

6 Views of Mars, Nestlé and Treats

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Introduction

6.1. This chapter summarizes the views of Mars, Nestlé and Treats. These were given to us in written submissions and at hearings.

The views of Mars UK Limited

Mars's first submission

6.2. Mars submitted that its activities and practices were designed to bring about competition in a market where competition had been grossly distorted by BEW, which enjoyed a scale monopoly due to

its size, strength and resources and which exploited its market position for its own benefit and to the detriment of consumer interests.

6.3. Mars attached high priority to breaking through in the impulse ice cream market in the UK and elsewhere in Europe. Mars's objectives in Europe both through business moves and through involvement in regulatory and legal action were to establish free and open access to retail outlets by outlawing the practices of freezer, outlet and distribution exclusivity, so that consumers could choose from the products of a number of manufacturers at the point of sale; to stimulate the development of independent ice cream wholesalers carrying a full range from various manufacturers; and to bring to an end all anti-competitive practices in this market.

6.4. The UK impulse ice cream market was the most successful single European market for Mars, but it still did not achieve the standards required of a long-term business. The challenges faced in other European markets were similar. Recently, Mars had managed to make a reasonable profit on take-home ice cream in the grocery sector in the UK but its take-home and impulse businesses together barely broke even. Mars's parent company was watching the European scene carefully in order to gauge the future of the market. Mars was very positive about the prospects of its business in the UK if it were able to operate in a fair and contestable market.

6.5. Mars considered wrapped impulse products to be in a separate market from soft mix and scoop ice cream. This was due to the combination of extensive differences between the products at the manufacturing, distribution, retail and consumer levels. Only a small proportion (probably 5 to 10 per cent) of the total number of retail outlets were likely to sell soft or scoop ice cream as well as wrapped impulse ice cream. These products were sold in substantially different competitive conditions. Any substitutability between the products would occur only at the margins and in a small number of outlets.

6.6. In Mars's view, the new Wall's Direct operation was potentially even more restrictive of competition than the former dedicated distributor arrangements. The Wall's Direct system created a further unbalancing of the playing field as Wall's Direct could operate outside the constraints considered necessary by the 1998 inquiry, in terms of dealing even-handedly at the wholesale level. It could bypass the wholesale trade and gain new business direct with retailers and reinforce its connection with retailers already supplying the Wall's range, by offering terms that could not possibly be matched by independent wholesalers either for the Wall's range or for a selection of products from different manufacturers. As a result, it provided BEW with the opportunity to take business from its ex-dedicated distributors, thereby making the livelihood and prospects of the ex-dedicated distributors very precarious. It seemed to Mars that BEW's strategy might be to run Wall's Direct as a non-commercially viable operation for a short period, until such time as any risk of serious competition from an independent wholesale network had been eliminated.

6.7. Mars believed that BEW was employing a number of dubious practices in pushing Wall's Direct to retailers in preference to the wholesale trade, and especially its ex-dedicated distributors. In principle, the fact that the ex-dedicated distributors could now act as wholesalers supplying all manufacturers' ice cream was a positive move because it made available to retailers a single source of supply of a range of products from different manufacturers. However, in practice BEW had engaged in a number of activities which were designed to have the effect of inducing retailers to use Wall's Direct. Mars gave as an example a symbol group previously supplied by BEW's dedicated distributors which believed that it would be to its significant advantage to switch to Wall's Direct, because the discounts it could receive would be significantly greater than if it opted for supply through its old distributor. As a further example, some retailers had been led to believe there would be greater security of supply in peak periods, greater availability of special promotions which would not be available from the wholesale trade and the ability to recover bonuses and rebates more easily from Wall's Direct than from independent wholesalers. In the case of multiple outlets, BEW was aggressively attempting to reverse the choice of industry freezers by persuading the customers back to exclusive BEW freezers and exclusive BEW outlets through inducements such as the granting of special terms and financial and other incentives.

6.8. The national wholesalers who distributed Mars's products gave good service but neither the wholesale trade nor Mars (nor other suppliers) could generate the economies of scale which they ought to be able to achieve in a contestable market. Many retailers wanted to stock at least some BEW products and to have deliveries in a single drop; BEW was exploiting this situation. The new Wall's Direct operation was anti-competitive because of the size of BEW's share of the impulse ice cream market and the market power which that conferred on BEW. That market power was being abused by BEW in its Wall's

Direct operation and generally. Competition was distorted because BEW's in-house distribution system intrinsically inhibited other wholesalers setting up or seeking to expand (or, in the case of the ex-dedicated distributors, seeking to retain the businesses that they had successfully built up). BEW had introduced unnecessary, unreasonable and unfair complexities for wholesalers and retailers as regards the discounts that were available and the procedures necessary to obtain them. The paperwork in BEW's systems appeared to be considerable and the evidence suggested that the dice were very heavily loaded against a retailer taking the whole range of different manufacturers' ice cream products from a wholesaler and against the ex-dedicated distributors who were trying to set up as full-range wholesalers.

6.9. In conjunction with its new in-house distribution arrangements, BEW was going to great lengths to try to maintain exclusive supply wherever possible in order to fight against the establishment of industry freezers. The huge base of BEW exclusive freezers, coupled with extensive BEW outlet exclusivity, provided BEW with a powerful advantage in launching and maintaining Wall's Direct.

6.10. With regard to the question of precisely where the abuse lay in the Wall's Direct operation, Mars reiterated that, in a situation where the major supplier (BEW) had an overwhelmingly dominant market share, the operation of an exclusive or dedicated distribution system effectively denied other companies the chance to have an efficient distribution network because the collective scale of their business would not generate the same scale economies and efficiencies as those which could be generated by a network of independent wholesalers. It might not be fundamentally anti-competitive for the market leader to operate its own distribution system if products were available on transparent and equivalent terms to all other distributors and if the market leader were precluded from foreclosing competition from other distributors by entering into deals on special and individual terms direct with retailers. But the combination of market power and integration raised the possibility of abuse; and there were great practical difficulties in effective policing of the even-handedness of a direct operation. Mars's contention was that the market leader (BEW) was not making available on a totally even-handed basis its products to independent wholesalers who also had the opportunity to supply other manufacturers' products; as a result, retailers were not offered a fair choice between sole supply from a dominant manufacturer or supply from wholesalers who could offer a range of products from all manufacturers. Furthermore, this abuse could not be looked at in isolation from the practices of BEW to enforce its exclusive freezers and to promote exclusive deals.

6.11. Following the 1998 Commission inquiry, undertakings were given, but they had been rendered ineffective by the start of the 1999 season. There was an interlocking web of objectionable practices by BEW and the attempt made by the undertakings to cut away one strand of the web had merely caused BEW to create a further strand which had similar anti-competitive effects and greater ability to distort or eliminate competition. Mars believed that confectionery was an example of a market where competition was found on a level playing field in the way that would be desirable for impulse ice cream. The effect of BEW's practices was to deny entry to any company which did not have a complete range of products. Mars had only been able to enter the UK and Irish markets by making distribution arrangements with the second largest company in the market at the time (Lyons Maid in the UK). It was worth noting that in certain other countries, for example Norway and Sweden, companies with small market positions found it hard to maintain market share when competing against predominant market leaders who had similar arrangements to those of BEW in the UK.

6.12. Mars had recently started a small trial van sales operation planned for ten city centres, but eventually conducted in only nine city centres. This operation had been planned in areas where there were opportunities to improve distribution. Mars had been able to scale back the size of the trial as a result of the recent availability of the ex-dedicated distributors. Mars said at the beginning of the inquiry that the operation was unlikely to make money but it would identify new or underutilized outlets and would get products in front of the consumer. The outlets would be introduced to a local wholesaler once it had taken up Mars products. Mars had previously used van sales operations on a temporary basis in its confectionery business in order to identify where there were opportunities to improve distribution and was currently retrialling the initiative in confectionery. Mars told us during the course of the inquiry that the van sales operation had not been successful due to the high proportion of outlets that were foreclosed due to the placing of exclusive freezers.

6.13. There were practical problems caused by BEW in trying to persuade retailers to switch from stocking Wall's ice cream to stocking brands of all manufacturers. Wall's Direct appeared to be disregarding notifications that retailers wished to switch from Wall's supplies to an industry range and/or making bureaucratic demands in relation to them; and to be slow in removing BEW freezers with the

result that retailers could not switch easily and conveniently to the industry freezer that they had ordered. The mechanics whereby retailers could order Wall's supplies from a wholesaler, rather than Wall's Direct, involved three alternative sets of complicated paperwork for claiming discounts, whereas the option of phoning Wall's Direct with an order to be delivered the next day appeared very easy by comparison, with discounts being paid automatically.

6.14. Moving to the topic of freezer exclusivity, Mars submitted that there were a very significant number of outlets selling impulse ice cream for which only one freezer was viable, and therefore if that freezer was reserved for the products of one manufacturer, in effect the result was not simply an exclusive freezer but an exclusive outlet. In Mars's view, BEW as the market leader was behaving in an anti-competitive way by practising, and inducing, freezer exclusivity. Asked about similar practices by other manufacturers such as Nestlé, Mars said that it felt the practice might be anti-competitive even if undertaken by manufacturers with a smaller market share, because it encouraged the continuance of the practice elsewhere and created barriers to entry for any business that was not able to present a full range of products. Therefore the practice was restricting effective competition in, and the growth of, the market. It also created barriers to consumer choice because, in many outlets, consumers would not be able to choose from a range of products from different manufacturers and were denied the benefits of competition between manufacturers.

6.15. Companies which wished to develop new brands or go into the industry as a result of licensing (for example, Treats' Ribena product) were precluded by the practice of freezer exclusivity from getting new products into the market. Small manufacturers were also precluded from entering. Asked about the position of a manufacturer such as Häagen-Dazs, Mars submitted that its case was rather different. Häagen-Dazs offered very high-quality products which were, in the main, designed for home consumption (for example, as a dessert) or on special occasions or in special situations. In the impulse market, it offered small tubs and also had a minor presence in stick products. Its products tended not to be offered in the mass market but in niche outlets. The majority of its products were sold in exclusive freezers which carried both its take-home and the (small) wrapped hand-held range. However, they were also stocked in freezers in some outlets alongside the wrapped hand-held products of other manufacturers. The effects of the practice of freezer exclusivity by Häagen-Dazs were more likely to be felt by other manufacturers of similar products (for example, Ben & Jerry's) rather than by the manufacturers of wrapped hand-held ice cream for the mass market. Mars also noted, however, the potential for a company such as BEW to link the sales of its take-home and its impulse ice cream in an anti-competitive manner.

6.16. Mars would prefer all freezers to be industry-driven (ie serving a range of manufacturers regardless of who provided the freezer). Asked what share of the market would need to be served by industry freezers for barriers to entry to be removed, it emphasized the importance of both the quality as well as the quantity of distribution for impulse products. It said that whilst it was difficult to be precise, it judged that at least 75 per cent of all freezers, representative of the range of outlets in terms of quality, would need to be served in this way. In addition, an efficient industry-wide distribution operation would be needed.

6.17. Mars added that freezer exclusivity became a serious competition problem only when abused by a company which had a strong market position and market power and used the practice to exploit that market power. Mars acknowledged that the present inquiry needed to address the issue of whether there were any complex monopolies, particularly as regards the practice of freezer exclusivity. Mars itself had exclusive freezers in exceptional cases. Typically they were in the retail sector where they were placed in order to gain distribution in outlets with one or more exclusive freezers and in the leisure sector where Mars had to compete with existing arrangements of other suppliers. Often other freezers were available in such outlets. However, Mars's policy was clearly to place industry freezers in the great majority of outlets. In industry freezers, Mars required that 30 to 40 per cent of space be reserved for its products, and felt that this was fair given its share of the market and its funding of the freezers.

6.18. Asked about the practice of some wholesalers who request that freezers supplied by them be stocked only with products supplied by them, Mars said that, if retailers were not happy with that position, there were other wholesalers who could provide the business. This showed the importance of ensuring that there was a strong, vibrant and competitive wholesale distribution network. Retailers would have a choice of competitive offerings from wholesalers and consumers would be given the opportunity to choose from a range of impulse ice cream from various manufacturers.

6.19. Mars further submitted that when secondary freezers were placed in an outlet which was effectively dominated by a BEW freezer or freezers, those freezers tended to be in a less attractive location within the outlet, with the result that the sales of Mars's products were artificially suppressed. Sales from industry freezers of similar BEW products and Mars's products were about the same. However, in outlets where the Mars products were placed in a freezer which was not in a prominent position, sales of Mars's products were considerably less. For instance, in industry freezers where both Mars and BEW Magnum Classic were both stocked, Mars outsold Magnum Classic by 2 per cent in 1998. In all the impulse outlets included in the audit used by Mars, the average distribution of Magnum Classic was 49 per cent higher than that of Mars. Combining these two factors would suggest that Magnum Classic would be expected to outsell Mars by 46 per cent due to its higher level of distribution. But in fact, in all audited outlets, Magnum Classic actually outsold Mars by 124 per cent, thus showing that the sales of impulse products were significantly affected by the quality of distribution and display, and not just by the quantity of distribution. Mars (and other suppliers) were disadvantaged in situations where an outlet had two freezers, one BEW-owned and one Mars-owned. The fair, and pro-competitive, position would be for there to be one industry freezer. Mars could not, realistically, recommend to retailers either that they move the BEW freezer to a less prominent position or that they cease to stock the products of the market leader, given its overwhelming dominant position.

6.20. Asked if there was any evidence that the presence of industry freezers enhanced price competition, Mars said that it certainly had evidence that industry freezers enhanced the amount of its impulse ice cream that was actually bought. Industry freezers also enabled Mars to price promote its products effectively, such as by offering special value or price-off packs. Price promotions tended to be carried out for Mars ice cream bar and Snickers products because those were the products which sold in the greatest volume; and so logistically the efforts involved in these promotions could be justified. Retailers were influenced by rate of sales but it was difficult to say at present that promotions led directly to price competition within industry freezers, since BEW did not generally engage in responding to Mars's price promotions. Given BEW's market position, and its stranglehold over distribution, it presumably did not feel the need to engage in price competition. In general, manufacturers tried to create separate identities for brands so that each offered consumers a distinct set of characteristics to those of competing brands, but there remained direct competition between products. Mars's Galaxy was in competition with Wall's Magnum, and for that reason Mars had instituted price promotions for the Galaxy product. Thus, for instance, in the summer of 1997 Mars had price-promoted Galaxy with an offer of 50p against a normal price of £1.00. The promotion was partly driven by the introduction of industry freezers, as one concern was to maintain Galaxy's market share and justify its continued inclusion in industry freezers. Where Mars had a product that was similar to the product of another manufacturer (for example, Skittles Fun Up), this would tend not to be stocked in industry freezers where it might duplicate other thirst-quenching products of other manufacturers, but it would be offered in the exclusive freezers supported by Mars.

6.21. Mars stated that both BEW and Nestlé were offering incentives to retailers to switch from industry freezers to exclusive freezers. These incentives included a free offering (say £100) of ice cream products plus a free freezer by Nestlé. Other more covert offers were thought to have been made by BEW. Mars on the other hand was prepared to provide free stock only where the retailer bought a freezer through a wholesaler.

6.22. Summing up, Mars submitted that BEW's practices in effect created in many cases outlet exclusivity as a result of a combination of its exclusive freezers and its distribution arrangements (together with the offer of special terms and conditions), including the complexity of paperwork which had been imposed by BEW on former dedicated distributors which were now wholesalers and on the retailers who sought to buy through a wholesaler rather than from Wall's Direct.

6.23. Mars submitted that BEW's exclusive agreements with leisure outlets, even if invariably made at the customer's request (which requests would not be difficult for a company in BEW's position to procure), were anti-competitive. These agreements gave an opportunity for the outlets to abuse their customers (ie the consumers) by offering less choice and charging higher prices. The predominant position of BEW in the market meant that it could bid its way into exclusive supply in a way that a smaller company would never have the opportunity of doing. Mars thought that the share which BEW had of the leisure sector was higher than the share it had of the high street retail sector, perhaps as high as 90 to 95 per cent. It was clearly reinforcing its monopolistic position in leisure. In effect, BEW was buying market share and market presence and visibility so as to enhance its image in the eyes of the consumer and of the retail trade generally, and to ensure that Mars (and other suppliers) were denied the chance to break through in the leisure sector and so to achieve economies of scale which would in turn

allow greater success overall in the impulse market. Many leisure outlets were potentially large and valuable customers for industry freezers serviced by the ex-dedicated distributors and other wholesalers; BEW was determined to ensure that it retained near-absolute control over the leisure sector.

6.24. Because BEW would not support industry freezers and retailers considered that Wall's products were 'must-stock' items, BEW was able to provide massive incentives for customers to ask for exclusive deals. These incentives took the form (inter alia) of up-front lump sum payments as well as retrospective payments on the basis of turnover. A leisure outlet would typically be able to make a margin of over 60 per cent on its ice cream, not including gate money offered by BEW. Nestlé also engaged in this practice. In these circumstances, it was exceptionally difficult for Mars (and for wholesalers) to persuade the proprietors of leisure outlets to support industry freezers (which was why it did offer exclusive freezers to leisure outlets).

6.25. In Mars's view, BEW's refusal to support industry freezers serviced by an independent wholesale network, distorted competition and operated against the public interest as, in view of BEW's overwhelming dominant position, it served to reinforce the practices of freezer and outlet exclusivity, to support Wall's Direct and to protect BEW's market share and position. Consumers were denied the opportunity of choosing from offers of the products of different manufacturers when they made their impulse purchase; and wholesalers were denied the opportunity of competing for business and of servicing retailers in the most effective and economic way. Where BEW products were included in industry freezers (as they normally must be, due to their important position in the market), their presence was effectively subsidized by the investment of others. Even where industry freezers were installed, BEW sought to induce the retailer to use Wall's Direct as the supplier of BEW products, rather than allowing an industry wholesaler to service the retailer for all its requirements.

6.26. Mars referred to the practice of premium pricing, which it noted was especially prevalent in those outlets that had exclusive supply arrangements in the leisure sector. It considered that such outlets could be persuaded to appreciate the benefits of lowering their prices, and increasing their volumes, by offering a range of products from different manufacturers and benefiting from the growth in the market that greater competition between manufacturers, and at the wholesale level, would provide. Manufacturers would be encouraged to promote their products, with value and price offers; and wholesalers, rather than manufacturers, would compete for leisure accounts. Investment by BEW in gaining and retaining exclusivity did not benefit consumers, but only benefited BEW and the outlets concerned, especially where premium prices could be extracted from consumers; whereas investment in consumer promotions would benefit consumers directly, as well as all participants in the industry, by stimulating growth.

6.27. Mars did not consider that the practice of recommending retail prices was relevant to products being sold at or above the recommended price. RRP's were useful to provide an indicator to the retail trade of an appropriate level of prices, but retailers were entirely free to choose their actual selling prices. RRP's also provided an important benchmark for price-off promotions, such as those run by Mars. Mars had tried to discourage premium pricing by special mark-down promotions which were available on all Mars's products, whether sold through industry freezers or Mars's exclusive freezers. Mars believed that such promotions would be an increasingly important feature of competition between manufacturers if the market was opened up to effective competition as a result of this inquiry.

6.28. In response to our questions, Mars said that a dominant supplier, such as BEW, should be able to demonstrate a clear link between the net income that it received from its customers (after taking account of all discounts, rebates, allowances, and other consideration or benefit provided, directly or indirectly, in cash or in kind to the customer) and its costs of supplying those customers. Such a supplier should have a clear, transparent structure for its terms of business with customers which was applied in a uniform and non-discriminatory manner.

