response to our letter of 13 March 1998 (see Appendix 7.1, setting out emerging issues and hypothetical remedies), BEW made the points set out in paragraphs 7.60 to 7.84.

Jurisdiction

7.60. BEW did not accept that we were entitled to reach conclusions on matters that were either specifically excluded from our terms of reference or which plainly had no bearing on whether a course of conduct specified in the reference constituted an anti-competitive practice. It would be *ultra vires* for us to reach conclusions on other practices (even in conjunction with those referred).

7.61. BEW thought that the issues that we had put to it went beyond these constraints in three respects:

- (a) First, BEW said that correspondence that it had had with the OFT made it 'quite clear that terms to mobilising franchisees [mobiler wholesalers] were expressly excluded from the refer-

ence’ and that ‘the OFT accepted that sales in the mobiling channel were not to form part of the reference’.

- (b) Second, dedicated distributors’ exclusivity had been discussed at length in the course of the OFT’s inquiry, but was not included in our terms of reference. Notwithstanding this, exclusivity was mentioned at three points in the issues.
- (c) Third, BEW said that freezer cabinet exclusivity was raised as a hypothetical remedy in the issues letter. But the reference practices related essentially to wholesaling. Hence BEW thought such an unconnected and disproportionate remedy would be irrational, and would call into question the conclusions of the MMC’s inquiry in 1994.

Courses of conduct

Alleged refusal to supply

7.62. BEW said that a list of wholesalers alleging refusal to supply (see Table 1 of Appendix 5.3), put to it with the issues, contained only four potentially relevant cases. It had not seen details of them, to enable it to verify their accuracy—a material consideration given that two of the respondents had contradicted themselves in subsequent discussion with the MMC. Accordingly, BEW thought this a wholly inadequate basis on which to conclude that it had engaged in the reference practice. BEW accepted, however, that its refusal of supply to a West Midlands ice cream wholesaler had been in error.

7.63. BEW was concerned at our having suggested in Issue A(a)(i) that ‘refusals to supply prior to the [reference] period ... could, in the absence of indication that supply would now be agreed, be regarded as tantamount to a course of conduct within the period we have to consider’. BEW said that the question to be addressed was whether there was actual, not hypothetical, refusal by BEW to supply in the reference period. BEW said that it had seen no reliable evidence of cases of such refusal which amounted to a course of conduct when set against its avowed policy of supplying all wholesalers (excluding those with substantial competing manufacturing facilities, although none had been refused in the reference period).

7.64. BEW was also concerned that Issue A(a)(ii), although technically within the terms of reference, did not address the matter that the paragraph was intended for.

Alleged refusal to supply wholesalers on contractual terms as favourable as those of dedicated distributors

7.65. BEW did not believe, from its discussions with the OFT, that the terms of reference were intended to deal with Issue A(b), ie mobiler wholesalers receiving reduced terms for sales to non-mobiling outlets. Nor did BEW think it correct for retailers’ bonuses to be taken into account in determining wholesalers’ contractual terms.

Alleged refusal to supply wholesalers with other benefits as favourable as those of dedicated distributors

7.66. BEW did not consider that the ‘other benefits’ identified in Issues A(c)(i) to (iii) were of importance, or that they put dedicated distributors in a favoured position. In particular, BEW had done everything in its power to dispel the misconception that only a dedicated distributor could supply ice cream to a BEW freezer cabinet.

Discounts to retailers purchasing from dedicated distributors

7.67. BEW said that the discounts it granted on direct accounts (and on some indirect accounts supplied by wholesalers) were not dependent on whether the customer obtained its supply from a

dedicated distributor. The discounts were the result of direct negotiations between BEW and the customer. Although discounts to retailers supplied by wholesalers differed in size from discounts to direct accounts, it was not the difference that was relevant in the terms of reference, but whether or not the discounts were given at all. This bore on Issue A(d).

Possible anti-competitive practices

7.68. BEW did not agree with our suggestion that it would be appropriate to look at the cumulative effect on competition of any reference courses of conduct that we found: BEW thought that, on a proper construction of the Competition Act, each course of conduct should be considered separately.

7.69. BEW thought it misleading for us to suggest that it had been prepared to sustain much lower profits on sales through dedicated distributors, and hence to infer that it deliberately favoured dedicated distributors: this reflected the circumstances of the different customers supplied by each distribution channel.

7.70. We put it to BEW that various aspects of the market suggested that competition was uncertain, notably BEW's continued high market share, the prevalence of exclusive freezers, the increase in prices relative to the RPI, the increase in BEW's advertising while that of other companies declined, the apparently poorer profitability of other companies in the industry, the suggestion to us of negotiation by BEW of significantly lower terms to major leisure and other sites to prevent other manufacturers having access to them (including recent solus deals) and the limited penetration of general wholesalers to retailers with BEW cabinets. In response BEW made the following points:

- (a) it was misleading to say that BEW's market share of impulse products had increased substantially since the 1994 report: it had remained steady at around 63 per cent until 1997, when it had increased to 69 per cent; BEW's volume share of the multipack market had increased in the same degree;
- (b) in the four years to January 1997 the number of freezers owned by BEW had increased by 14,000 and the number of retail outlets by 10,500; but the average size of display freezers had diminished from 245 litres to 229; however, BEW thought these changes had no bearing on whether its supply and discounts to wholesalers were anti-competitive;
- (c) prices of BEW's wrapped ice cream had not increased relative to the RPI since the 1994 report, nor was the price trend of relevance unless it could be shown that it was attributable to reference practices;
- (d) advertising levels were of no relevance to the reference practices;
- (e) profitability of other ice cream manufacturers was similarly irrelevant;
- (f) the negotiations of terms for leisure sites had no bearing on the reference practices: BEW's terms were not dependent on supply by dedicated distributors; and
- (g) in the vast majority of cases BEW was unable to monitor wholesaler turnover into its cabinets, because it had no direct contact with the retailer.

More generally, BEW pointed to paragraph 9.43 of the 1994 report in which the MMC concluded that 'competition has been effective'. It argued that developments had if anything been favourable since then and gave no grounds to conclude now that competition was uncertain.

7.71. On Issue B(i), BEW said that it would be absurd to postulate that a producer which had an inefficient distribution system was engaging in an anti-competitive practice: to reach that conclusion it would have to be demonstrated that the practice was harming competition. On two related factors BEW made the following points:

- (a) it could not be concluded that a practice, particularly in the wrapped ice cream market, was anti-competitive merely because it did not reflect costs: dedicated distributors' services provided non-quantifiable value to BEW's marketing and promotional strategy; and

- (b) BEW did not accept that it was obliged to show that any difference in terms was related to costs.

7.72. On the specific points related to Issue B(ii), BEW said that:

- (a) the results of its retailer survey confirmed that national wholesalers were able to compete satisfactorily with dedicated distributors;
- (b) wholesalers were not at a disadvantage, given the terms that retailers could be offered direct by BEW;
- (c) only 15 regional wholesalers were supplied on terms less favourable than those offered to dedicated distributors; they accounted for a minute proportion of BEW's impulse sales; and
- (d) the notion that BEW's wholesale terms contributed to de facto outlet exclusivity was contradicted by the evidence of its retailer survey.

7.73. In relation to Issue B(iii), we asked BEW whether national wholesalers could be expected to offer as effective a means of distribution as dedicated distributors; whereas if regional wholesalers were unable effectively to distribute BEW's ice cream, they would also be unable to distribute other manufacturers' brands, thus weakening the position of those manufacturers. BEW said that these points appeared to address the reference practice, but in fact addressed the question of exclusive distribution, which was outside our terms of reference. The standard of service of national wholesalers was determined by their own business priorities, not by the (admittedly favourable) discounts that BEW granted them. BEW's survey of independent retailers suggested that the service offered by national wholesalers fell below that of dedicated distributors, but not by a wide margin.