6.29. We asked Mars for its views on BEW's advertising and promotional expenditure. Mars said that BEW's overall level of advertising and promotional expenditure reinforced BEW's objectionable conduct and practices. Advertising was only economic and effective for impulse products if the quality and quantity of distribution was sufficient to ensure sufficient take-up of the products in response to the advertising. BEW's advertising supported the quality and quantity of the distribution that it secured through its objectionable conduct and practices; conversely, its competitors were denied the quality and quantity of distribution by such conduct and practices that would enable them to justify advertising on the appropriate scale. BEW's promotional expenditure also appeared to be deployed to a very substantial

degree in securing and supporting such conduct and practices through individually negotiated, selectively applied, non-transparent terms and conditions, often apparently involving sizeable consideration.

6.30. Mars considered that BEW's conduct and practices reflected the abuse of its market power and had the purpose and effect of sustaining and reinforcing the market-dominating position which conferred that market power on BEW. In particular, the practices of freezer and outlet exclusivity and the creation and deployment of Wall's Direct, taken together with terms and conditions of business which consisted, in addition to the published terms, of a panoply of individually negotiated, selectively applied, non-transparent terms and conditions, were all part of a mutually sustaining package which ensured that any threat to BEW's power and position was unlikely to emerge. BEW put its own interest in preserving that position over the interests of open and fair competition, the public interest and, above all, the interests of consumers.

Mars's response to the issues letter (see the statement of issues, Appendix 2.1)

Market definition

6.31. With regard to market definition and the terms of reference, Mars noted that the issue of market definition had been handled in various different ways in previous Commission and European cases. Mars considered that the structure of the market and the conditions of competition for wrapped hand-held ice cream were wholly different from those for soft mix and scoop ice cream on both the supply and the demand side. The extent of substitutability was very limited.

6.32. The existence of a wider impulse market including confectionery, packaged snacks and soft drinks was, in Mars's view, irrelevant to this inquiry. As for ice cream in catering outlets, Mars suggested that the governing factor in a decision about inclusion in the terms of reference should not be the nature of the outlet or the circumstances in which the purchase was made, but the nature of the product and the intention of the manufacturer, evidenced in the choice of packaging for the product, that it should be for immediate consumption on purchase.

6.33. Concerning slush, Mars considered that this was a very different product from wrapped hand-held impulse ice cream, and verged on being a cold drink. As for the sale of multipacks, Mars believed that any possible partial consumption of the contents of multipacks was not relevant to this inquiry. With regard to possible amendments to the terms of reference, Mars said that any amendments at a late stage in the inquiry would merely serve to cause delay and confusion. It did consider the technical amendment of adding 'soft ice cream mix' to be appropriate. We asked Mars if it would be appropriate to exclude ice cream purchased for consumption as a meal or part of a meal; Mars agreed that ice cream purchased as part of a meal should be excluded but thought that the distinction between 'ice cream purchased as part of a meal' and 'ice cream purchased as a meal' was hard to draw.

Distribution

6.34. On Issue 1(a) (exclusivity of distribution arrangements), Mars stated that Wall's Direct was more restrictive of competition than the previous system, found to operate against the public interest by the Commission in 1998. BEW's development of 'direct accounts' (elastically and widely defined) had restricted the ability of other distributors to compete with Wall's Direct as many retailers might consider it preferable to acquire, and/or could be induced to acquire, direct from the dominant manufacturer with 70 per cent market share, which in combination with other factors jeopardized the viability and survival of any alternative distribution systems. The use of direct accounts also made it much easier for BEW to operate in a discriminatory or anti-competitive way, through variations in terms for these accounts. Specifically, the insistence on the use of liveried vehicles by Wall's Direct meant that efficiency of distribution of products of other suppliers could not be maximized by the Wall's Direct contractor as that contractor was forced to maintain an entirely separate fleet for the non-Wall's business. On weighted distribution, the distribution of individual products was less than their market share would merit. As to Nestlé, Mars noted that Nestlé's distribution system had some considerable similarities to BEW's former and present distribution system and accounted for a significant proportion of Nestlé's sales. Nestlé could well attempt to impose exclusivity on its preferred concessionaires/distributors; it used such a system elsewhere in Europe. Nestlé's system, both on its own but especially when taken together with BEW's system to which it had considerable similarities, limited the ability of independent distributors to

compete. It also supported anti-competitive practices, including freezer and outlet exclusivity. Independent distributors therefore found it difficult to compete with a range of manufacturers' products in many outlets that should, in principle, be open to competition for them.

6.35. On Issue 1(b) (BEW actions to attract business to Wall's Direct), Mars stated that it had heard a considerable number of 'stories in the trade' to the effect that BEW had encouraged retailers to switch to Wall's Direct. Mars also provided details of various instances that had been reported to it. With regard to the introductory offer to customers of Wall's Direct, Mars did not accept that this was a normal 'introductory offer' for a new service as BEW had apparently claimed. BEW appeared to be trying to justify the action by reference to the kind of 'load-in' offer often made at the beginning of the season, which was made to all retailers. Concerning encouragement to use Wall's Direct, Mars considered that there was ample evidence from BEW's own material about Wall's Direct and from the reports from the field that retailers had been encouraged, persuaded or induced to use Wall's Direct by BEW. Whilst some retailers had resented the frequent calls, in person and by telephone, from BEW, many had clearly been confused—often by misleading statements made by BEW or its representatives. Mars noted that, in the Commission's retailer survey (see Appendix 4.2), two-thirds of the users of Wall's Direct did not know that they had changed supplier.

6.36. On Issue 1(c) (terms to distributors), Mars stated that BEW's terms adversely affected the ability of distributors to compete with BEW/Wall's Direct, given its market share and the 'must-stock' nature of its brands. BEW had preserved the distinction between dedicated distributors and wholesalers, albeit in slightly modified form, which had been condemned by the Commission in 1998. A 22 per cent margin had previously been found insufficient (in the 1998 report, paragraph 2.71) to allow independent wholesalers to compete to supply many accounts including leisure and direct accounts. The level of margin currently offered to independent wholesalers was below this, typically around 10 to 15 per cent, being composed of £1.10 per case and a possible retrospective discount of up to 5 per cent.

6.37. In addition, on direct business wholesalers received a standard fixed case rate which in practice was well below the 'costs plus 10 per cent' received by contractors for Wall's Direct. Mars commented that, as the Commission had found in the 1998 report (paragraph 2.70), in comparing the position of independent distributors with dedicated distributors, it was necessary to consider the aggregate of payments made to the dedicated distributor and the retailer.

6.38. On Issue 1(d) (direct accounts), Mars reiterated that the ex-dedicated distributors had been offered inadequate terms, compared with the 'cost plus' arrangements for Wall's Direct contractors; loss of income from deliveries to direct accounts would substantially affect the businesses of ex-dedicated distributors, especially when coupled with the other actions taken by BEW to encourage, persuade or induce accounts to switch to Wall's Direct.

6.39. On Issue 1(e) (buying entities), Mars said that BEW's sole purpose in refusing to recognize ICW as a buying entity was to avoid the ex-dedicated distributors being able to obtain terms which might have enabled them to compete more effectively. BEW was not entitled to rely on a provision in the undertakings which it had itself proposed to modify the Commission's recommendations in order to decline buying group terms to a group of ex-dedicated distributors; it should have raised the matter with the OFT, rather than relying on a technicality in the undertakings.

6.40. On Issue 1(g) (provision of discounts), Mars noted the reports received from wholesalers (including both ex-dedicated distributors and other wholesalers) who were having difficulty in dealing with retailers' bonuses and with the complexities of the BEW systems and procedures for dealing with these. The changing and confusing definitions of 'direct accounts' were designed to secure as much 'direct' business for BEW as possible to the exclusion of independent wholesalers. The provision of 'seasonal discounts' was but one example of the selective, non-transparent and discriminatory discounts offered by BEW which disadvantaged other distributors seeking to secure business by offering a variety of manufacturers' products. On Issue 1(g) relating to Nestlé, Mars understood that Nestlé did pay such discounts and considered that such discounts distorted competition between distributors.

6.41. On Issue 1(h), Mars noted that it appeared that BEW had imposed additional obligations on its dedicated distributors to provide information on their customers and then used that information to compete with them. On Issue 1(i) (effect on distribution costs), Mars considered that the restrictions and distortions of competition between distributors arising from BEW's distribution system, behaviour and practices inevitably restricted and distorted competition between manufacturers by making distribution

for products of other manufacturers less efficient and more expensive than was necessary to meet the needs of retailers and consumers in the market, by denying access to many retail outlets for their products and by discouraging innovation and investment by such manufacturers. BEW had a purely predatory objective in establishing Wall's Direct: to retain control over distribution despite the clear conclusions of the 1998 report, to ensure that ex-dedicated distributors were unlikely to be viable as independent ice cream distributors, and to further weaken competition at manufacturing, distribution and retail level. The development of an independent distributor network was seriously threatened.

6.42. Mars provided a study of distribution costs by its consultant, Dr Ray, in an area with 4,000 outlets and initially 12 distributors. This showed that if the number of outlets per distributor rose from 250 to 500 (ie with six distributors) the cost per call would fall from £10.95 to £8.64; if there was a further increase to 1,000 outlets per distributor (ie four distributors), the cost per call would fall to £7.17. Beyond this level, economies continued but at a much reduced rate: if a distributor supplied one-half of all outlets, the cost per call would be £6.12. Economies of scale would therefore permit three or four competing and overlapping distributors in the area. At present, because of freezer exclusivity, there were only about 500 outlets viable for delivery at these cost levels: freezer exclusivity kept costs high and prevented new distributors entering the area and creating a competitive environment.

6.43. Moving to Nestlé, Mars considered that the restrictions and distortions of competition between distributors arising from BEW's and Nestlé's distribution systems, behaviour and practices inevitably restricted and distorted competition between manufacturers by making distribution for products of other manufacturers less efficient and more expensive than was necessary to meet the needs of retailers and consumers in the market, by denying access to many retail outlets for their products and by discouraging innovation and investment by such manufacturers.

Freezer exclusivity

6.44. On Issue 2(a) (freezer exclusivity), Mars stated that freezer exclusivity remained a prevalent practice. Insistence by the scale monopolist on freezer exclusivity in effect set the standards for the industry, but for other manufacturers to place non-exclusive freezers was not generally a viable proposition, particularly given BEW's distribution system and its commercial practices and behaviour. Any such freezers could be swamped with BEW products. Competition therefore became focused on competing ranges of products, at the expense of true product-to-product competition. Other manufacturers and distributors were forced to invest in additional freezers, raising a significant barrier to entry and expansion, since incremental business could not simply be gained on the basis of the quality of the products and the sales and marketing activities of the manufacturer or distributor. The retailer had first to be persuaded to take a second freezer and that freezer had to be paid for, procured, installed and maintained. The arguments that retailers were happy with existing arrangements ignored the commercial terms that BEW offered, including terms dependent on total purchases. Secondary manufacturer exclusive freezers were often not as well positioned in store as BEW exclusive freezers and did not optimize the display of available products to assist consumer choice and maximize sales; they were often also switched off in the winter months. Additional manufacturer exclusive freezers also imposed additional space requirements and running costs on retailers compared with industry freezers. Freezer exclusivity therefore prevented competition at all levels, between manufacturers, between distributors, and between retailers, as shown also by performance in industry cabinets, which showed that increasing competition led to an increase in total sales from such freezers. Mars provided summaries of research showing this effect in industry freezers, further discussed in paragraphs 4.117 and 4.118. As to Nestlé, Mars considered that Nestlé's position was influenced by considerations relating to its arrangements and position in other European countries.

6.45. On Issue 2(b) (developments since the Commission's 1994 report), Mars stated that the Commission had reached its conclusion in 1994 only on the basis that there was 'insufficient evidence' that freezer exclusivity 'in the market as it was then developing' operated against the public interest. The 1994 report had overestimated Mars's market share. Subsequent to that report, BEW's market share increased significantly while that of Nestlé declined. As well as continued growth in market share, the 1998 report found that BEW was the only leading manufacturer that was profitable. Mars and Nestlé showed continued poor financial performance which confirmed the difficulty of entering the market and competing profitably on any scale; product-directed advertising expenditure by Mars and Nestlé had been reduced in response to such low profitability; and the Commission could not be confident that both Mars and Nestlé would stay in the market. All these indicators showed that this was a market in which competition was not effective.

6.46. On Issue 2(c) (positioning of freezers), Mars commented that the position of the freezer was crucial. Where BEW retained the primary exclusive freezer, it would ensure that any other freezers that it installed had an equally prominent position; but when another manufacturer's freezer was installed, this was likely to be placed in a secondary or tertiary position (whether or not at BEW's behest). Secondary freezers were also likely to be switched off during the winter. Mars believed that the average size of BEW's principal freezers had increased, even if the average size of BEW's overall freezer fleet had not, due to the placing of many small BEW exclusive freezers sited close to tills, as had the number of BEW exclusive freezers per outlet.

6.47. On Issue 2(d) (policy on industry freezers), Mars commented that BEW's policy of not supporting industry freezers restricted or distorted competition between manufacturers and distributors. Smaller manufacturers such as Mars, Nestlé, Treats and others found it very difficult to counter the anti-competitive propositions involving freezer exclusivity offered by BEW to retailers. BEW's policies and practices actively discouraged retailers from accepting industry freezers, for example by threatening to reduce their margins if they switched to industry supply.

Terms to retailers

6.48. On Issue 3(a) (terms to retailers related to supply of other products), Mars believed that BEW was increasingly seeking to link the supply of its impulse ice cream products with supply of other products (for example, take-home ice cream) and within the impulse sector to link the supply of different categories, for example the supply of wrapped with the supply of scoop and/or soft mix.

6.49. Asked whether there was any cross-selling by Mars between confectionery and ice cream, Mars said that it was not its general policy to cross-sell across its product groups. Apart from its merchandising link where it shared resources, its objective was to establish an independent ice cream business and an independent confectionery business because they were not logistically similar and their seasonal patterns were quite different. Mars did not generally promote packages involving both confectionery and ice cream, although it did promote its ice cream brands by referring to the same confectionery brands and it did use the same merchandising force to provide advice and support to retailers for both ice cream and confectionery.

6.50. On Issues 3(b) and (c) (discounts, bonuses and incentives), Mars submitted that in principle volume-related end-of-year bonuses and discounts were only anti-competitive when they were used by a company in a dominant position and had the effect of inducing customers to purchase from the dominant company at the expense of the non-dominant competitors, in order to ensure they secured the benefit of the highest level of discounts on all their purchases of the year. However, such discounts and bonuses could be pro-competitive when applied by a non-dominant company. Hence Mars considered the nature and extent of its own terms to be perfectly conventional and normal. BEW's bonuses (some £18 million in 1997) were given on a selective and discriminatory basis. The terms were not published, and they were not transparent; most of these incentives were paid or given not with the primary purpose of increasing the sales of BEW products, but to ensure that BEW's products displaced those of other manufacturers in the retail trade.

6.51. On Issue 3(d) (relationship between prices and costs of supply), Mars stated that there was no economic justification for requiring non-dominant suppliers to supply only on terms that related to costs; the dominant supplier on the other hand should generally be required to cost-justify its terms and to provide some other objective justification for differences in the terms offered to distributors and to retailers. The price terms and other incentives offered by BEW were not cost-justified, and without any other objective justification. They therefore distorted competition by inducing distributors and retailers to handle the products of the dominant supplier rather than those of the non-dominant suppliers who were forced either to attempt to match the terms offered by the dominant supplier, or accept that they would be foreclosed from many outlets.

Outlet exclusivity

6.52. On Issue 4(a) and (b) (outlet exclusivity), Mars submitted that outlet exclusivity was practised by BEW across most categories of outlet deliberately and extensively for the sole purpose of preventing competitors expanding the number of outlets in which their products could be stocked. The practice was closely tied to other anti-competitive practices such as the offering of inducements not to stock the

products of other manufacturers. In many cases those incentives took the forms of price or other terms which were offered on a selective and discriminatory basis. Those terms were withdrawn, or withdrawal was threatened, if the outlet indicated that it proposed to stock the products of other suppliers as in an industry freezer. The practice of outlet exclusivity by Nestlé was also liable to prevent, restrict or distort competition; Mars practised outlet exclusivity to only a very limited extent and principally only in the leisure sector. The scale of the practice by Mars and indeed the purpose of adopting the practice by Mars was different from that of BEW. If Mars found that the only way of obtaining sales in an outlet was to offer exclusivity, then it would do so where the level of trade margin was affordable. Its main objective was to increase the sales of its products and to improve its competitive position in a market in which the conditions of competition had been wholly distorted by BEW. Mars was, however, prepared to accept in the market conditions forced upon it that the practice by Mars could give rise to a complex monopoly situation.

Advertising and promotional expenditure

6.53. On Issue 5 (advertising and promotional expenditure), Mars submitted that at first sight, there was nothing per se objectionable about BEW's level of advertising; but taken in conjunction with the foreclosing effects of other behaviour and practices, it supported such foreclosure. By foreclosing competing manufacturers from effective distribution and display in many outlets, BEW's level of advertising ensured it a sufficient level of sales without having to compete on consumer promotions or on price. Conversely, competing manufacturers could not advertise at the appropriate level as the advertising did not generate sufficient sales to justify the expenditure. The level of BEW's promotional expenditure on discounts, bonuses and payments (rather than consumer promotions) was very high and was objectionable of itself as it restricted opportunities for competitors and created barriers to entry and expansion for other, smaller manufacturers. BEW's total distribution discounts, retailer payments and advertising and promotion represented 54 per cent of BEW's net sales and 44 per cent of its gross sales. The purpose and effect of much of this expenditure was to incentivize the trade in such a manner that it was foreclosed to competitors; there was little or nothing spent by BEW on consumer promotion or on price competition.

Recommended retail prices

6.54. On Issue 6 (retail prices), Mars's view was that the practice of recommending retail prices did not at present have the effect of restricting competition. Competition between retailers was restricted as a result of the lack of competition created by the behaviour and practices of the scale monopolist, and if BEW were prohibited from engaging in anti-competitive practices and abuses of market power, there would be an immediate stimulus to competition between manufacturers and distributors. Because of the extensive regulation of consumer offers, most price offers from manufacturers to consumers had to be made by reference to RRP; if Mars lost the ability to continue to recommend retail prices but other anti-competitive behaviour was prohibited in the expectation of opening up the market, Mars would be denied the benefit of one of the most effective tools that it could use to stimulate and promote competition. Mars noted that whilst the prices of its own products had increased at well below the rate of inflation measured by the RPI, BEW's prices had increased above RPI up to the time of the 1998 report. Caution was needed in making international price comparisons.

6.55. There was a lack of price competition in the impulse ice cream market but this was attributable to the current structure of the market, resulting from the practices and behaviour of BEW. In contrast to the impulse market, there was extensive competition in the multiple grocery market for take-home ice cream: exclusivity did not prevail; manufacturers' supply of exclusive freezers were not the norm; there was no outlet exclusivity; distribution exclusivity did not arise as most products were distributed to central depots; there was no dominant supplier; retail customers tended to be larger and more powerful and more sophisticated.

The effect of a combination of practices

6.56. On Issue 7 (the effect of a combination of practices), Mars argued that the BEW dedicated distribution system supported freezer and outlet exclusivity and that freezer and outlet exclusivity

supported the BEW dedicated distribution system. Both the BEW dedicated distribution system and freezer and outlet exclusivity were supported by a comprehensive system of discriminatory, non-cost-related price and other terms and inducements. The effect was that a substantial proportion of outlets were closed to competitors' products and many of those that appeared in principle to be open were in effect at best only partially open since competitors' products would be displayed separately from the BEW products and in a less prominent position. Hence at the retail level there was no direct competition between the differentiated products of a number of manufacturers.