7.74. On Issue B(iv), BEW said that consumers were either unaffected by its distribution arrangements in terms of price, or benefited from them in terms of choice. In particular, 99.5 per cent of the independent retailers covered by BEW's survey said that they charged the RRP or above, which strongly suggested that BEW's discount structure for wholesalers had no effect on prices paid by consumers; and 89.4 per cent of the retailers believed they stocked a sufficient variety of products to meet their customers' needs.

7.75. On Issues C(i) and (ii), which were related, BEW said that the evidence tended to confirm that access to retail outlets and consumer choice were not adversely affected by BEW's terms for wholesalers and dedicated distributors.

7.76. On Issue C(ii), BEW did not accept that the reference practices had restricted availability of other manufacturers' products, and in any event it doubted whether availability would have had any appreciable effect on retail prices.

7.77. Issue C(iii) raised the question of whether total distribution costs and retail prices would be higher if competitors had to duplicate BEW's distribution system. BEW believed that this question was outside our terms of reference. Nonetheless, BEW drew our attention to paragraphs 11.64 and 11.73 of the MMC's report on *The supply of national newspapers*,¹ which in its view dealt with a distribution situation analogous to that of wrapped ice cream. BEW thought two points could be drawn from this:

- (a) it might be possible to minimize costs only by having, in effect, monopoly distributors reaping the maximum economies of scale; and
- (b) it illustrated the need for caution, because imposing structural change carried the risk of unforeseen effects.

¹*The supply of national newspapers: a report on the supply of national newspapers in England and Wales*, HMSO, Cm 2422, December 1993.

Public interest

7.78. Issue C(iv) dealt with 'offsetting benefits to the public interest from any course of conduct which otherwise constitutes an anti-competitive practice'. BEW's comments on its courses of conduct, and the extent to which they might entail anti-competitive practices, are set out in paragraphs 7.62 to 7.67 and 7.68 to 7.77 respectively. Its views on the benefits to the public interest of the dedicated distribution regime are set out in paragraphs 7.43 to 7.49 and 7.53 to 7.58.

Possible remedies

7.79. Possible remedies were identified in Issues D(i) to (v).

7.80. Issue D(i) was whether certain courses of conduct should be discontinued: four possibilities were identified:

- (a) The first possibility was whether BEW be required to allow mobiler wholesalers to supply retail outlets on appropriate terms. BEW observed that the OFT had said, prior to the reference, that it was not concerned with restrictions on mobiler wholesalers. But BEW accepted that as a technical matter its refusal to supply mobiler wholesalers for on-sale into traditional retail outlets fell within our terms of reference. However, BEW did not think that the diversion to regional wholesalers of ice cream supplied on mobiling terms had substantial effects for BEW in sales terms, and its prevention could not seriously be treated as an anti-competitive practice.
- (b) The second possibility was whether there should be no difference between the terms and conditions of supply to dedicated distributors and to other wholesalers. BEW told us that such a remedy would severely distort competition, because it would remove the freedom of wholesalers to negotiate with BEW in accordance with their sales volumes and importance; it would probably result in some dedicated distributors becoming insolvent (because of reduced terms) or alternatively in increased costs for BEW; given the paucity of evidence the remedy would be wholly disproportionate to the perceived problem; and it would be futile if BEW were to take distribution back into its direct ownership and management (as the only means to ensure maintenance of the quality and efficiency of physical distribution and the necessary level of marketing effort and sales promotion of BEW's products).
- (c) The third possibility was to have no differential discounts to retailers that reflected the method of distribution. BEW thought such a remedy unnecessary, since in future the annual and seasonal bonuses would be offered regardless of the source of supplies, provided the purchases could be verified.
- (d) The fourth possibility was that there should be specified maximum differences. BEW thought this could not be justified save by reference to some inappropriate cost-based theory. It would also be difficult and costly to monitor, in effect a complex form of price control.