6.57. At the distribution level, distributors seeking to compete with the BEW distribution system could not develop their businesses economically and efficiently. They had to offer the products of BEW because of its market position, but could not obtain those products on competitive terms and therefore had to concentrate their competitive efforts on the products of other suppliers. Further they were denied access to many of the retail outlets that they would otherwise compete to serve as these were foreclosed to them because they were tied—contractually or in practice—to BEW. Hence, even if they could assemble a competitive range of products, the economics of their operations were far from optimal in terms of drop size and route density.

6.58. Manufacturers competing with BEW were in practice denied the routes to market at both the distribution and the retail levels. Developing their businesses was made exceptionally difficult so that they could not achieve the necessary economies in manufacturing or distribution if they could not ensure a wider availability of their products through an efficient distribution system. In contrast, evidence of comparative sales and products through industry freezers and through the grocery market gave a reasonably good indication of the likely demand for Mars's products if the market were not foreclosed to it. This was shown in certain studies of industry freezers in 1998. These are discussed further in Appendix 4.9.

6.59. Mars referred to the relationship between distribution levels and sales for individual impulse ice cream products (both overall and by channel) and to a comparison between distribution levels and sales in impulse ice cream and in chocolate and sugar confectionery which showed that a much wider range of manufacturers' brands secured a high level of distribution in the confectionery market. Mars also provided a survey carried out on its behalf by NOP which is discussed in paragraph 4.19.

Oscar Bronner

6.60. On aspects of EC legislation, Mars made a submission on the *Oscar Bronner* case. Mars argued that the legal test to be applied by the Commission was that under the Fair Trading Act, not article 82 of the EC Treaty (ex 86). Mars argued that *Oscar Bronner* was not the legal test by which Wall's Direct would fall to be examined after 1 March 2000, and that *Oscar Bronner* would not be relevant to the application of article 82 to Wall's Direct. Wall's Direct was neither an essential facility nor a facility but a series of contracts and should be treated in the same way as any other anti-competitive conduct. Mars pointed out that Wall's Direct was specifically adopted in order to avoid the application of the undertakings required following the Commission's 1998 report. BEW could not have created Wall's Direct if there had been effective competition in the impulse ice cream market and BEW's conduct fell within the classic definition of 'abuse' for the purpose of article 82. Mars said that BEW's suggestion that, if competition authorities were to intervene in the Wall's Direct system, that would remove incentives for competing manufacturers to develop competing facilities, was spurious: the existence of a dominant manufacturer using exclusive freezers, exclusive outlets and employing selective and discriminatory price terms and inducements would not incentivize any manufacturer to compete.

Remedies suggested in the issues letter

6.61. On the remedies suggested in the issues letter, Mars commented that a comprehensive package of remedies was needed. Remedies must also reflect the different circumstances of the main and other manufacturers; some practices required a remedy only in the case of the scale monopolist. Remedies should be proposed as a complete package because of the possibility that BEW might attempt to achieve its aims indirectly, and Mars thought that the Commission should indicate fall-back remedies if the market did not open up in the way envisaged.

6.62. Mars made the following points on specific possible remedies. The objective of any distribution remedy must be to allow access to economically viable distribution for the products of all manufacturers. This objective would not be achieved by a requirement on BEW to supply all distributors on economically viable terms and not to discriminate. The only appropriate remedy, which could be applicable to both BEW and Nestlé, was not to allow any manufacturer to maintain any in-house or sub-contracted distribution arrangement or any exclusive arrangement for distribution to retail premises.

6.63. Mars submitted that freezer exclusivity imposed by significant manufacturers should be prohibited. Outlet exclusivity should not be permitted to continue. BEW should be obliged to publish terms of supply to all categories of distributor or retailer and to supply only on those terms. BEW should be prevented from diverting its funds to equally objectionable anti-competitive use, including a cap on prices relative to costs, on the level of margin offered to wholesalers, and on promotional and trade expenditure. The latter should be accounted for and justified. Anti-avoidance measures would be needed to deal with the following: potential exploitation of distributors as an indirect means to secure de facto exclusivity or achieve preferential placing of products (for example, by making special offers available to retailers only via certain distributors, or by subsidizing margins to certain wholesalers and then preferentially encouraging use by retailers of those wholesalers in order to cause them to offer de facto exclusive supply); potential replacing of freezers with terms that amounted to virtual exclusivity; potential use of freezer maintenance or servicing as a means to retain control over freezers; increased risk of soft promotional investment such as branding or free goods; and potential risk of activities on reference products linked to other Unilever products.

Mars's response to the remedies letter

6.64. Mars responded to the remedies letter (see the statement of remedies in Appendix 2.4). Mars considered that the objective of any remedies should be to create an environment in which normal market forces could be allowed to operate so that effective competition could take place between manufacturers, distributors and retailers to meet the needs of consumers, free from the distortions caused by anti-competitive behaviour and conduct. It was fundamental to the creation of a dynamic, competitive market that in formulating remedies the Commission should distinguish between the position of the scale monopolist and the position of the members of any complex monopoly. On the one hand, the scale monopolist must be comprehensively constrained from abuse of market power; on the other hand competition in the market had to be encouraged and facilitated. The history of abuse by Unilever of its market power was extensive and the Commission must assume that BEW would, if unconstrained, continue to operate beyond the permissible limits for a dominant supplier. None of BEW's competitors currently had a market share in excess of 15 per cent, in contrast to BEW's share of around 70 per cent. Even if, from a purely technical point of view, the Commission were able to show similar courses of conduct that justified formal complex monopoly findings, it must then consider what the effect would be if similar remedies were imposed on both the scale monopolist and the complex monopolists. The difference in market position of the parties justified a different treatment of the scale and complex monopolists. The smaller suppliers needed to have the freedom to act in the same way as they would do if there were no dominant supplier and normal competitive forces were at work in the market. If such a distinction were not made there was a considerable risk that the status quo would be preserved because the smaller suppliers would simply be unable to compete effectively, due to the combination of the actions of BEW and the constraints imposed on them as complex monopolists following the Commission's inquiry. This point was particularly relevant to remedies in relation to discounts and other terms granted to retailers. Discounts and incentives that were a valuable competitive tool for suppliers in a competitive market might be an abusive device in the hands of a single manufacturer with very strong market power.

6.65. Anti-avoidance measures would be needed. BEW's use of an exclusive distribution network, of freezer exclusivity and outlet exclusivity were explicitly recognized by it as tools to drive out competition. It must prudently be assumed that if BEW were denied the use of its current practices, it would attempt to achieve the same result by some new, equally abusive conduct. If remedies along the lines proposed were imposed, Mars expected BEW to restructure its terms and incentives to wholesale and retail customers so that they had the effect, in each trade channel, of inducing retailers to buy either exclusively or predominantly from BEW, even in the absence of the contractual restraints conferred by freezer and outlet exclusivity. BEW's aim would be to retain exclusivity or near-exclusivity to the greatest extent possible by indirect means and to increase the cost to, and difficulties for, other suppliers

in doing business in each trade channel. BEW's size and market position provided it with the economies of scale and the resources to achieve this.

Freezer exclusivity

6.66. On freezer exclusivity, Mars considered that the prohibition of freezer exclusivity should apply to all significant manufacturers. That should certainly include BEW, Nestlé and Mars. Mars agreed that a *de minimis* exception to allow smaller manufacturers to develop their businesses was appropriate but suggested that a lower figure of £5 million turnover in impulse ice cream was more appropriate than the suggested figure of £10 million, on the basis that the exclusion was intended to cover small regional businesses. The threshold should explicitly refer to gross turnover (ie GSV) and there should also be some escalator (for example, by reference to the RPI). In Mars's view, wholesalers should be under a similar restriction in relation to freezer exclusivity, in order to avoid abuse by, in particular, BEW, who might seek to place exclusive freezers through wholesalers. Independent wholesalers should, however, remain free to enter into contracts agreeing exclusivity for products supplied by that wholesaler, provided that there was no link to the products of any manufacturer and the wholesaler in question supplied a range of at least three or more manufacturers' products.

6.67. Mars did not consider that any remedy proposed by the Commission in relation to freezer exclusivity should enable some part of a freezer—whether 60 per cent or some other proportion—to be reserved exclusively by a manufacturer. Mars thought that a remedy allowing the dominant manufacturer to reserve space was itself inherently anti-competitive and should not be endorsed by a competition authority. It would be impossible for anyone involved in the market to understand which part of a freezer was 'exclusive space' and which part was 'contestable space'. A 'part-exclusive' freezer would become a battleground for arguments as to whether the limited contestable space was in fact contestable space or exclusive space. BEW would no doubt seek to persuade retailers to 'choose' to fill all, or a major part, of the contestable space with its own products, in addition to rigidly policing and enforcing its exclusive space. Other manufacturers and distributors seeking to sell into that contestable space would argue with each other, and with BEW. There would be regular complaints to the DGFT about practices of BEW in relation to contestable space.

6.68. Reservation of exclusive space would also be open to abuse by BEW. Suppose for instance that BEW reserved its exclusive space, but specified the brands that were to be sold in that space. BEW might choose to allocate all—or a part—of the exclusive space to its less popular brands in the certain knowledge that retailers would then put the more popular BEW brands, and certainly the 'must-stock' BEW brands, in the contestable space. Alternatively, BEW might require or encourage (for example, through discounts and other incentives) retailers to stock a minimum number of lines, or give minimum drop incentives or offer 'load-in' deals in the certain knowledge that this would mean that freezers were substantially or fully stocked with its products. Furthermore, if a dominant manufacturer with the largest freezers and the most extensive freezer base were able to reserve the majority of the space in the freezers which it supplied, it would be open to that supplier to conclude deals with other manufacturers which provided for the filling of the allegedly contestable space. For instance, BEW might decide that an arrangement with a weaker supplier, such as Frederick's/Cadbury's, to maximize the presence of its products in the contestable space would be in BEW's best interests as it would deny Mars, Nestlé and other suppliers the opportunity to make their products available to consumers.

6.69. Allowing BEW to reserve 60 per cent of space in its own and other freezers and to claim up to 40 per cent of space in all other exclusive freezers might paradoxically contribute to the consolidation of BEW's dominant position rather than restrain it. As a result of its current market share of over 70 per cent BEW could, in the medium term, expect to claim a high share of the contestable space in any freezer; so it could expect its existing freezers to be substantially filled with BEW products, whilst gaining a share in the rest of the freezer base supplied by other manufacturers. This was especially the case as BEW tended to have the larger freezers and the 'must-stock' brands, whereas other manufacturers (including Mars) had smaller freezers. Thus, for instance, Mars would have to allow 40 per cent of the space in its smaller freezers to become contestable space and to be taken by competing manufacturers—including BEW. This would mean that Mars would not be able to offer in its own freezers the full range of Mars's ice cream in sufficient quantities to ensure that retailers had the necessary stocks to cover the period between deliveries. Reservation of space would also provide an advantage to BEW if it were also permitted to retain its own in-house distribution system. It would encourage BEW both to retain and to maximize the use of that system. Because density and drop size were the critical factors in the

distribution cost of impulse ice cream, reserving a high proportion of space in a very large number of freezers, and being allowed access to a significant proportion of the contestable space in many other freezers supplied by competitors, would continue to justify a dedicated distribution system for BEW. Conversely it would impose considerable cost disadvantages on the smaller suppliers competing for the contestable space through an independent distribution chain which was carrying much smaller volumes. Allowing manufacturers to continue to supply part-exclusive freezers would also discourage the development of an independent, competitive supply of freezers for the resale of impulse ice cream. There were already a large number of suppliers in the market who supplied refrigeration services to retailers. The evidence of the Commission's retailer survey (see Appendix 4.2) was that if manufacturers did not supply freezers, then retailers would acquire their own, as they did with freezers for frozen food and chilled food cabinets.

6.70. Mars submitted that if, despite these concerns, a system for reservation of space in freezers were permitted, the proportion of permitted reserved space should be much lower than the 60 per cent suggested; a figure of not more than 30 per cent would be more appropriate. Indeed, there could well be a case for requiring the dominant supplier to open up a much greater proportion of its freezers than the smaller suppliers given the respective sizes of their fleets and the relative sizes of the freezers in these fleets. Furthermore, if space reservation were to be permitted, there would have to be clear and enforceable rules as to the practices that could, and could not, be pursued in relation to 'exclusive space', especially by the dominant supplier. For instance, there would be an issue as to whether the manufacturer was able to specify precisely which areas of freezers were exclusive; some areas of a freezer were more attractive than others and this varied depending on the size and the type of freezer. A dominant manufacturer could ensure that the contestable space was the part that was least accessible to consumers and therefore least attractive. There would also have to be rules as to the anti-competitive practices which could not be pursued in relation to the contestable space (for example, a manufacturer could not specify what products could, or could not, be displayed in that space or enter into arrangements that favoured one manufacturer over another in relation to that space). Apart from the reservation of space, there could be no other restrictions or conditions as to the use of the freezer other than that it had to be used for the stocking of impulse ice cream. Accordingly, Mars considered that there should be no permitted exception to a general prohibition on the imposition of freezer exclusivity by reference to any level of capacity or display area. Should there be such an exception, the permitted level of reserved space should be no higher than 30 per cent.

6.71. On possible exceptions, for example kiosks or franchisees, Mars did not consider that any exceptions should be permitted since any exceptions would be exploited to the full by BEW, probably far beyond their intended scope and however closely they might appear to be drawn. For instance, a 'kiosk' was often little more than a form of outlet exclusivity and Mars saw no reason to allow freezer exclusivity just because a manufacturer had paid to have its colours and brands displayed. BEW also installed what it would probably regard as 'kiosks' in many sites, including some indoor sites (for example, in entertainment centres and cinemas). 'Kiosk' was a very broad term, and it could easily be exploited to circumvent any prohibition on freezer exclusivity. 'Franchisee' was also a loose, rather elastic, term which was used in many different ways in relation to the distribution of consumer goods and the provision of services. It would be easy for BEW to set up one or more chains of alleged 'franchisees' and then exploit the exception to circumvent any prohibition on freezer exclusivity. Mars noted the concern that a genuine operator of franchised ice cream parlours such as Häagen-Dazs might have regarding these remedies. If the Commission were to conclude that an exemption were the only possible means to safeguard the position of an operator such as Häagen-Dazs, that exemption would have to be tightly drafted to catch only genuine franchised ice cream parlours, which employed separate staff, had their own cash collection points and offered seating for the consumption of ice cream. Mars noted that mobilers were often described as franchisees. It saw no reason why products sold through mobilers should be exempted from the proposed remedies. In order to clarify the position, Mars suggested that mobilers be explicitly included in the definition of a 'retail outlet controller', for instance by altering this so that it covered '... premises or outlets (including mobilers) ...'.

6.72. With regard to the need for annually-published terms, Mars submitted that this issue should not arise as, in its view, no reservation of exclusive space should be permitted. However, Mars had concerns that if, contrary to its views, the Commission did recommend some reservation of space, the requirement for 'annually-published terms' might be used by BEW to claim that all agreements or arrangements with retailers had to be on an annual basis and that retailers could change their minds about the source of their freezers only once a year with the prospect that a considerable number might want to do so at the same time, thereby creating structural rigidity in the market and huge logistical difficulties. Mars considered

that it would be advisable to retain limitations on freezer contracts in this respect similar to those adopted following the Commission's 1979 report, ie an agreement should be capable of termination after the first 12 months by the retailer on not more than one month's notice in writing and inducements and incentives not to exercise the rights of termination should be prohibited.

6.73. Mars noted that no remedies were proposed as regards restrictions on the use of promotional materials or point-of-sale or selection materials. It considered that whether freezer exclusivity were completely prohibited or part-exclusivity were permitted, there needed to be remedies to ensure that a manufacturer, especially the dominant manufacturer, could not by other means give the impression that freezers were exclusive or secure exclusivity over other aspects of in-store promotion or otherwise restrict the promotion of the products of other manufacturers in freezers.

6.74. Mars submitted that, if the Commission were to recommend part exclusivity, it would be necessary also to recommend detailed rules for ancillary conduct or arrangements that would also be prohibited, perhaps coupled with a general prohibition on any conduct or arrangement that would have the object or effect of securing more than the exclusive space to the relevant manufacturer. Such rules would also be necessary in the case of the complete prohibition of freezer exclusivity. The risk remained that BEW would pursue conduct that would result in de facto exclusivity or otherwise seek to influence which products were, or were not, stocked in freezers. For example, one possibility that had occurred to Mars was that BEW could offer 'load-in' deals across a wide range of lines (for example, 16, 20 or even 24 lines) at the beginning of the season with the object of filling freezers with its products and in the knowledge that once the lines were stocked, retailer inertia would make it difficult to replace them with another manufacturer's lines until the following season. The result would be, at worst, de facto freezer exclusivity and at best reservation of a very high proportion of the space in freezers. Another possibility was that BEW would seek to deal on terms that affected the retailers' choice of competitors' products.

6.75. Mars considered that, in order to safeguard the openness of freezers, and in case the position should not for any reason be adequately covered by the outlet exclusivity remedy, it would be necessary to have a prohibition on any conduct or arrangement by a manufacturer that had the object or effect of securing exclusivity and also a prohibition on any manufacturer entering into any agreement or arrangement with a retail outlet controller in relation to any freezer the object or effect of which would be that the impulse ice cream of any other manufacturer could not be stocked in that freezer, or that such stocks were to be limited.

Outlet exclusivity

6.76. On outlet exclusivity, Mars considered that a prohibition on outlet exclusivity should apply to all significant manufacturers. That would certainly include BEW, Nestlé and Mars. The practice of outlet exclusivity had already been prohibited by the European Commission. A *de minimis* threshold of £5 million turnover of impulse ice cream would be appropriate. The remedy should also apply to any wholesaler agreeing exclusivity for the products of a manufacturer.

6.77. Mars noted that the remedy could be largely circumvented by a manufacturer agreeing contracts which might not directly impose outlet exclusivity but which could have much the same effect, for example by agreeing what other products might be stocked or under what conditions. This point would appear to be covered if the remedy extended to any limitation on supplies of the products of other manufacturers. Mars regarded this as an important aspect of the remedy in the light of its experiences with particular retail outlets.

6.78. As to the possibility of the reservation of space in an outlet, Mars considered that this was impracticable. The difficulties identified in relation to freezer exclusivity would be more pronounced in relation to entire sites or outlets, which were typically in the leisure sector. In particular, there would be constant scope for disagreement over whether the capacity limit had, or had not, been exceeded in any site or outlet which had a number of freezers; for instance some leisure sites might have up to 20 or more freezers. In addition, the introduction of new freezers would increase the total freezer capacity of the outlet; so the division of space in a new freezer would be dependent on the existing use of freezers at the site or outlet. Finally, there would be plenty of scope for BEW to ensure that, even though it formally reserved only 60 per cent of the space in the freezers, it in fact obtained, say, 80 or 90 per cent of the space or even retained de facto exclusivity. As a result, in these important leisure sites, the smaller suppliers (not just Mars, but the existing small suppliers and new entrants) would find it difficult to get

their products made available to consumers. Furthermore, the leisure sector represented a considerable business opportunity for independent freezer suppliers who might already, for instance, be supplying and/or maintaining other refrigeration at such sites. If BEW could continue to offer freezers with substantial reserved space, such suppliers would find it more difficult to offer impulse ice cream freezers to the site owners.

6.79. Mars did not consider that any exemptions from a prohibition of outlet exclusivity were necessary or appropriate. In particular, as already indicated, an exemption by reference to kiosks or franchisees would be an open invitation to BEW to develop allegedly new schemes with a view to preserving outlet exclusivity. There was no case for exemption for the leisure sector. The leisure sector was in reality no different from other retail outlets save for the fact that, in many cases, the operator charged the consumer for entry, and in most cases would have captive customers, and might seek to leverage its position with suppliers by offering exclusive deals for products to be resold to consumers on site. Mars was not persuaded by the points put to it during the course of hearings about the freedom that operators of these sites should have to enter into exclusive deals, especially with dominant suppliers, and to ‘cross-subsidize’ (as site operators would put it) entry ticket prices with higher margins on the resale of products and services on site. Consumers were becoming more price sensitive and would become more so as a result of the Government’s proposals set out in its recent Consumer White Paper ‘Modern Markets: Confident Consumers’. The Commission should be concerned generally about issues of cross-subsidization and with the interests of consumers in terms of choice and price. Indeed the Commission’s own conclusions on exclusive agreements in the leisure trade in its inquiry into carbonated drinks¹ were especially interesting in that regard.

6.80. To the extent that there was an issue regarding the level of margin needed to be achieved by leisure sites, there was no justification for the linkage of that margin to the sale of exclusive rights. Leisure site operators had a number of other alternatives to obtain the overall return they found necessary for the operation of their businesses. They could exact higher margins from distributors or from a range of manufacturers, negotiating on the basis that the alternative would be them ceasing to stock impulse ice cream altogether. They could aim to maximize the returns on their retailing operations by running them in the most effective way—such as through the offering of a range of competing products. They could charge an entry price which fairly reflected the cost of running the facility. They could adopt some combination of the foregoing. Consumers were increasingly, and rightly, expecting that they should not be exploited by operators, especially when they were in a captive site, selling well-known brands at premium prices or not offering a full range that meets the needs of consumers. The best way of avoiding consumers being exploited was to make them well informed about the value of products and ensuring broad distribution of products from suppliers operating in competitive, innovative markets.

6.81. Nor, in Mars’s view, was there any case for permitting some degree of exclusivity in a proportion of sites. This would cause considerable confusion to consumers (for example, why they had a choice of impulse ice cream in some motorway service areas but not in others operating under the same brand) as well as opportunity for anti-competitive divisions of outlets between manufacturers, perhaps even encouraged by the retail site controllers concerned.

6.82. However, if the Commission were to allow some limited outlet exclusivity, then Mars considered that contracts should last for no more than one year, should be subject to an annual tendering process and should be subject to published terms.

6.83. Whilst Mars noted that no remedies were proposed as regards the use of promotional activities or materials, it proposed that, in conjunction with a prohibition of outlet exclusivity, there should be a similar requirement to that described above (see paragraph 6.73) in relation to freezer exclusivity. This was even more critical in the case of leisure outlets or kiosks where consumers would often not have the opportunity to self-select a product from the choice on display as, for instance, in a CTN, but might be dependent on the point-of-sale material to make an informed choice, as the products were stored in, and served from, a freezer behind a counter.

6.84. As in the case of freezer exclusivity, there remained a risk that BEW would pursue conduct that would result in de facto exclusivity. It would therefore be necessary to have a prohibition on any conduct or arrangement by a manufacturer that had the object or effect of securing exclusivity.

¹*Carbonated drinks: a report on the supply by manufacturers of carbonated drinks in the United Kingdom*, HMSO, Cm 1625, August 1991.

Terms to retailers

6.85. With regard to discounts and other terms to retail outlet controllers, Mars considered that any remedies on discounts and terms should apply only to the scale monopolist, BEW. Mars did not consider that there was any case for restricting the ability of non-dominant manufacturers to deal on such terms of business as they considered appropriate in the circumstances. In particular, there was no case for requiring the terms offered by non-dominant manufacturers to be volume- or cost-related or for requiring those terms to be published and to be applied on a non-discriminatory basis. There was a lack of effective competition in the impulse ice cream market not as a result of any discounts or other terms offered by smaller suppliers, but solely as a result of the activities of, and the terms offered by, the scale monopolist through the abuse of its market power. BEW had built up, through anti-competitive behaviour and practices, a very strong position in the impulse ice cream market. It would not be easy to dislodge BEW from that position even if all the remedies proposed by the Commission were in fact imposed, and even if BEW did not find ways around them. Exposing all significant competitors to the same constraints would assist BEW in maintaining its present market position and would not enable the other suppliers to invest in competing with BEW by gaining distribution and in encouraging retailers to display, promote and sell their products alongside those of BEW.

6.86. Mars submitted that to apply remedies on discounts and terms to the non-dominant suppliers would be inconsistent with the Commission's practice in previous inquiries. Mars referred in particular to Commission inquiries into the supply of matches and disposable lighters, classified directory advertising services, the supply of recorded music, Tambrands Ltd, carbonated drinks and contact lens solutions¹. The principles derived from the Commission's previous inquiries had direct application to the practices of BEW and the treatment of the other complex monopolists. BEW had a market share in excess of 70 per cent, commensurate with, or higher than, that of the scale monopolists considered in previous cases; there were no substantial countervailing restraints on the use by BEW of its market power conferred by this market share; BEW had used discounts and other terms to foreclose the market to smaller competitors; and other manufacturers had neither the market power nor any other ability to use discounts and other terms in an anti-competitive manner. It was therefore entirely appropriate, and consistent with the Commission's past practice, to apply remedies relating to discounts and other terms to BEW alone.

6.87. Mars further submitted that to apply remedies on discounts and other terms to non-dominant suppliers would also be inconsistent with EC law and practice under the Community's competition rules. Under those rules, non-dominant suppliers subject to article 81 (ex-85) EC Treaty were free to set their own independent terms of business, including their discount and other terms, with their customers. It was only if a supplier was dominant that its freedom was constrained by the application of article 82 (ex-86) EC Treaty. The terms of business of a dominant supplier must not be abusive. In particular, a dominant supplier must not discriminate between customers in a similar position; any differences must be objectively justified by reference to costs or some other factor; and a dominant supplier must not employ discount, bonus, rebate or similar schemes (or engage in other conduct or practices) the economic effect of which was further to reduce or impede effective competition by excluding or restricting the activities of actual or potential competitors. According to EC jurisprudence, a company in a dominant position had a special responsibility to ensure that the remaining competition in the market was preserved.

6.88. In the public interest letter, the relevant complex monopoly had been identified by reference to the practice of giving volume-related year-end bonuses (or discounts) to retailers. In the remedies letter, the Commission had identified a complex monopoly also in relation to offering or giving unpublished price-related and other incentives in connection with the supply or promotion of impulse ice cream products. The evidence that Mars had from the 1998 report and from the trade about the nature and scale of BEW's discount, rebate, bonus and other incentive schemes suggested that they were wholly different in nature and scale, as well as in their objectives, from the practices of Mars. It was therefore inappropriate, as a matter of principle, to consider them all together as part of a complex monopoly and also inappropriate not to consider, on their own, the effect of the schemes of the scale monopolist.

¹*The supply of matches and disposable lighters: a report on the supply for retail sale in the United Kingdom of matches and disposable lighters*, HMSO, Cm 1854, March 1992; *Classified directory advertising services*, HMSO, Cm 3171, March 1996; *The supply of recorded music: a report on the supply in the UK of pre-recorded compact discs, vinyl discs and tapes containing music*, HMSO, Cm 2599, June 1994; *Tambrands Ltd: a report on the granting of discounts by Tambrands Ltd on condition that the whole or part of the Tambrands range of tampons is stocked*, HMSO, Cm 3168, February 1996; *Carbonated drinks* (see footnote to paragraph 6.79); *Contact lens solutions: a report on the supply within the United Kingdom of contact lens solutions*, HMSO, Cm 2242, May 1993.

6.89. Mars would also be surprised if the only manufacturers to engage in this new complex monopoly situation were BEW, Mars and Nestlé. It believed that other manufacturers, just as they also practised freezer and outlet exclusivity, would also offer non-volume-related discounts and unpublished incentives to retailers. Whilst it seemed to Mars entirely logical to prohibit the practice of freezer or outlet exclusivity for all significant manufacturers in view of the structural barriers created by those practices, Mars did not consider that it was logical that either Mars itself or other smaller manufacturers should be restricted in the terms that they could offer to retailers. Indeed to apply the remedies to Mars (and Nestlé) as well as to BEW but not to other smaller suppliers would put Mars (and Nestlé) in the worst of all possible worlds—in a squeeze between the dominant supplier and the smaller suppliers. Mars (and Nestlé) would be exposed to the actions of BEW designed to maintain its dominant position and to the actions of the smaller suppliers, which they could not replicate, to develop their businesses.

6.90. It might be put to the Commission that BEW would be placed at an unfair or unreasonable competitive disadvantage if it were subject to remedies in relation to discounts and other terms to retailers, whereas other suppliers were not. It might be suggested that by having to publish its terms and operate them in a non-discriminatory manner, BEW would be vulnerable to having its business ‘picked off’ by competitors who would know the terms offered by BEW and could match or improve on those terms. However, it could not be denied, even by BEW, that it had a very strong existing market position. BEW attributed this position to the superiority of its products, skills and resources; to the satisfaction of the retailers who sold its products; and to the satisfaction of the consumers who purchased them. If such claims were correct, such superiority and satisfaction would continue to deliver to BEW high levels of availability of its products in the trade and of sales of those products. It was unrealistic to think that BEW could be, or would be, dislodged from its dominant position either easily or quickly; and, as Mars had already indicated, it expected BEW to respond in every conceivable way to hold on to its position. So there was no question of BEW’s dominant position evaporating overnight.

6.91. Moreover a dominant company, such as BEW, had no credible right to claim special protection against competition from non-dominant suppliers; all the more where that dominant position had been developed and strengthened by rigorous and ruthless pursuit of anti-competitive behaviour and conduct; and the market share of the dominant company was around 70 per cent, whereas its next nearest competitors, from whom it might suggest protection was necessary, had shares of less than 15 per cent. If there should be any concerns about the potential impact on BEW alone of the remedy on discounts and other terms, then that was a matter that could be dealt with as part of the regular review of the remedies that would be carried out by the DGFT.

6.92. As in the case of freezer and outlet exclusivity, Mars submitted that the remedy should also apply to any wholesaler offering or giving incentives relating to the supply or promotion of the products of BEW.

6.93. Mars was uncertain that the distinction between terms and incentives was as clear as the remedies statement might suggest. The proposed remedies did not sufficiently address the potential for continued abuse of its market power by BEW. In the light of its market position, BEW was able to generate very substantial funds which it was then able to deploy in the trade to protect its position. The remedies did not appear to Mars to prevent the possible diversion of these funds into trade terms which could broadly satisfy the terms of the remedies but which nevertheless, because of their size and the way and form in which they would be deployed, would make it impossible for smaller suppliers to compete effectively in the market. BEW could simply drive up the margins offered in the wholesale and the retail trade to levels which it knew that competitors, because of the size and financial condition of their businesses, could not sustain and in that way purchase the loyalty of the trade to BEW and its products, even though formal exclusivity of freezers and outlets, and practices having similar object or effect, had been prohibited.

6.94. Accordingly, Mars considered that, in order to prevent abuse of BEW’s market power, any remedies on discounts and terms imposed on BEW would have to be accompanied by caps on the absolute levels of margin that could be offered or given by BEW to wholesalers and to retailers. In determining such margins all terms and incentives of whatever form or type would have to be taken into account. In relation to wholesale margins, the Commission had already given an indication of the range of wholesale margins that it considers might be appropriate to maintain a viable independent wholesale sector. Depending on precisely what was included in those suggested figures, the range suggested by the Commission did not appear unreasonable to Mars. So far as retail margins were concerned, a comprehensive cap should be structured in such a way that, on the one hand, abuse of market power by BEW was

prevented and, on the other hand, the normal process of bargaining between suppliers and customers which would be expected to take place in a competitive market was not constrained.

6.95. In any structuring of the remedies, and in particular in relation to any caps, there would have to be a clear understanding as to how particular types of activity were to be categorized. For instance, so-called 'presence marketing' (for example, in the form of sponsorship of a ride or payment for the construction of a facility in return for display of the brand), even if it were formally delinked from any requirement for exclusivity, could still be used by BEW as a powerful tool to induce retailers to buy exclusively, or near exclusively, from BEW. It would therefore have to be clear that any such expenditure was classified as an incentive and could not be classified, for instance, as part of general advertising or general marketing activity.

6.96. Mars argued that, in principle, a dominant supplier should supply, and should be required under the competition rules to supply, on terms that related the discounts granted to the volumes purchased. However, it would be necessary to determine what 'volume-related' meant: in particular, whether the volume concerned was per order, per delivery, per month, per season or per year; and how the discount or bonus was related to the volume, for example, by reference to costs or other objectively justifiable factors. Furthermore it would need to be determined whether there were any limits to the scale that could be used, such as in terms of the relationship between volume and discount, or the number of points on the scale, or the steps and rate at which the scale would escalate. Such limits might be essential to prevent the dominant supplier adopting a scale which escalated rapidly and therefore had a suction effect on customers' purchasing decisions. Furthermore, it would have to be determined whether the remedy would allow different scales for different channels of trade (for example, to address a perceived need for different margins in different channels) and, if so, how channels of trade could, or should, be defined. The Commission had referred to 'any discount or bonus' being 'volume-related' and also to the 'price for incremental sales' not being 'less than incremental costs at every point on the scale'. Mars believed that the two remedies should be applied together, and should only reflect cost savings to BEW flowing from (or other objective factors relating to) such increase. If the two remedies were not applied together, Mars would have significant concerns.

6.97. With regard to the suggested remedy that any unpublished or other incentives should be on an annually published basis and be non-discriminatory, Mars submitted that such incentives needed to be objectively justified by costs or other factors. However, some flexibility would be necessary to cover seasonal incentives and special offers. Mars suggested that the requirement for annual publication should apply only to incentives offered or given for the entire season; other incentives could be offered subject to prior notice being given (for example, a minimum of 12 weeks' notice) to all wholesalers and retailers so as to enable the trade generally, and the national wholesale trade in particular, to be prepared to handle them.

6.98. Mars observed that in any event the case for additional selective terms and incentives should largely disappear once the principle was established that exclusivity and any reservation of exclusive space had been prohibited, since a large proportion of such terms and incentives were offered or given by BEW in order to support exclusivity or preferential treatment in-store. Mars did not see any case for exemption by type of outlet or by types of discount or incentive.

Distribution

6.99. With regard to distribution, Mars emphasized its agreement with the Commission's objective of ensuring the survival of an independent wholesale sector in the short and long term. Recent events had shown how precarious the businesses in the independent wholesale sector were, and how exposed they were to the abuse of market power by BEW.

6.100. Mars did not see that there was any basis for applying any of the distribution remedies to all manufacturers, subject to a *de minimis* exception. The remedy was only required due to the quite extraordinary steps taken by BEW to protect its dominant market position, particularly following the 1998 inquiry. Its objective had been to secure as far as possible the distribution of its own products for its own distribution business, Wall's Direct, at the expense of the ex-dedicated distributors and all other independent wholesalers, with a view to denying to its competitors an effective and efficient distribution system.

6.101. In Mars's view, any remedy which required BEW to supply independent wholesalers on terms which permitted distribution 'on an economically viable basis' while still continuing to operate its own distribution system would not meet the objective set by the Commission, namely 'to ensure the survival of an independent wholesale sector in the short and long term'. For so long as BEW had its own system, and a dominant market position, that system would be in conflict with the independent distribution sector and would continuously threaten its viability, and therefore its survival.

6.102. Indeed the position would become circular—but beneficial to BEW. Every additional customer secured by the BEW distribution system would take business away from the independent wholesale sector. To the extent that this reduced the viability of the sector, BEW would have to improve its terms. But since its volume through the independent sector would be falling, so would its share of the responsibility of ensuring that the independent sector remained viable. Conversely, the share of the responsibility carried by other suppliers using the independent sector would rise, and wholesalers would look to those other suppliers also to increase their margins. As suggested by the results of Dr Ray's distribution study (see paragraph 6.42), independent distribution might not be viable on any basis in a market where a supplier with over 70 per cent market share forced distribution of its products through its own distribution system. As the system strengthened, the margins necessary to maintain a viable independent network would rise to compensate for the reduced share of the distribution business.

6.103. Mars did not consider that a remedy framed by reference to an 'economically viable basis' was workable. The specialist distribution system should be independent and dynamic. Wholesalers would have different businesses under the same roof; different summer and winter activities; their costs would vary according to the nature of the area served (for example, urban or rural), the geography of the area and the density of drops and drop sizes. In any event, viability could not be established only by reference to terms. Manufacturers had to have access to outlets and to be able to compete effectively within the sector and against other suppliers outside the sector (for example, Wall's Direct or any other BEW distribution system). Distributors had to be able to offer the necessary service levels, but not to be driven to offer uneconomic service levels, especially in the case of a dominant manufacturer. A viable basis for an independent wholesale sector could not be established by reference to any in-house or contracted-out arrangement as that was unlikely to replicate the true costs of an independent, entrepreneurial wholesaler. In particular, any suggestion that BEW's Barking depot was a 'model' or 'standard' should be firmly rejected, not least because the depot had had the benefit of serving exclusive freezers and outlets in a dense urban area for a dominant supplier, so that its costs would not be representative of the position of an independent wholesaler supplying the goods of a range of manufacturers. Indeed, Mars did not consider that there was, at present, any realistic model which could be used as a basis for comparison, as a result of the dominance and actions of BEW both in relation to the ex-dedicated distributors and generally. If there were to be any allowance for 'service levels' this would no doubt be abused by BEW which would seek to impose on wholesalers absurd service levels (for example, one box within 24 hours—as with Wall's Direct) in order to justify better terms. The market—the demands of the retail trade on an efficient independent distribution system—should be left to determine what were the appropriate service levels.

6.104. Under normal market conditions, the level of discounts suggested by the Commission (17.5 to 22 per cent GSV) appeared to be appropriate levels of margin for independent wholesalers, provided that they represented the off-invoice margin only (ie discounts given to the wholesaler on the face of the invoice) and were guaranteed to be paid, rather than being discretionary or based on performance. However, given the considerations set out above, Mars did not consider the imposition of a minimum margin for independent wholesalers to be an adequate remedy. As indicated in paragraph 6.94, Mars thought that it might be necessary for the Commission to prescribe the maximum levels of discount that BEW might offer or give in order to prevent abuse of its market power.

6.105. Mars did not consider that a possible remedy of separating manufacturing from sales and delivery was practicable, especially in view of the conduct of BEW in the last year. If freezer and outlet exclusivity were prohibited for all significant manufacturers and BEW were constrained in the ability to offer anti-competitive price and other terms, then it would be illogical for BEW to seek to retain its own distribution system. A remedy that only required segregation of manufacturing from sales and distribution would confer a huge advantage on a supplier with a 70 per cent market share. Offering separate sales and distribution for one manufacturer's impulse ice cream products only made sense in the case of a dominant supplier, whilst imposing disadvantages on retailers (the need for at least two suppliers, two deliveries and two accounts) and others (including consumers and the environment) and denying independent distributors the opportunity to offer customers an efficient and cost-effective service. A remedy

which merely required the separation of manufacturing from sales and distribution on the part of a supplier with a 70 per cent market share would not meet the Commission's objective of ensuring the survival of an independent wholesale network in the short and long term. The size, resources, national coverage and 'must-stock' nature of its brands, coupled with its extensive knowledge of the retail market and of the freezer base, would give BEW an overwhelming advantage over an independent wholesale trade. It was also inappropriate to require merely that BEW should not operate such a segregated entity for sales and distribution at a loss. Any segregated entity should in any event be expected to operate as a stand-alone operation and to earn a profit commensurate with its activities and the investment made in it.