7.81. Issue D(ii) was whether BEW's terms with retailers, dedicated distributors and franchisees, which took effect on 29 March 1998, would adequately remedy any such adverse effects. In response, BEW made the following points:

- (a) It did not believe the retailer was likely to be inconvenienced by the new system for annual and seasonal bonuses: it was likely that the administration would be undertaken by the wholesaler. BEW said that its IT consultant was confident that it could provide an interface package which any respectable wholesaler could use, but was also prepared to take the information in written form and scan it if necessary: it did not expect any substantial difference from the method used by Mars.
- (b) Any difference in wholesaler and dedicated distributor terms reflected the value to BEW of the dedicated distributors' involvement in promotion and marketing. The chief reason why dedicated distributors' profitability appeared much lower than that of wholesalers was that dedi-

cated distributors served many more large direct accounts, which negotiated substantial discounts with BEW.

- (c) BEW did not believe the prevention of parallel businesses was a substantive change from the spirit of the previous agreement with dedicated distributors.
- (d) BEW thought the March 1998 revision in mobiler wholesalers' terms and conditions was outside our terms of reference.
- (e) BEW said that it was with reluctance that it had introduced the right to terminate the new agreements in the light of the recommendations we might make in this report, but it was essential for BEW to be able to adjust terms without being in breach of contract.

7.82. Issue D(iii) was whether any additional services supplied by dedicated distributors (for example, movement of freezers or delivery to direct accounts) should be contracted separately by BEW and available to be undertaken by other distributors. In response, BEW said that the new terms for dedicated distributors would go some way to ensuring that services which wholesalers could provide would carry the same discounts as were available to dedicated distributors. But some elements of the dedicated distributors' services could not be separated off and separately priced. BEW thought the remedy, therefore, was likely to add disproportionate administrative costs for diminishing returns, and be difficult to monitor.

7.83. Issue D(iv) was whether the exclusive purchasing obligations of dedicated distributors should be abandoned. BEW found this not only totally unacceptable but arguably outside our terms of reference. There was no evidence that it was an anti-competitive practice and there were no compelling arguments that the cessation of the practice would remedy its adverse effects. BEW thought the suggestion that freezer exclusivity should be limited was 'seriously disreputable' and would overturn conclusions reached in the 1994 report.

7.84. Issue D(v) was whether the remedies set out in this section would cause BEW to take distribution in-house and, if so, what further action would be required to remedy any effects adverse to the public interest. BEW saw no reason why it should not take distribution in-house if it saw fit, and thought it 'bizarre' to frame a remedy against an action which might not even happen.

Articles 85 and 86, Treaty of Rome

7.85. We put it to BEW that at a late stage in our inquiry we had received comments that the new distribution agreement with dedicated distributors fell within the prohibition contained in Article 85(1) of the Treaty of Rome; was not block exempt under Article 85(3); did not fulfil the conditions for individual exemption under Article 85(3); constituted an abuse of a dominant position under Article 86; and that the imposition of the agreement itself constituted an abuse of a dominant position.

7.86. It appeared to us that aspects of the agreements referred to in the above contexts included prohibition of the dedicated distributors selling products at prices in excess of specified maximum levels; the requirement that distributors purchase all requirements from BEW; the prevention of distributors from dealing with direct customers in their own right; the limitation on distributors' choice of customers; the requirement on distributors to provide cold storage solely for the use of BEW; the restriction, by formulation and imposition of a business plan, on distributors' ability to compete by determining their own business objectives; the prohibition of distributors being concerned or interested in the sale of competing products; the requirement on distributors to disclose detailed sales data (including that on sale of competing products where permitted); and the transfer of distributors' own customers to BEW on termination of the agreement.

7.87. In response BEW said that it did not accept any of the allegations made. The agreements did not fall within Article 85(1); if they did they would benefit either from the block exemption contained in Regulation 1984/83 or from individual exemption (which could be granted without notification given that they were national, bipartite agreements); as such they were objectively justified and could

not constitute an abuse of a dominant position. BEW did not enter into detailed comments on the specific provisions mentioned but its general remarks applied to each one of them.

P G CORBETT (*Chairman*)

R BERTRAM

D HAMMOND

G OWEN

R RAWLINSON

P A BOYS (*Secretary*)

30 April 1998