6.106. Concerning the hypothetical remedy of access to a competing manufacturer's distribution system, Mars submitted that this remedy was neither practicable nor necessary. The remedy would not meet the Commission's objective of ensuring the survival of an independent wholesale sector in the short and long term. It would also inevitably place competing manufacturers at the mercy of the dominant supplier, and BEW's behaviour over the last few years suggested that it could not be trusted to act fairly and reasonably in relation to competitors' products. The BEW system had been designed to suit BEW and to serve BEW's exclusive freezers and outlets and the terms on which it currently did business. The system could not, and should not, be permitted to continue.

6.107. Mars had already had one unsatisfactory experience of access to a Unilever distribution network. As a condition of the clearance of Unilever's acquisition of Ortiz Miko in France by the European Commission, Unilever had given undertakings that Mars should have access to the Ortiz Miko distribution network for a period of two years following the acquisition. Mars found that Unilever never fully respected the undertakings and the distribution of its products was never effective during the period. Mars would not wish to repeat the experience in the UK.

6.108. If, contrary to Mars's views, the Commission were to conclude that the BEW system could continue subject to a limitation on the proportion of BEW's sales through Wall's Direct, Mars suggested that that proportion should certainly be no more than 30 per cent of BEW's sales, and preferably should be less. It was only if the proportion were at or below that level that there would be sufficient business to encourage the survival and development of an independent wholesale sector. This remedy would still need to be combined with a requirement that independent wholesalers be supplied on an economically viable basis, with non-discriminatory, published terms, as well as being combined with the separation of manufacturing from sales and distribution.

6.109. Concerning the possible remedy of restricting sales and deliveries to, and contracts with, retail outlet controllers, Mars stated that a remedy was essential and should be recommended in relation to BEW only. Appropriate additional restrictions, in Mars's view, were that there must be no limitation on the acquisition, stocking or promotion of other manufacturers' products, whether or not at the request of the retail outlet controller, and the terms must be unlinked to the use of a distributor, or with the acquisition of other goods, or between different classes of impulse ice cream.

6.110. Mars agreed with the Commission's view that any exception for national accounts should be very limited in its extent, ie only to those few retailers who arranged their own distribution to retail outlets. It did not consider delivery to such accounts to be widespread. Its estimate was that such national accounts represented no more than 10 per cent of total sales of impulse ice cream and such distribution would not be carried out by chains with less than 50 outlets. Mars suggested that a national account should be described as follows: a national account retailer must have a minimum of 50 outlets operating under a fascia or fascias owned by it and control its own distribution of a wide range of products of all types (not just ice cream products), from a range of manufacturers, to all its stores. In addition, should 10 per cent or more of BEW's sales fall under the exemption, the DGFT should have power to review the operation of the exemption and to change its terms or impose further conditions. If special terms were to be permitted for national accounts, these should also be published and non-discriminatory. These should be based on the terms for retail outlet controllers with a published deduction for the retailer carrying out its own distribution.

6.111. As to a possible restriction on the use of information provided by distributors, Mars stated that any potential to misuse confidential business information supplied by distributors, in the way in which BEW appeared to have done over the last year, could be greatly reduced if BEW was limited in its ability to sell or deliver to retail account controllers. It would, however, continue to be a major issue if alternative distribution remedies were adopted. Mars generally agreed with the tenor of this proposed remedy.

Other issues on remedies

6.112. In Mars's view, it was essential that the Commission's recommendations on remedies should include a provision that all remedies should be introduced simultaneously and in time for the start of next year's season. The interrelated nature of the remedies and the interlocking nature of BEW's practices meant that any other approach would be likely to lead to the remedies being ineffective and open to abuse and circumvention.

6.113. Remedies for freezer and outlet exclusivity and in relation to distribution should be of unlimited duration, as they should be intended to prohibit inherently anti-competitive practices for which there was no justification. It might be appropriate to recommend limits on the duration of any remedies in relation to discounts and terms to retailers. Since these were only necessary as a result of BEW's market power, they should not be considered for removal unless BEW's market share fell to a level which meant that it could not be regarded as dominant; this figure should be 40 per cent. In any event, these remedies should be imposed for a minimum of five years by which time it should be clear how the market would develop. The DGFT should be permitted wide powers of review of any remedies once implemented, including a general power to demand changes to the remedies if it became clear that they were not achieving the intended opening up of the market. Furthermore, if the Commission had doubts as to whether any of the remedies outlined in the remedies letter should be implemented initially, then the Commission should at least recommend that those remedies should be held in reserve by the DGFT so that, if the remedies initially proposed did not achieve their objective, additional remedies could be implemented without a further inquiry.

6.114. Mars noted that the Commission was considering preventing any manufacturer to which a prohibition was applied from enforcing any existing agreement to the extent that it did not comply with that prohibition. Mars agreed that such a remedy was essential. Indeed, unless it was recommended, BEW would immediately enter into as many long-term deals as it could in order to protect its position.

6.115. Mars wished to clarify the scope of the term 'impulse ice cream' in the context of the remedies; in particular whether it included both wrapped hand-held 'singles' and similar products when sold in multipacks; and whether or not it also included soft and scoop ice cream. This was particularly important in clarifying the relevant turnover for the purposes of applying some of the proposed exemptions.

6.116. A further general point was the continuing future of the undertakings given by BEW following the 1979 and 1998 inquiries. The 1982 undertakings addressed limitations on the use of outlet exclusivity, freezer exclusivity, contractual conditions entered into with retailers, exclusive distribution arrangements and mobiling franchises. All those areas were being considered in the current inquiry and remedies which might supersede the 1982 arrangements had been proposed in all of them with the exception of mobiling. The 1998 undertakings addressed discrimination by BEW between dedicated distributors and non-dedicated wholesalers. Again, the Commission's conclusions might have an impact on the 1998 undertakings. In so far as the Commission concluded that restrictions more stringent than those in the existing undertakings were appropriate, the existing undertakings should be terminated as being no longer applicable. If the Commission intended in any respect to build on the existing undertakings, it would be necessary to take account of changes in the structure of the market since these were negotiated. In particular, it would be desirable to clarify disputed definitions in the 1998 undertakings and to reconsider the issue of the exception for wholesalers purchasing more than £7.5 million of BEW products in the light of BEW's refusal to supply the buying groups composed of former dedicated distributors. A similar issue arose in the context of the 1982 undertakings, which contained an exemption for franchised outlets. Mars was concerned that the definition of a franchise was wide enough to permit BEW to present much looser concessions as franchises, so qualifying for exemption. Mars therefore proposed that the preferred solution would be to suggest comprehensive remedies that superseded all previous undertakings.

6.117. Any proposed remedies should be recommended with a requirement that the DGFT consulted widely and quickly on the detailed terms of any remedies. Mars was particularly concerned that there should be such a provision following the experience after the 1998 report where an exemption was permitted for wholesalers with a turnover of over £7.5 million. This was not contemplated by the Commission and had proved to be open to abuse by BEW. A similar position appeared to have occurred following the 1979 report, when the provision that the prohibition on outlet exclusivity did not apply where the retailer requested exclusivity had been introduced at the undertakings stage.

6.118. Mars submitted that the Commission should not be sympathetic to any suggestion made by BEW that the remedies in the remedies letter were disproportionate. They were only regarded as disproportionate by BEW because BEW realized that, for the first time in many years, its market power, built on anti-competitive practices, was liable to be curtailed and that those practices on which it had relied to build its business might be prohibited. The remedies suggested were entirely proportionate in their application to BEW, both in view of the need to restore a competitive market and in the light of BEW's past behaviour. It was only the fear of effective competition in a contestable market, and nothing more, that drove any claim on disproportionality by BEW.

6.119. Mars further submitted that, in order to avoid the possibility of future abuse, Unilever should be precluded from acquiring any interest in any wholesale or distribution business serving the impulse ice cream industry without the consent of the DGFT.

6.120. Mars also proposed that, in order to ensure fair treatment of all distributors and all retailers, BEW should have a standing, published policy for the allocation of any product in short supply and should undertake to apply that policy at all times.

6.121. Lastly, Mars said that the potential scope of the remedies proposed could, and should, have far-reaching effects on the impulse ice cream market. In order to minimize confusion and the risk of the impact of the remedies being represented in a misleading manner, suppliers should be required to announce the impact of the remedies in a letter to each of their wholesale and retail customers with whom they had direct contact, in a form approved by the DGFT.

Further observations on remedies

6.122. We asked Mars about the practicalities of getting any remedies implemented effectively in time for next season. Mars believed that there was sufficient capacity and flexibility in the trade to enable changes to be implemented rapidly; it pointed to the changes introduced by BEW at short notice for the present season. Whilst it was essential that certain measures be put in place for next season, other measures could be left for detailed negotiation of undertakings in the light of the development of the market and BEW's reaction, including a further assessment by the DGFT of BEW's behaviour. Mars considered that the three main areas that needed to be addressed by the beginning of next season were: (a) the prohibition of freezer exclusivity; (b) the prohibition of outlet exclusivity; and (c) the prohibition of direct sales and distribution.

6.123. On the prohibition of freezer and outlet exclusivity, Mars reiterated that exceptions or qualifications other than a *de minimis* gross turnover exception, for example, based on reservation of space or capacity, were unnecessary and would only introduce a range of difficulties and complexities. They would add considerably to the burden of framing any undertakings or orders and in operating and policing them. Exceptions and qualifications would play into the hands of those in whose interest it would be to cause delay in the opening up of the market.

6.124. In response to the Commission's questions as to whether there should be some exception for seaside leisure sites, licensed by local authorities, who relied on manufacturer-funded kiosks in order to provide facilities for the sale of ice cream in resorts, Mars considered that in an open market situation, these kiosks would continue to be funded by a variety of manufacturers, who would have a shared interest in ensuring the availability and effective display and promotion of impulse ice cream without any need or requirement for exclusivity. The perception on the part of such sites that they would be losing something if they were not able to use exclusivity as a bargaining tool was mistaken. They had become conditioned by the practices of the established manufacturers and had not experienced the benefits of an open market. Mars did not consider that a 'partial exclusivity' exemption for such sites was necessary, and indeed thought such an exemption could introduce a degree of arbitrariness and complexity into the situation. However, Mars suggested a possible form of exemption should the Commission wish to pursue it. Mars confined its suggestion to the specific example of seaside sites. It did not appear appropriate to Mars to extend the exemption to commercial operators, whether at the seaside or in other leisure venues inland, or to other travel or leisure operations such as motorway service areas.

6.125. On distribution, Mars emphasized that the proposed remedies of a requirement to supply on 'an economically viable basis' and for corporate and accounting separation would not, in themselves, be sufficient solutions. Mars continued to believe that the only appropriate remedy was the prohibition of

BEW (and Nestlé) engaging in direct sales and distribution (subject to a limited exception in relation to national accounts) coupled with published and non-discriminatory wholesale terms and with a prohibition on supply being linked to a particular distributor. Mars referred to possible terms for a national accounts exception in its written response (see paragraph 6.110). The argument for some other limited exception, allowing a proportion of business (for example, a percentage of market share) to be serviced direct caused great difficulty. BEW itself had continually emphasized the need for specialist dedicated distribution, and once it was accepted that the vast majority of the dominant supplier's sales would be through an open and independent system, the commercial case for retaining a 'toehold' in direct business was not sustainable. The direct distribution business would always be regarded as a threat by the independent network; Wall's Direct had devastated the independent network this year. Even a limited direct distribution business could easily be used (for example, geographically) to attack smaller wholesalers (for example, in urban areas). It would have no real value as a so-called 'benchmark'; a supplier would do better to concentrate on monitoring and seeking to improve the relative performance of his wholesalers.

6.126. As regards wholesale terms, Mars considered, subject to one point, that provided these met the broad conditions set out by the Commission (paragraph D.4(a) of the remedies statement—see Appendix 2.4), this should be sufficient. In relation to any volume-related scale, Mars believed that the requirement should be for a volume-related scale linked to the average size of individual orders to each customer over a season (to take account of seasonality and avoid complexity) and that the scale must be drawn on a basis that reasonably reflected the actual costs of distribution. Although the position that Mars took in its written response to the remedies letter was that there was no case for Mars to be included in any such distribution remedy, it would be content to undertake or be required to support the independent distribution network through the application of this remedy to it.

6.127. On discounts and other terms, Mars commented that this area was of great concern because of the risk that BEW would simply use its resources to buy a very strong market position once it was no longer able to protect its existing position through exclusivity. Mars therefore considered that some reasonable and temporary cap on BEW's wholesale margins was essential. If, for instance, BEW were to go to the new, independent wholesale network, and offer a margin of 40 per cent, then all other manufacturers would either have to follow suit or suffer serious loss of their sales; in either case their financial position would be further imperilled. Increased margins would be at the expense of consumer promotions, and it was unlikely that consumers would see much benefit from the increased wholesale margins. The terms that BEW had imposed on the ex-dedicated distributors had demonstrated BEW's willingness to impose non-commercial (low) terms to drive competition at the distribution level out of the market. If BEW were required to support the independent distribution network, it might well seek to drive other manufacturers out of that network by imposing non-commercial (high) terms. Mars also did not see any need for any manufacturer to have more than one set of wholesale terms.

6.128. As far as retail terms were concerned, Mars repeated that the need for intervention only arose because of the clear likelihood of abuse by BEW. Mars believed that the potential for mischief would be reduced if all discounts, terms, bonuses, allowances and incentives available to retailers from BEW were available on published terms and on a non-discriminatory basis. This would include, for instance, terms for supply of kiosks, sponsorship of rides, provision of any form of presence marketing, subject to a *de minimis* provision (to cover umbrellas, litter bins etc) of, say £100 per outlet per year. Volume-related scales would have to be established so that they did not have a 'suction effect' and would be primarily defined by reference to a limited number of well-established channels of trade. Mars did not see the need for many different scales or sets of terms. It believed that BEW's existing complex system was neither necessary nor desirable. It had only been built up by BEW so that it could discriminate unfairly between customers in order to secure exclusivity and to extinguish competition.

6.129. Mars considered that there were only three basic channels of trade: independents, multiples (including petrol, convenience, symbol and off-licences) and leisure/seasonal (including mobilers). The terms offered to these different channels should be required to be cost justified or justified by reference to other objective factors (such as the proven requirement for higher margins in the channel concerned). These differences would not have to be set by the Commission, or by the DGFT. (Even if it was argued that leisure and seasonal should be split into two channels, and that petrol, convenience, symbol and off-licences should each be split off from multiples, that would still give only a maximum of eight channels where different terms would have to be cost or objectively justified.) Mars did not see that there would be any case for requiring other manufacturers to be subject to the same constraints as BEW. The objective was to prevent the dominant manufacturer continuing to abuse its market power by buying trade

presence through the selective use of discriminatory and unpublished terms. The fact that all retailers would be able to claim whatever they were eligible for would be a powerful incentive on BEW not to offer over-generous terms. Instead, BEW could deploy its resources on competing at the retail level with other manufacturers by offering price and value promotions to consumers. As previously stated (see paragraph 6.90), Mars did not see that there was any serious risk of BEW finding that its business was being 'picked off' by other manufacturers as a result of BEW having to publish and adhere to its terms. Retailers would still find many BEW products very attractive because of their rate of sale and 'must-stock' nature; and no doubt BEW would market its products effectively, indeed perhaps more effectively, by engaging in more competition in price and value to the consumer. In any event, the duration of this remedy would be limited, and BEW's position could not possibly be seriously threatened in this period.

6.130. The case for remedies that could be implemented for next season had been strengthened by the serious signs of financial distress among the ex-dedicated distributors in the final weeks of the inquiry. Mars believed that there was a real and substantial risk that, unless at least some remedies were implemented very soon after the Commission's report, more ex-dedicated distributors would be forced out of business. There would be a point at which it was no longer practicable to seek to plug holes in the network or to attract other distributors to join it since they would have no confidence as to the future. Mars thought that the Commission could assist in a number of ways: first, by reaching conclusions and making recommendations which built confidence; secondly, by emphasizing the urgent need for remedial action; thirdly, by making it easier for the Secretary of State and the DGFT to decide upon the appropriate form and content of any remedies; and fourthly, by suggesting that certain remedies should be introduced immediately, with others coming in later or held in reserve.

6.131. The trade, and especially the wholesale trade and the ex-dedicated distributors, would have their confidence in the future strengthened if the Commission's conclusions and recommendations made absolutely clear that BEW's conduct had been unacceptable and that fundamental changes to the structure of the industry were required in order to ensure that there would be a competitive market in the consumer's interest. Once the report was published and during any period of consultation on remedies, it would at least be possible to use the Commission's analysis to build confidence in the trade and to prepare the trade for possible changes as well as for all manufacturers and wholesalers to develop their plans. That would be an excellent starting point. Mars hoped that the Commission would be able to explain and stress the urgency of the situation in its report together with the need for many of the remedies to be in place for next season.

6.132. Although Mars understood that both acceptance of the report and the form and content of remedies were matters for the Secretary of State, the Commission could formulate its remedies and comment on the relative use of undertakings and orders to implement any remedies, in order to assist the Secretary of State and the DGFT. In particular, as regards the formulation of remedies, the Commission could stress that these should be framed in simple, broad terms, and not subject to detailed exceptions and qualifications. It also seemed to Mars that this was the kind of case where a combination of orders and undertakings might be required. Orders would be appropriate where there were a number of companies involved, and others might be drawn within the terms of the prohibition in the future (such as by growth in sales). Undertakings would be more appropriate where just one company was involved and the restrictions were intended to last only for a period. In relation to undertakings, the history of BEW's dealings (including the recent variation in relation to the north of Scotland) suggested that BEW was well able to cause delay in the detailed negotiation of terms as well as to evade the whole purpose of any undertakings that were finally agreed.

6.133. Mars thought that the pressing need for remedies for next season, but the concern that some remedies might require time for consultation, negotiation and implementation, could be reconciled in the following way. Certain simple and straightforward remedies could be introduced immediately, mostly by order, with other remedies being left to be discussed and considered for a second stage (perhaps the 2001 season), if they should prove to be necessary. Mars suggested the following:

- (a) A prohibition on freezer exclusivity, or any agreement, arrangement or course of conduct (for example, relating to stocking, point-of-sale materials, discounts, incentives or promotions) having the same or similar object or effect, subject to the *de minimis* gross turnover exception, to come into force by interim or final order no later than 1 March 2000.
- (b) A prohibition on outlet exclusivity, or any agreement, arrangement or course of conduct (for example, relating to stocking, point-of-sale materials, discounts, incentives or promotions)

having the same or similar object or effect, subject to the *de minimis* gross turnover exemption and (if considered to be essential) a limited seaside outlets exception, to come into force by interim or final order no later than 1 March 2000.

- (c) A prohibition on exclusive distribution, to come into force by interim or final order no later than 1 March 2000.
- (d) A prohibition on direct sales and distribution and on any term or condition that linked supply (or terms of supply) to the use of a particular distributor or class of distributor, subject to the *de minimis* gross turnover exemption and a limited national accounts exception, to come into force by interim or final order no later than 1 March 2000.
- (e) BEW to undertake to the DGFT no later than 1 March 2000 not to offer discounts, bonuses, allowances or other terms or incentives to the wholesale trade that exceed, in the aggregate, 22.5 per cent of the published price of the products without the prior consent of the DGFT. This undertaking would last for a minimum of five years, unless the DGFT decided otherwise.
- (f) BEW to undertake to the DGFT no later than 1 March 2000 not to acquire any interest in any business engaged in the distribution of impulse ice cream without the prior consent of the DGFT. This undertaking would be without limit of time, but would be subject to the usual process of review.

6.134. Mars believed that these orders and undertakings would be relatively simple to draft and prepare. In particular, there would be little scope for BEW to cause delay over negotiation of the terms of the undertakings.

6.135. As regards the issue of retail terms, Mars appreciated that this could be an area where there could be a case for allowing more time for the framing of remedies. However, it seemed to Mars to be wrong if the Commission, having undertaken the current thorough inquiry, were simply to leave any issues raised in this inquiry in relation to terms to be dealt with by a new investigation under the new Competition Act. Mars therefore suggested that the Commission should also recommend that:

- (a) Undertakings be sought from BEW in relation to retail terms, on the basis of the following principles, namely:
 - (i) all discounts and incentives to be published;
 - (ii) all discounts and incentives to be available on a non-discriminatory basis;
 - (iii) all discounts and incentives to be related to cost or other objective factors;
 - (iv) appropriately justifiable different terms to be available in a (limited) number of distinct channels;
 - (v) no linkage between terms and incentives and the use of any distributor or class of distributor; and
 - (vi) no linkage between impulse ice cream and any other goods or between different classes of impulse ice cream.
- (b) BEW's wholesale and retail terms should be subject to regulation by undertakings or, if necessary, by order if, in the opinion of the DGFT, its terms were causing distortions of competition in the market.

6.136. However, whilst the undertakings should be put out for initial negotiation and discussion, the DGFT should be given discretion not to bring the matter to a conclusion if he was reasonably satisfied that the terms that BEW adopted for the next season, and thereafter for a period of five years, generally followed these principles and its behaviour was not otherwise anti-competitive. The undertakings would be based on well-established principles applying to companies in a dominant position, albeit that they would require some detailed discussion in their application to this market. Mars considered that the purpose of this proposal and formulation was to encourage BEW to act responsibly, without the need for detailed negotiation of undertakings and what might be regarded as undue intervention by the compe-

tition authorities. If BEW failed to act responsibly, knowing the clear consequences of its actions, then undertakings should be sought and, if BEW refused, an order should be made regulating its conduct, but without the need for yet another time-consuming and expensive inquiry. The remedy in paragraph 6.135(b) would be the ultimate sanction that would be held in reserve if BEW continued to misuse its market power through terms and declined to give, or delayed in giving, undertakings. Whilst there would be some initial work on the potential undertakings, the hope would be that BEW would, at least in a broad sense, behave responsibly in the light of the Commission's conclusions and recommendations and that both BEW and its competitors would find it more interesting and productive to be competing in an open market than making complaints to, and engaging in discussions with, the DGFT about the regulation of the impulse ice cream market.

The views of Nestlé UK Ltd

Nestlé's first submission

6.137. Nestlé submitted that the dominant market position held by BEW was not of itself a cause for complaint as it was not unusual and perfectly legal for a successful business to hold a position of dominance. There was no reason why such a business should not strive for further growth—an ambition which Nestlé would also regard as perfectly natural. However, once such a position was reached, there was a fine dividing line between practices on the one hand which might be seen to be abuses of market power foreclosing market development by competitors and on the other hand those which should be allowed as fair competition. Domestic competition law in the UK did not at the current time recognize as unlawful the abuse of a dominant position in a particular market place. However, Nestlé considered that BEW could and did pursue courses of conduct which abused its market power to the detriment of competition and the public interest. Nestlé had indicated in its submission to the Commission in the 1998 inquiry that it believed that the market power enjoyed by BEW was reinforced by a system of exclusive distributors, the use of substantial discounts and the use of unfair terms and conditions.

6.138. The market for ice cream was broadly split between the take-home sector dominated by the major multiple retailers and the impulse sector consisting of other multiple chains and other smaller retailers. Competition was extremely keen in the major multiple retailers where take-home products were more prevalent; in that sector, potential competitors were able to gain access to consumers. However, in the impulse ice cream sector such open competition was more difficult to achieve. In the leisure and other impulse sectors, competing manufacturers found it difficult to obtain freezer space for their products due to BEW's dominance. Nestlé's attempts to gain access to these outlets were repeatedly frustrated by the ability of BEW, who held an 83 per cent share of the market in independent CTNs, to offer incentive payments which could not be matched by a loss-making business. This superior buying power of BEW effectively prevented Nestlé from gaining distribution and making its products available to the consumer. There had been a number of occasions when BEW had effectively blocked Nestlé's entry to the market place, or bought it out of existing customers' business.

6.139. Nestlé did not have any objection per se to the existence of exclusive distribution networks. Such systems might afford advantages to customers and consumers by reducing prices and affording greater product availability. The specific difficulty which existed in the UK and which was a matter of concern for Nestlé was that there were few major distributors, free to take on products, which could compete effectively with BEW's network. Nestlé therefore agreed with the conclusions of the 1998 report on BEW. The actions of BEW to dismantle its dedicated distributor network following the 1998 report had resulted in much activity in the distribution market as BEW's former dedicated distributors assessed how to develop their businesses. There were signs that this might result in increased opportunities for other manufacturers, but it was too early to tell how far-reaching any advantageous effects would be.

6.140. With regard to discounts, Nestlé in its 1998 submission had drawn attention to BEW's price list and the straight-line annual retrospective volume discount which BEW offered to customers. The effect of this was that, if Nestlé were to aim at taking a small slice of BEW's business, it would have to match the highest level of discount being offered by BEW—notwithstanding that it would be un-economic to do so in relation to the small amount of business acquired. Nestlé believed that BEW was offering substantial discounts and other incentive payments to induce customers to transfer business to BEW (or indeed to stay with BEW) and the effect of these payments was to limit development of the market.

6.141. Nestlé remained of the view expressed in 1998 that it was the combination of the variety and scale of trade incentives offered by BEW, the economies of scale available to BEW, BEW's low distribution costs coupled with a lack of alternative distribution available to other manufacturers and BEW's significant advertising spend that together operated as a virtual lock-out of the market for potential new entrants.

6.142. On freezer exclusivity, Nestlé said it was aware that the issue had recently been examined by the European Commission in the case of Van den Bergh Foods Limited against the Commission. Nestlé, like other manufacturers, engaged in the practice of lending freezers to retailers free of charge against a condition of exclusivity. Nestlé also arranged for freezers to be maintained and repaired regularly and offered a damaged product replacement service free of charge. Nestlé believed that the existence of exclusive freezer cabinets was an inherent part of the competitiveness and consequent success of the ice cream market worldwide. Its success in the UK market had been hindered not by the existence of exclusive freezer cabinets but by BEW's other practices in distribution, price incentives and scale of advertising. These, because of their potential duration, had a much greater market foreclosing effect.

6.143. Nestlé's position in relation to freezer exclusivity had been set out in a submission from Nestlé (Ireland) Ltd to the European Commission on 29 October 1998. That submission argued that the success of exclusive freezer cabinets provided benefits to the consumer in the form of improved product availability, lower prices, greater choice, a catalyst for innovation and better quality, hygiene and cleanliness.

6.144. The submission stated that freezer exclusivity resulted in more ice cream availability at a lower cost and price. Because freezers were lent to storekeepers free of charge, more ice cream was sold to consumers. The manufacturer eliminated the investment barrier of cost and management time for the shopkeeper to enter the business of selling ice cream. Moreover, the cost of purchasing and maintaining the freezer was eliminated for the retailer and significantly lessened for the manufacturer because centralized efficiencies could be realized. In return for the investment of providing a freezer free on loan which was to be used only for the manufacturer's products, the manufacturer obtained reliable and predictable demand leading to fewer out-of-stock situations and larger drop sizes per store. This latter point was important because if drop sizes were too small it was uneconomical for the manufacturer to make a delivery. Freezer exclusivity therefore reduced manufacturers' costs and consumer prices.

6.145. Freezer exclusivity led to innovation and consumer choice. A manufacturer owning freezers was forced to keep his range of products attractive for both retailers and consumers. Otherwise, the retailer might decide to remove the freezer and replace it with another manufacturer's freezer or his own freezer, or stop selling ice cream altogether. That was a real risk, as ice cream was competing not only with other brands but also with soft drinks, confectionery and other impulse items. Manufacturers competed not only on price but also on the variety and novelty of ice cream products offered. Developing a new product was always a risk for a manufacturer, but if he owned a certain number of freezers, he was at least assured of finding a way to offer it to the customer. Many novelties, especially sophisticated ones with a small target audience (for example, mango-flavoured sticks), would never reach the consumer without manufacturer-owned exclusive freezers. In a world without freezer exclusivity, wholesalers would determine the products on offer and they would simply choose a limited number of big-selling items, yielding big margins, at the expense of smaller novelties, with corresponding lower margins, and ultimately at the expense of innovation and consumer choice.

6.146. A manufacturer owning freezers would support the sale of his full range by producing attractive on-site advertising such as boards and flags which could be combined with the livery of the freezers themselves. Nestlé's studies showed that part of the pleasure of ice cream consumption was choosing which product to buy. Without good on-site advertising, the sale of ice cream would be substantially lower. Without freezer exclusivity, the manufacturer could not be expected to invest in on-site advertising, as the products displayed alluringly on the boards could not be guaranteed to be present in the anonymous freezer. This would have the effect of literally turning away a disappointed customer.

6.147. Not least importantly, the diligent and systematic maintenance and repair devoted by Nestlé to its own cabinets and its damaged products replacement programmes ensured that Nestlé ice cream would be sold in optimum conditions of quality, hygiene and cleanliness. Ice cream was very sensitive to physical deterioration by improper handling and storage. Nestlé was convinced that no one would pay better attention to those aspects than the brand owner himself. Without freezer exclusivity, most retailers, especially smaller ones, simply would not be able to provide the dedicated maintenance, repair and prod-

uct replacement services which they currently received from the cabinet's owner. Again, the consumer's interest would suffer.

6.148. An example of how the absence of freezer exclusivity had had a negative effect on the market as a whole, to the detriment of consumers, was the USA. In that country, freezer exclusivity had historically not been widely practised. In general, product availability, quality, choice and innovation were all inferior to Europe. As a result, freezer exclusivity was in the process of being expanded in the USA.

6.149. The submission from Nestlé (Ireland) Ltd to the European Commission concluded by saying that the present European ice cream market was a highly competitive one. The exclusive freezer cabinet system was an inherent part of that competitiveness and of the consequent success of the market. Like any other industry, the distribution of ice cream had to obey certain economic realities. Those realities differed between the impulse channel and the traditional grocery channel. One of those realities was that in order for an impulse outlet to benefit from stocking ice cream, it must offer an attractive range of products to consumers. The use of exclusive freezers allowed manufacturers to provide an attractive selection of products. The retailer who chose not to invest in his own freezer benefited from the choice between different manufacturers' cabinets. This allowed him to compare the different offers and choose either one or more of them according to whatever best suited his outlet. Where a retailer had such choice, there was no restriction of competition on account of exclusive freezers.

6.150. Manufacturers who were unable or unwilling to present a competitive range of products to retailers in the impulse channel might not be in a position to convince as many impulse outlets to stock their ice cream as they would prefer. They would instead tend to concentrate on the traditional grocery channel (supermarkets), where even a single ice cream item could be successfully stocked.

6.151. Nestlé fundamentally disagreed with those who might seek to argue that competition in the UK ice cream market was frustrated due to the existence of exclusive freezer cabinets. To reach such a conclusion was, in Nestlé's view, missing the point. Cabinet exclusivity had positive benefits for customers and consumers alike.

6.152. Nestlé added that it continued to find the trading environment within the ice cream sector to be extremely difficult, exacerbated by a particularly poor summer in 1998.

Nestlé's response to the issues letter

6.153. With regard to the existence of possible complex monopoly situations, Nestlé submitted that its distribution was not exclusive. As to terms, it gave the highest discounts to national wholesalers because they were national accounts, which stock a wider range. Nestlé delivered centrally to them; in turn they offered Nestlé marketing advantages, had invested in better infrastructure with higher overheads, and supplied larger customers who warranted higher discounts. Nestlé had to match competitors. It had no objection in principle to extending to other wholesalers the arrangement whereby retailers get the Nestlé discount irrespective of source of supply, as long as they invested in the systems necessary to transmit the information to allow this. Nestlé believed that its distribution system was fundamentally different to BEW's and had a minimal effect on competition.

6.154. On market definition and the terms of reference, Nestlé believed that, within the overall impulse sector, impulse ice cream was itself a market. Slush was more akin to soft drinks than ice cream. Nestlé considered that some substitution did occur between soft and scoop ice cream on the one hand and wrapped impulse ice cream on the other. It thought it was appropriate to exclude from the terms of reference ice cream served as a meal or part of a meal.

6.155. Nestlé drew our attention to the fact that all wrapped impulse ice cream was branded, whereas most soft and scoop ice cream was unbranded. Competition in the industrial impulse market was closely linked to brand visibility and brand promotion so that it was BEW's dominance in the branded segment which was, in Nestlé's view, the critical factor in assessing the extent of competition in the present market structure.

6.156. On Issue 1(a) (exclusivity of distribution arrangements), Nestlé submitted that the creation of Wall's Direct had undermined the benefits of the 1998 inquiry. BEW had a stranglehold on cost-effective distribution because of its share of the market; Nestlé's impact was minimal.

6.157. On Issue 1(c) (terms to distributors), Nestlé was concerned that the terms offered to independent wholesalers by BEW represented a significant threat to their long-term viability. Moreover, the dependence of independent wholesalers, particularly ex-dedicated distributors, on sales growth payments provided a strong incentive to sell BEW rather than other products, and to remain, in effect, tied to BEW.

6.158. As regards Nestlé's terms to distributors, Nestlé stated that differentials between distributors were justified by the different levels of service provided; but no distributor received less than 17.5 per cent discount, and the differences in terms had no effect on competition.

6.159. Nestlé said that its contracted distribution arrangements through Brakes [
Details omitted. See note on page iv.

]. However, the arrangement was not to the detriment of Brakes because deliveries by Brakes were fitted in with its general delivery business; moreover, Brakes stipulated a minimum drop size and maximum level of business. The reasons for allowing highest discounts to national wholesalers were that these were national accounts with a wider range of stock; that they took central deliveries and offered marketing advantages; that they had invested in better infrastructure with high overheads; and that they supplied larger customers who wanted higher discounts, and generally must match their competitors. Nestlé further stated that although discounts to retailers were generally available only through Nestlé's own distribution system or ICW, it believed that its discounts to wholesalers were sufficient to allow them to finance retailer discounts themselves and it had no objection in principle to extending to other wholesalers an arrangement whereby retailers could get Nestlé discounts irrespective of source of supply, as long as they invested in information systems. Nestlé therefore believed that its distribution system was fundamentally different from BEW's and had minimal effect on competition.

6.160. On Issue 1(f) (terms to mobilers or distributors who supply mobilers), Nestlé stated that its different terms reflected different levels of commitment. It believed that recent complaints were from mobilers whose terms had been reduced due to insufficient turnover or who were in fact, contrary to their agreement, acting as wholesalers.

6.161. On Issue 1(g) (discounts to retailers), Nestlé said that it had no objection in principle to extending to all wholesalers the arrangement whereby retailers who were direct customers or serviced by ICW received the Nestlé level of discount, provided those wholesalers invested in information systems. Nestlé's existing arrangements are discussed in more detail in paragraph 4.81. Nestlé believed that its discounts to wholesalers were sufficient to allow them to offer competitive terms to retailers.

6.162. On Issue 1(i) (effect on distribution costs), Nestlé believed that its own distribution practices had no effect on distributors or manufacturers. The existence of Wall's Direct, on the other hand, and the opportunity for a high proportion of wrapped sales to be handled by it meant that other manufacturers were deprived of the opportunity to benefit from cost savings they would enjoy, were they able to distribute products in vehicles that presently exclusively handled BEW products. Nestlé's disappointing performance showed how difficult it was to break into the market; availability through effective distribution was vital to achieve growth, cost savings and investment in advertising. BEW's stranglehold on cost-effective distribution, plus its pricing policies and exclusive ties, gave BEW the market power which enabled it to distort the market in its favour. Nestlé had no objection, however, to BEW's exclusive telesales operation.

6.163. On Issues 2(a) and (b) (freezer exclusivity and developments since the Commission's 1994 report), Nestlé stated that the 1994 findings remained valid. Retailers had the choice not to have an exclusive freezer; competition was not precluded; and outlet exclusivity generally did not result. Freezer exclusivity remained a cost rather than a barrier to entry. Weakening freezer exclusivity could increase distribution costs and would be unlikely to increase choice or affect price levels. The modest increase in market share Nestlé had subsequently obtained would not have been possible without exclusive freezers. Exclusive freezers had declined over time; but they gave manufacturers an incentive to provide freezers and innovate and were entirely at retailers' choice. Only through exclusive freezers could Nestlé compete with BEW with its whole range: its range would be decimated without them and it would lose branding and point-of-sale advantages. Nestlé claimed that small CTNs might stop selling impulse ice cream if manufacturers did not provide freezers. With regard to the effects of installing industry freezers, Nestlé thought the result would be that only the top best-selling products would be stocked, and therefore it would not be able to promote its full range.

6.164. On Issues 3(b) and (c) (discounts, bonuses and incentives), Nestlé stated that it offered year-end bonuses at a higher level than BEW in order to be competitive, but that it could not penetrate BEW's loyalty bonus, because if sales were split between BEW and Nestlé, the retailer's total bonus was inevitably less than it would have been had sales been only from BEW. Nestlé found that it had to offer discounts or incentives in order to secure business in outlets such as leisure parks. In Nestlé's view, such practices when engaged in by BEW were exclusionary and reinforced BEW's dominant position.

6.165. On Issue 3(d) (relationship between prices and costs of supply), Nestlé was of the opinion that pricing below cost by BEW, if this occurred, distorted competition.

6.166. On Issues 4(a) and (b) (outlet exclusivity), Nestlé submitted that outlet exclusivity was not necessarily against the public interest, but when practised by the dominant supplier it consolidated the dominant position, distorted competition and deprived competitors of vital visibility, for example in motorway service stations. In particular, BEW's large payments for exclusivity in multiple impulse outlets restricted competition; competitors could not match those incentives. Outlet exclusivity could be justified for non-dominant suppliers in leisure outlets, but the contestability of those outlets needed to be improved by limiting BEW's ability as the dominant supplier to conclude exclusive arrangements, including banning BEW's loyalty discounts; making it publish fair, consistent and non-predatory terms for all trade channels; limiting excessive incentives and key monies; and banning agreements of more than one year and any exclusive agreements (or exclusive agreements of more than one year in the leisure sector).

6.167. On Issue 5 (advertising and promotional expenditure), Nestlé said that its sales were insufficient to justify the advertising spend necessary to create additional demand for its products. This resulted from a market structure where there was a dominant supplier with an established position, distribution and brand strength way beyond those of its competitors.

6.168. On Issue 6 (retail prices), Nestlé did not believe that lack of price competition between retail outlets reflected lack of competition between manufacturers; retailers tended to take price promotions in higher margins. Retail prices were more likely to increase if RRP's were abolished.

6.169. Nestlé also provided some comments on the Oscar Bronner case.

6.170. Nestlé said that there was no legal reason why the Commission should not apply UK competition law in a way which might differ from the principles set out in *Oscar Bronner*. There were fundamental differences between the Fair Trading Act and article 82. Article 82 was a directly effective legally enforceable prohibition sanctioned by substantial fines, and as such was tightly construed, whereas the monopoly provisions of the Fair Trading Act did not render any conduct unlawful per se, conduct was not sanctioned by fines and remedies lay only in relation to future conduct. It was notable that the Fair Trading Act monopoly provisions were to be retained following the implementation of the Competition Act. Nestlé said that there were significant differences between the factual and market contexts of *Oscar Bronner* and this case, such as the need for the cold chain. Moreover, the Commission's inquiry involved a greater range of practices than was the case in *Oscar Bronner*, including outlet exclusivity and BEW's pricing and discounts structure.

6.171. With regard to the remedies suggested in the issues letter, Nestlé stated that any remedies should only be directed to BEW to correct the present structural imbalance in the market and suggested that BEW should not be permitted to enter into any outlet exclusivity agreement (other than leisure) for more than 12 months; should not enter into any agreement to supply for more than 12 months; should publish and not depart from terms for wrapped impulse ice cream; should not offer higher bonuses or discounts if purchases exceeded certain thresholds; should not require any distributor not to carry, stock or sell other products or enter into any agreement with the same effect; and should be required to limit the percentage of product supplied through Wall's Direct.

Nestlé's response to the remedies letter

6.172. Nestlé responded to the remedies letter (see the statement of remedies in Appendix 2.4). Nestlé considered that the suggestion of imposing remedies on all manufacturers with a turnover of over £10 million in impulse ice cream was fundamentally misconceived. Proportionality to detriment should be the key principle and the only market participant with market power was BEW. The wrapped ice

cream market should not be characterized as an oligopolistic market. The few suppliers of wrapped impulse ice cream were not comparable in terms of market shares. Remedies should be imposed only on the scale monopolist except where the imposition of the proposed constraint on any manufacturer would have damaging effects on the market, or where there was a clear need in terms of achieving full market contestability for imposing an even-handed remedy on all participants. Nestlé did not believe that freezer exclusivity should be prohibited for any manufacturer, as this would lead to market contraction and a decline in competition. Nestlé proposed imposing remedies relating to exclusive distribution upon any manufacturer supplying 25 per cent or more of the market through direct sales (currently only BEW). However, Nestlé was willing to accept a general prohibition on contractual outlet exclusivity in the retail channel, though not in leisure. This view of proportionality was consistent with the Commission's own recent approach, and with EC competition law.

6.173. Nestlé considered outlet exclusivity as being the practice with the greatest potential foreclosure effect, because outlet exclusivity necessarily entailed exclusivity in all freezers in an outlet. Nestlé believed that, in the context of the UK market, express contractual outlet exclusivity in retail outlets was not justified by reference to any compensating benefits and should in general not be permitted. The exception was in respect of leisure outlets where special considerations applied. In the non-leisure sector, contractual outlet exclusivity unnecessarily restricted the availability and visibility of competing products without any countervailing advantages. Except with respect to the leisure sector Nestlé was not a party to any arrangement for contractual outlet exclusivity and would be prepared for any prohibition of contractual outlet exclusivity to apply to itself as well as to other market participants. On this basis, Nestlé believed that the even-handed approach was acceptable although it would not be wrong in principle to confine this remedy also to BEW. Nestlé did not see the need for any exceptions by reference to size.

6.174. Nestlé did consider that different considerations applied in the leisure sector. Nestlé did not believe it practicable to limit the permitted exclusivity to a proportion of outlets on any site. Leisure customers themselves sought solus arrangements due to the added investment and higher level of communication involved. Furthermore, exclusivity was the norm in such outlets across all product categories, such as confectionery and soft drinks. If exclusivity were prohibited for ice cream, other products would still enjoy the benefit of exclusivity arrangements and thereby maintain their current prominence in these outlets, resulting, in Nestlé's view, in a decrease in the visibility and availability of ice cream.

6.175. So far as the definition of the leisure sector was concerned, Nestlé believed that the key distinguishing feature of the sites was that they were destinations in their own right visited by persons for purposes other than making retail purchases of goods (usually for the purposes of leisure, entertainment or recreation). They were also to be distinguished in that they often involved the installation of special selling facilities for ice cream (for example, kiosks) or were themselves such special selling facilities (ice cream parlours) or for ice cream and other products for immediate consumption. The creation of the special facilities usually required investment on the part of the supplier of ice cream which justified in economic terms the exclusivity required to enable the investment to be recouped.

6.176. Nestlé believed that the extent of the exception for contractual outlet exclusivity in leisure outlets should be limited in the case of BEW, since BEW had achieved and consolidated its dominant market position through the long-term arrangements it had made to exclude competitors from leisure sectors and increase and develop the visibility of its brand. Nestlé therefore believed that in BEW's case the exclusivity should be conditional on any agreement being for a duration of no longer than 12 months and being on published terms, for as long as BEW maintained a dominant position of over 40 per cent in the impulse market. Nestlé considered that without these safeguards BEW would remain in a position to foreclose from competition a segment of the market which was of fundamental importance to the development of a stronger market position on the part of its competitors.

6.177. Nestlé made a distinction between outlet exclusivity as such and freezer cabinet exclusivity. In general, freezer provision was a beneficial component of competition in the impulse ice cream market, as explained in Nestlé's first submission (see paragraph 6.142). The ability for manufacturers to supply freezers on loan to retailers was dependent upon the return that the manufacturer was able to achieve through sales of its products from the freezer. Without freezer exclusivity, Nestlé would be unable to achieve more than a very limited number of products stocked given the overwhelming brand dominance of BEW. Moreover, retailers should not be denied the opportunity to accept freezers from manufacturers if they believed this to be in their best interests. Some retailers preferred to install industry freezers, others to take freezers from manufacturers. However, in no sense did freezer provision foreclose the

market since even where a retailer did choose to accept a manufacturer's freezer on terms of exclusivity, the retailer might at any time return the freezer and decide instead to take an industry freezer, a freezer from another manufacturer or, indeed, not to stock impulse ice cream at all.

6.178. The removal from retailers of the manufacturer freezer option would certainly result in fewer outlets stocking impulse ice cream given the advantages that they derived from the efficiency of manufacturer provision in terms of product delivery and freezer repair and maintenance. Manufacturer provision was also attractive to retailers since it involved them in no 'sunk costs'. From the manufacturers' point of view, the provision of freezers in outlets (particularly those outlets which would not otherwise stock ice cream at all) led to increased opportunities for brand promotion and widespread availability of the product to consumers.

6.179. To remove the incentive to manufacturers to supply freezers would therefore be bad for the whole impulse ice cream sector. Freezer provision was only economic where the sales of product of the manufacturer supplying the freezer were sufficient to cover the basic costs of provision and maintenance. In Nestlé's case, the minimum sales value threshold required to cover the cost of freezer provision was in the region of £[] a year. In the majority of retail outlets, this level of sales could not be achieved other than where the entire freezer was used for the sale of the products of the supplying manufacturer. Nestlé currently supplied on loan 22,916 freezers, of which 14,048 were placed in single outlet retailers. If Nestlé were only allowed to reserve 60 per cent of the capacity of these freezers, it estimated that some 59 per cent would cease to be viable in that the sales from the freezers would not cover the costs of freezer provision. Nestlé would be obliged to withdraw the freezers, which would reduce the availability of its products, the visibility of its brand and its potency as a competitor to BEW. BEW's position would, on the other hand, be strengthened since BEW would still have the incentive to provide freezers given the status of so many of its products as 'must-stock' items.

6.180. The economics of freezer provision in multiple retail outlets was different. These outlets (typically each of which would have an average selling area of not less than 1,500 square feet) supported very much higher levels of ice cream sales. They were usually professionally managed multiple operations and their size often permitted the installation of more than one freezer or of large 'island' freezers. In the case of these outlets, the operators would choose to stock ice cream whether or not the cabinets were provided on loan and, indeed, would seek to negotiate a variety of different arrangements with ice cream suppliers. These terms would usually entail the manufacturer in increased costs (for example, investment in the provision of large freezers and customized point-of-sale materials). Additionally, as these freezers were often not of a standard size or design, manufacturers would face difficulties in placing them elsewhere if retailers were free to return them at will. The terms agreed would accordingly usually involve the provision of freezers for a defined period and therefore have a potential for foreclosure, which was not found in the case of the provision of freezers to independent outlets on an elective free-on-loan basis. In these cases, Nestlé did consider it reasonable to limit freezer exclusivity to a percentage of the capacity of the freezer. Given the typical throughput from such a freezer, Nestlé considered that freezer provision could still be justified if only 80 per cent of the capacity of the freezer were reserved to the supplier. A permitted freezer-sharing arrangement of this kind in multiple outlets would have the greatest potential for ensuring the stocking of a wide range of products. Mars's study of multi-brand freezers also supported this conclusion.

6.181. Nestlé considered that imposing remedies in relation to freezer exclusivity would also have a significant and undesirable impact on distribution efficiency. A remedy which removed the manufacturer exclusive freezer option for independent outlets and which did not allow at least 80 per cent of the capacity of a freezer to be reserved to the supplying manufacturer in multiples would, by rendering manufacturer freezer provision uneconomic, reduce the number of outlets stocking impulse ice cream. The consequence of this would be to increase the unit costs of distribution for the remaining stockists and, accordingly, in the long run, to give rise to the need to increase the prices paid by consumers.

6.182. Given BEW's dominant position in the market place and its ability through its brand strength to retain the dominant position on the market, Nestlé considered that if the Commission were to permit the reservation of freezer capacity up to 80 per cent of a freezer in multiple outlets, it should be on terms that no arrangement by BEW should be for a duration exceeding 12 months and that any such arrangement by BEW should be on publicized terms.

6.183. As to the Commission's suggestions for remedies with respect to freezer exclusivity, Nestlé considered that a failure to continue to allow elective freezer exclusivity in independent outlets would lead to a contraction of the market. Industry freezers were more expensive for retailers than manufacturer-supplied freezers and marginal outlets would therefore cease to stock ice cream at all or would be offered freezers only by BEW without a formal tie but on a basis which led to a decline in the competitive position of other manufacturers. Nestlé did not believe that in independent outlets it was practicable or helpful to allow freezer exclusivity only up to a fixed percentage of the freezer's capacity. If Nestlé were permitted to supply on an exclusive basis only 60 per cent of the capacity of freezer supplied by it on loan to retailers, the arrangement would be uneconomic for Nestlé and Nestlé would not be able to make the freezer available. Nestlé did consider that freezer exclusivity in multiple outlets could be limited to a percentage (not being less than 80 per cent) of that freezer's capacity, but that any such arrangement entered into by BEW should be on publicized terms and for a maximum duration of 12 months.

6.184. Regarding discounts and other terms to retail outlet controllers, Nestlé's position was that cumulative discount arrangements were a feature of normal competition unless practised by an enterprise with market power such as BEW. This position was consistent with the treatment of discount arrangements as practised by a dominant manufacturer in EC competition law. It was not appropriate that any prohibitions relating to discounts or other pricing terms should be imposed on Nestlé or Mars or any other manufacturer which did not have market power, that is, at least a 25 per cent share of the UK wrapped impulse ice cream market.

6.185. Nestlé believed that BEW as the dominant supplier should not give any discounts at a level which resulted in selling below cost; or offer discounts on a progressive scale particularly where the discount level achieved applied to all sales rather than those just above the threshold. The present practice provided an insurmountable barrier to competitors since not only must they sell at the highest applicable rate of discount but they might also have to compensate the retailer for loss of discount on all its purchases from BEW. Even if the higher discount levels applied only to purchases in excess of the threshold, they made it more difficult for the competitors of BEW to achieve any sales to the outlets in question.

6.186. Nestlé considered that BEW's prices should be on annual published terms and be non-discriminatory. The Commission should beware that if this remedy were applied to all suppliers, there would be no opportunity for price negotiation and therefore no price competition. Although independent retailers usually had limited scope to negotiate prices, this was not the case with multiple and leisure outlets that could do so strongly. The proposed remedy with respect to the offering or giving of any other unpublished price-related or other incentive should apply only to BEW for the reasons set out above. Similar restrictions on wholesalers should apply only where the incentive was financed (or otherwise assisted) by the manufacturer. The proposed remedy should not prevent discounts for prompt payment provided that these were not disguised forms of volume-related discounts.

6.187. On distribution, Nestlé supported the Commission's objective to ensure the survival of an independent wholesale sector. Nestlé did not believe that direct distribution systems in themselves were anti-competitive. Direct distribution was efficient and cost-effective, and improved standards across the whole distribution sector. It therefore enhanced competition and improved provision to the customer, provided that an exclusive direct system did not become so extensive as to foreclose the market. In Nestlé's view, however, the extent of Wall's Direct did foreclose the distribution market and the key to attaining the Commission's objective was to restrict the size of Wall's Direct.

6.188. The size of Wall's Direct was such that in Nestlé's view BEW now had a scale monopoly in distribution. However, even if this were not the case Wall's market share as a manufacturer was sufficient to give it market power which extended into distribution. The third party distribution sector for wrapped impulse ice cream was reliant on supplies from BEW as manufacturer.

6.189. It was wrong to regard Nestlé as a member of a complex monopoly in distribution for reason of its telesales operations. This was the only part of Nestlé's direct distribution system which is 'in-house'. All the other elements of the system were available for and were indeed used by competitors. It was unrealistic to expect Nestlé's in-house sales force to solicit orders for competing products. No manufacturer's direct sales operation did this. It would, for example, be absurd to expect First Direct (HSBC) to offer the services of competing banks or for Direct Line to sell the services of competing insurers.

6.190. The offering by Nestlé of different terms for different distributors was not discrimination. It was the result of a process of negotiation between market participants where discounts reflect the differing levels of service and investment on the part of different distributors. Nestlé did not as a matter of principle make the availability of discounts to retail outlets contingent on supply through particular distributors. It was prepared to make those discounts available to all distributors who were efficient and had invested in the necessary IT systems and capabilities in order for them to transmit the necessary information to Nestlé. Nestlé did not offer distributors terms which were insufficient to enable them to operate on an economically viable basis. No wholesaler received a discount less than 17.5 per cent and the average of all off-invoice discounts allowed by Nestlé to wholesalers was approximately 27.5 per cent. Accordingly, Nestlé submitted that it was not a monopolist in relation to distribution and the Commission was not able to impose remedies on Nestlé.

6.191. Nestlé believed it was very difficult to prescribe that distribution be carried out on an 'economically viable basis'. The market was best left to achieve this and would do so if BEW were required to limit the volume of wrapped impulse ice cream that it could sell through Wall's Direct while leaving Wall's Direct as a force in the market beneficial to competition between distributors. Nestlé would have no objection to BEW continuing to operate an in-house operation, but without the present unfair advantages. Indeed there might be a benefit to competition if, as BEW suggested, BEW were able to provide a 'gold standard' benchmark against which competing operations might be judged. Nestlé considered that if BEW (or any other manufacturer) were limited to supplying not more than 25 per cent of the overall wrapped impulse market through a direct sales organization, the volumes remaining for distribution through third parties would be sufficient to allow a viable independent wholesaling sector to subsist. Nestlé provided the following analysis showing the amount of distribution through wholesalers before and after such a change.

TABLE 6.1 **Distribution analysis with Nestlé remedies**

Market value (£m): 350

| | <i>Current</i> | <i>New</i> | <i>% change</i> |
|---------------|----------------|------------|-----------------|
| Wall's Direct | 45%—£158 | 25%—£88 | —44% |
| Nestlé Direct | 9.7%—£34 | 9.7%—£34 | 0% |
| Wholesalers | 45.3%—£159 | 65.3%—£229 | +44% |

Source: Nestlé.

Note: Market value based on 1998 report; Wall's Direct share based on Nestlé estimates.

6.192. Nestlé added that an economically viable basis would be better established by reference to the cost of an in-house arrangement. However, it would clearly be necessary to take into account any payment made direct by manufacturers to retailers since such payments would otherwise need to be provided by the wholesalers.

6.193. Nestlé was pleased to see that the Commission believed that a discount range of 17.5 to 22.5 per cent was appropriate for independent wholesalers. Nestlé terms for wholesalers did give the wholesalers a minimum discount level of 17.5 per cent.

6.194. Nestlé did not believe that it was necessary to require use of a subsidiary for the purpose of establishing separate accounting for manufacturing and sales and distribution activities. The Commission should not impose specified forms of corporate organization on enterprises, particularly in view of the cost burdens which could result.

6.195. Nestlé believed that BEW should account separately for manufacturing activities and that distribution activities should not be operated at a loss. Nestlé also agreed that BEW should be required not to discriminate between supply to its own distribution unit and supply to third party distributors except where that discrimination was justified by reference to the extent of the distribution activity involved (for example, a distributor might offer both primary and secondary distribution or only secondary distribution). Nestlé considered that in order to ensure that BEW honoured these obligations it should be obliged to publicize and make transparent its costs and prices for distribution through Wall's

Direct. Nestlé also believed that these remedies should apply to any manufacturer supplying 25 per cent or more of the market through a direct sales organization so as to ensure the continuance of a viable third party wholesaling and distribution sector.

6.196. Nestlé believed that, provided BEW was required to limit the volume of sales through Wall's Direct, there was no need for Wall's Direct facilities to be made available for use by other manufacturers and distributors. However, the Commission should prohibit BEW (or any other manufacturer who supplied 25 per cent of the market through a direct sales organization) from securing by means of contract or otherwise the exclusive use of any third party distribution assets. All these specialist cold chain assets should potentially be available to other manufacturers. It should not be necessary to determine terms of access. Where third party assets were concerned, these would be freely negotiated.

6.197. Nestlé believed that any arrangements between BEW and retailers should be in an annually published form, non-discriminatory and on the basis that the retailer would not be tied to any particular distributor or class of distributor. Nestlé also agreed that there should be no linkage with the acquisition of any other frozen food products or between different classes of impulse ice cream. Nestlé did not believe that these remedies should apply to the other market participants given their lack of market power and because any requirement on all suppliers to deal only on annually published and non-discriminatory terms would render competition impossible. The competitive pressure able to be exerted by BEW's competitors would be undermined if they had to publish their terms. Furthermore, any remedy should have exceptions where required to tie in with any permitted exception on outlet exclusivity. In particular, in the leisure sector, it was often appropriate for the operator to require the supply of a range of different products and not solely impulse ice cream. A total ban on contracts or arrangements between manufacturers and retailers seemed to Nestlé to be excessive in terms of regulation of the market.

6.198. With regard to contracts between manufacturers and distributors, Nestlé considered that the remedy should be worded so that no distributor of BEW was permitted to commit to the supply and delivery of such a quantity of BEW's products that it would not be possible for that distributor to carry any other manufacturer's products. Nestlé agreed that any rebate must be volume-related, ie no additional discount obtainable on reaching a particular volume threshold should be granted on sales beneath that threshold even once it had been attained. Nestlé also agreed that a distributor should be allowed to contract for distribution and resale of impulse ice cream of any class without being bound to purchase also other classes of impulse ice cream or other goods of BEW.

6.199. Nestlé considered that restrictions on the use which manufacturers might make of information supplied by distributors were impracticable, for example in the situation where the manufacturer were selling to a customer of the distributor. Such a restriction would have an adverse effect because it would inhibit competition in distribution services.

6.200. Nestlé considered that any remedies should apply to existing as well as future agreements.

6.201. In conclusion, Nestlé fully accepted that the object of competition policy was to promote competition rather than the interests of individual competitors. Nonetheless, where dominant market power subsists the remedies imposed must be directed towards the specific detriments arising from the exercise of that power by the monopolist; and not apply to other market participants where their application would weaken their competitive potency, and, in the case of Nestlé, risk prejudicing the development of its developing (and still relatively young) UK wrapped ice cream business.

6.202. Nestlé considered that the remedies it had suggested in the areas of outlet exclusivity, pricing and distribution would restore a contestable market in the ice cream sector and complete the necessary limitation on the misuse of BEW's market power which began with the implementation of remedies following the 1998 reference. The 1998 remedies had certainly facilitated Nestlé's ability to develop for the benefits of consumers a viable alternative full range of wrapped impulse ice cream products, but Nestlé (and, for that matter, Mars) remained some way from having profitable businesses able to offer effective competition to BEW. Nestlé provided the table below setting out its suggestions for remedies.

TABLE 6.2 Nestlé's proposals for remedies

| <i>Issue</i> | <i>Nestlé suggested remedy</i> |
|--|---|
| Outlet exclusivity | <p><i>Retail</i> Contractual outlet exclusivity prohibited for all market participants.</p> <p><i>Leisure</i> Contractual outlet exclusivity to be permitted in leisure sector.</p> <p>BEW limited to 12-month maximum and BEW arrangements to be on published terms (for as long as BEW dominant).</p> |
| Freezer exclusivity | <p>No remedy should be imposed in relation to freezers in independent outlets—freezer exclusivity should be allowed to continue to ensure widespread availability and visibility of ice cream.</p> <p>Freezer exclusivity in multiple outlets to be limited to 80 per cent of freezer. Imposed on all manufacturers but BEW arrangements to be on publicized terms and for maximum 12 months.</p> |
| Discounts and other terms to retail outlet controllers | <p>BEW to be prohibited from:</p> <ul style="list-style-type: none"> ● below-cost discounting ● loyalty discounts ● all unpublished price-related or other incentives. <p>BEW prices to be on annual published terms and non-discriminatory.</p> <p>Only to apply to wholesaler where financed by BEW.</p> |
| Distribution | <p>No manufacturer may supply more than 25 per cent of wrapped impulse market through direct sales.</p> <p>Any manufacturer who has 25 per cent or more of wrapped impulse market through direct sales:</p> <ul style="list-style-type: none"> ● to account separately for manufacture and distribution, the latter not to be operated at a loss ● to be prohibited from securing by means of contract or otherwise the exclusive use of any third party distribution assets. <p>Other remedies to be imposed on BEW:</p> <ul style="list-style-type: none"> ● any arrangements with retailers to be in annually published form and non-discriminatory ● no linkage with other products ● no BEW distributor to commit to the supply and delivery of such a quantity of BEW products that it would not be possible for that distributor to carry any other products. |

Source: Nestlé.

6.203. Concerning Mars, Nestlé commented on Mars's reply to the issues letter. Nestlé said that its distribution system was different from that of BEW's in ways already explained. It did operate exclusive distribution systems elsewhere in Europe, but these were not relevant to its UK distribution strategy. It did not believe that its system limited the ability of independent distributors to compete. It was Nestlé's belief that different solutions were appropriate for different markets. Mars itself operated exclusive distribution systems in some markets but not in others. Its physical distribution of products was non-exclusive and its small market share was in any event *de minimis* when set against the volume of product manufactured and distributed by the scale monopolist. Nestlé agreed with Mars that where a party had market power, physical distribution of products through a single supply chain route would tend to distort the supply side market for distribution. Since Nestlé did not enjoy this market power, Nestlé shared Mars's concern in respect of the very significant volume of product being diverted through BEW's exclusive system.

6.204. Nestlé reiterated that freezer exclusivity was necessary for the maintenance of a full product range. In this respect, its strategy was completely at odds with that of Mars. In the early 1990s, Mars had had an arrangement with Nestlé Lyons Maid whereby Mars's products were sold into Nestlé Lyons Maid

freezers. Mars's strategy was based upon a limited range of confectionery-leveraged, imported products, which did not include products developed for the UK market and which did not require UK-based research or facilities. Nestlé agreed with Mars that competition was presently focused on competing ranges of products but did not see why this should itself have a negative effect on market conditions. Mars itself had asserted that non-exclusive freezers were unlikely to be provided on a cost-effective basis and that such freezers were likely to be swamped with BEW products. Nestlé believed that such assertions indicated that it was unlikely that industry freezers would result in real product-to-product competition. Nestlé did not believe that exclusive freezers were a barrier to entry but a cost to entry. Nestlé had sold in 1995 £1.5 million worth of Mars's products, representing 0.7 per cent of the market. When Nestlé extended its range, it no longer required Mars's involvement and the arrangement was terminated.

6.205. Nestlé commented on the Mars industry freezer studies (see paragraphs 4.117 and 6.44). It was concerned about the accuracy of the studies and about the degree of sampling errors. It made specific comments about each test. While Nestlé agreed with Mars that multiple outlets could increase sales by introducing multi-brand ranges, it stated that these conclusions could not be simply applied to independent outlets. In general, it was Nestlé's view that it was very difficult to achieve a like-for-like comparison between different points of sale for ice cream. If the test and control stores were not identically matched, increasing the space available for ice cream in the test stores would inevitably result in greater sales. In addition the sale of ice cream depended upon visibility and therefore a change in layout or position of freezers would initially attract the consumer. Furthermore, the basis of Mars's argument was that industry cabinets promoted choice and this was at odds with Mars's own opinion, shared with Nestlé, that industry freezers would be swamped with BEW products.

Nestlé's further response to the remedies letter following a hearing

6.206. Dealing first of all with the issues arising out of the remedies hearing, Nestlé commented on three outstanding points:

- (a) whether Northern Ireland was significant for the purposes of the Commission's investigation;
- (b) agreement as to an appropriate level of cap that might be imposed on BEW in respect of discounts to wholesalers; and
- (c) Nestlé's submission identifying the effect of the Commission's proposed remedies in respect of freezer exclusivity and distribution on Nestlé's profitability.

6.207. Concerning Northern Ireland, Nestlé said that its sales in Northern Ireland were not significant; Northern Ireland represented a very small part of the market and, therefore, the imposition of remedies in relation to Northern Ireland would not significantly enhance the contestability of the UK market as a whole. For this reason it might appear to be capable of exclusion from the remedies; but to do so would, in Nestlé's view, risk leaving Northern Ireland completely unregulated—a situation which might be incongruous were the Commission to recommend remedies that would apply to mainland Great Britain and were the European Commission to apply remedies in respect of the market in the Republic of Ireland. For these reasons, Nestlé considered that Northern Ireland should be the subject of remedies.

6.208. Concerning the suggestion that a cap should be set on the margin offered by BEW to wholesalers, Nestlé was of the opinion that this should be set at 25 per cent of GSV. In arriving at this figure, Nestlé had attempted to reconcile the need to ensure that BEW was still able to offer attractive margins to wholesalers with the need to ensure that BEW was not able to offer excessive margins which might operate as a means of securing fidelity.

6.209. Nestlé proposed that the 25 per cent figure would be applicable for sales to a typical wholesaler carrying out radial/secondary distribution using both field and telesales teams and operating on a national basis. The figure could be lower for smaller regional wholesalers whose costs of operation would be key—Nestlé had noted the Commission's suggestion that a range of discounts between 17.5 and 22.5 per cent off GSV might be appropriate in these cases and would not disagree with these figures. The 25 per cent cap was less than the margin offered by Nestlé to equivalent wholesalers [*Details omitted. See note on page iv.*] but Nestlé believed that this was justified by the brand strength of BEW and the increased volume of BEW products which it was reasonable to assume would be handled by the wholesaler. This was consistent with retailer margins where Nestlé offers higher margins

to retailers in order to secure listings of its products. Within the 25 per cent cap, Nestlé had assumed that the agreed amount would be offered as an off-invoice discount in advance with no retrospective correction. The precise discount offered (from within the range of 17.5 to 22.5 per cent) must be based on the efficiencies and other services actually afforded to BEW by each wholesaler. The discounts could be based on a published scale set by reference to efficiency and services. No growth, loyalty or year-end retrospective bonuses should be permitted and each agreement should be non-exclusive and renegotiated annually.

6.210. Nestlé assessed the likely effect of remedies proposed by the Commission on Nestlé's profitability. It assumed three different scenarios, namely:

- (a) that freezer exclusivity was limited to 60 per cent of a freezer; the remaining 40 per cent being fully contestable;
- (b) that direct distribution was prohibited; and
- (c) a combination of (a) and (b).

6.211. In respect of the first situation, Nestlé sales volume would remain approximately the same but proceeds of sale would be lessened as Nestlé would have to discount more to achieve sales. Nestlé's estimate was that this would give a total loss to Nestlé of £[] million (as compared with a predicted loss of £[] million in Nestlé's 2000 long-term plan)—a worsening of £[] million. In respect of the second scenario, proceeds of sale would be reduced but Nestlé would save expenditure on distribution and on telesales. Accordingly Nestlé's assumptions gave rise to a total loss of £[] million (a worsening of £[] million on the 2000 long-term plan). In scenario three, proceeds of sale would again be less than the 2000 long-term plan as all sales would be discounted at a higher rate giving less contribution. While a revised product mix would give Nestlé a slight benefit and distribution costs would be slightly reduced, field sales costs could be assumed to increase. This gave a £[] million loss—a worsening of £[] million.

6.212. Nestlé said that losses shown in these scenarios would be incremental one-off costs. However, in the longer term, the imposition of any of these remedies would require Nestlé to review completely its strategy for growth in the UK. The present plan showing wider distribution based on a full range of products with [] would be totally inappropriate and would need complete overhaul. Nestlé believed that the imposition of these remedies would lead to Nestlé's competitive position being reduced to that of a limited range 'also ran' with attendant risks for the viability of its factory in Telford and the sales force based in York and in the field. For these reasons it had suggested alternative remedies to increase competition within the market place and which, wherever possible, had been expressed in an even-handed way. However, the significant difference was that Nestlé's remedies, if imposed, would not only preserve Nestlé's strategy (and therefore its competitive potency) but additionally would increase the contestability of the UK market—for Nestlé, Mars and others.

6.213. Since the remedies hearing, Nestlé had given further thought to the possibility of linking remedies to freezer size. Nestlé submitted a document, reproduced at Appendix 6.1, which set out a 'basic rule' prohibiting freezer or outlet exclusivity but allowing for certain exceptions to the basic rule in respect of freezers with an opening of not more than 0.8 square metres and, in respect of outlet exclusivity, for branded facilities and leisure areas.

The views of Richmond Frozen Confectionery Limited (Treats)

Treats' first submission

6.214. Treats told us that over the last eight years it had not changed its stance on the lack of competition and the negative effects this caused. The UK ice cream market was artificially manipulated by a major multinational brand (namely, BEW). BEW's tactics ensured that new competitors were restrained from making any serious entry into the market and current competitors were kept in check and prevented from building their business and gaining sufficient critical mass to grow. Mars and Nestlé were both

serious worldwide forces in ice cream and therefore took the view that they could not afford not to compete in the UK, though reputedly they had both lost money on ice cream in the UK for a number of years. Treats was a smaller manufacturer with interests only in ice cream and therefore had to provide a return to its shareholders and could not take the long-term view.

6.215. The market was built on two main success factors: (a) product availability, which was a function of mass availability of freezers and a good wholesaler network; and (b) consumer brand awareness. As a comparison, the chocolate confectionery market was absolutely built on brand awareness, but had the benefit of having to compete only for shelf space. The way the market had operated for the last ten years and more had allowed BEW to get more powerful without any recourse to fair competition. Exclusive freezers combined with an exclusive wholesale network gave an unfair platform from which to become larger. BEW was able to afford television advertising because it had over 70 per cent of a £300 million market. This was a fair commercial decision, seen in the light of other television-advertised brands. The advertising could not be seen in the same way as exclusive distribution and exclusive freezers, which were restrictive. However, the combined effect of the advertising, exclusive distribution and exclusive freezers was to restrict totally any other manufacturer from growing its business.

6.216. BEW and others defended their policy on exclusive freezers by pointing to the cost borne by them of providing the free freezer and the ongoing maintenance costs. However, retailers benefited from providing other significant brands, such as Mars ice cream, which was a top 20 best-selling line in the UK. In order to succeed in the UK market, an ice cream manufacturer needed access to all freezers in order to be able to offer products that were commercially acceptable. BEW ought to accept that it had obligations to consumers to allow lines of all manufacturers to be stocked.

6.217. Retail pricing was clearly contrasted between the grocery ice cream market and the impulse ice cream market. The multiple grocery market for take-home ice cream was driven by promotional offers and sharp retail pricing. Some of this was attributable to private-label ice cream which accounted for 45 per cent volume share of the multiple grocery market, but a great deal of it was attributable to free and open competition. In the multiple grocery sector, BEW, Nestlé and Mars competed in non-exclusive freezer displays. No manufacturer was in a dominant position to dictate pricing policy and year-on-year price inflation was kept in check. The impulse market was completely the opposite. Retail promotions rarely occurred and BEW always drove yearly RRP changes. The consumer was left having to pay an inflated price and one that was not even in line with other competing products such as soft drinks and confectionery, because BEW was the predominant and most widely available brand.

6.218. Treats' position was that competition ought to take place on a value-for-money basis at both the consumer and retail level. Treats suggested that, if the changes in retail pricing between the ice cream and ambient chocolate confectionery markets were tracked over the last ten years, ice cream would be likely to be significantly ahead of chocolate confectionery, and this effect would be partly attributable to the dominant market share of BEW.

6.219. As regards the practice of gate funding to large leisure and retail accounts, Treats said that the practice of gate money was common in the ice cream market. This practice was on the borderline between commercially fair and unfair, especially if the manufacturer were BEW, which started with all the benefits of dominant share, exclusive freezers and exclusive distribution. Treats also believed that, in the past, extra financial support had been offered to the customer if the distribution were performed through a BEW concessionaire, and considered that this practice was an additional barrier to fair competition.

6.220. Scale was needed for a wholesaler, manufacturer or retailer to be profitable in the market. With scale should come product and service innovation as a result of investment, and with these investments should come an improved service to the consumer. BEW's dominant position in the market restricted scale for others and this in turn restricted competition and made the battle for consumers' hearts and minds very one-sided. There was a difficult balance to be struck between what was commercially acceptable and what was anti-competitive. BEW was the largest player and artificially manipulated the market to its advantage. If it really believed in freedom for the consumer, it should have nothing to fear by following an open competition policy. Sir Michael Perry, Chairman of Unilever, had stated in a 1996 article in *The Times* that a free market economy worked because companies were forced to vie with each other for customer favour. If this had been correct in 1996, BEW should not be so protective of its position in ice cream.

6.221. As regards distribution, the difficulties of distributing frozen products and the costs involved in operating a frozen fleet ensured that there were bound to be fewer players in the market. In the UK there were only three national wholesalers. The BEW dedicated distributors had been a significant key to accessing the market and BEW had used its size and muscle to defend an exclusive distribution policy. This left very few other distributors and they were also hampered because they had to fight over the remaining 30 per cent of the market. They were bound to operate on tighter margins because of higher costs per case and smaller drop size, which they could not increase because of the restrictions BEW had placed on the market.

6.222. Treats said that the modifications made by BEW to the way it would distribute its products during the 1999 season had provided the ex-dedicated distributors with the freedom to buy independently from BEW. Treats had signed up nearly all of the ex-dedicated distributors to supply its products. In Treats' opinion, this change to distribution methods had the potential to be beneficial from a consumer point of view, as it would aid wider product and brand availability, but BEW would invest whatever necessary to retain control over the market. The freezer exclusivity problem would still exist, and this needed urgent attention by the Commission. The effect of exclusivity was that the consumer lost out; the ending of exclusivity would result in more innovation and price competition.

6.223. Treats said that both BEW and Nestlé offered additional discounts to mobilers whose vans were painted in their colours and stocked only their products. In addition, BEW's mobilers had exclusive rights to nominated postcode areas. These actions might be deemed anti-competitive.

6.224. Many leisure sites and theme parks with captive audiences had exclusive agreements, where a manufacturer purchased the right to supply. Treats did not believe this to be anti-competitive in the strict sense of the definition, but for a relatively small manufacturer, the cost of entry was usually prohibitive.

Treats' response to the issues letter

6.225. On market definition and the terms of reference, Treats submitted that inevitably ice cream was part of the greater impulse market, but due to its being frozen and its need for specialist distribution and storage, it ought to be viewed in isolation.

6.226. On Issue 1(a) (exclusivity of distribution arrangements), Treats believed that the decisions following the 1998 inquiry that led to the creation of Wall's Direct were a serious and huge mistake; it had massively reduced competition in the market, because the market that was left for the independent wholesalers was now even smaller. This inevitably had increased their costs, for example distribution, drop size and density, thus making them less competitive, allowing BEW to dominate the market even more. Treats felt that a customer who used Wall's Direct should be able to buy a Mars, Nestlé or Treats product from that 'in-house' wholesale distributor. In summary, Wall's Direct had enabled BEW to tighten its grip on the market, not reduce it.

6.227. On Issue 2 (freezer exclusivity), Treats believed that freezer exclusivity was the central issue that inhibited competition in this market and this needed to be addressed by the Commission. The retailers had to be given free choice to stock which product they chose, not which product the manufacturer chose.

6.228. On Issues 3(b) and (c) (discounts, bonuses and incentives), Treats' prime concern was where BEW offered to a wide range of leisure/pleasure accounts a 33.5 per cent discount off trade list prices, no matter the level of turnover. Consequently for even a small proportion of the business, Treats' wholesalers were expected to match this and thus the business was not viable.

6.229. On Issue 6 (retail prices), Treats stated that it did recommend prices for each of its products, but it did this to guide retailers. The product was clearly a seasonal one and therefore the retailer could forget from one year to the next what a fair price for a product line was. Treats' judgment was that the retailers needed help and assistance from manufacturers in setting the price. Treats did not believe that the removal of RRP's would aid competition especially if freezer exclusivity were permitted to continue. Treats would also support the view that RRP's provide an important benchmark for price-off promotions, and price promotions were a real way of injecting competition into the market.

6.230. Treats stated that competition in the take-home ice cream market was considerably fiercer than in the impulse market, for a number of reasons:

- (a) The presence of retailer own-brand ranges accounted for 43 per cent of the grocery take-home market.
- (b) The retailers had massive commercial power and were in a position to set the rules for their stocking policy.
- (c) Market share fluctuated from month to month depending on activity within each account; this was driven by promotions and the desire of the retailer to take an increased share of the market. BEW's share of this market (27 per cent) was considerably smaller than its share of the impulse market; in Treats' opinion, this was driven by more competition.
- (d) Freezers were always industry freezers with no brand allegiance.
- (e) Distribution was rarely done by the manufacturer direct to store; small manufacturers could compete in this market as the cost of getting the product to store was not a factored cost, because it was controlled by the retailer; this meant that the drop size to the distribution point was constant even for small competitors.

6.231. Treats believed that freezer exclusivity was a core barrier to competition in this market and that freezer exclusivity and RRPs had to be seen as connected competition issues. In practice freezer exclusivity largely meant outlet exclusivity, even when there was more than one freezer in an outlet. If freezer exclusivity were to be prohibited, smaller manufacturers would be able to improve their drop size and density profile. More drops in a tighter area would reduce unit costs, which in turn would increase the likelihood of price competition. At present the penetration of a brand such as Treats was so low that it did not make commercial sense to price cut and promote heavily. With the removal of freezer exclusivity, the potential for more stocking locations and increased penetration would accelerate scale and growth in the market which would drive cost from the system and germinate competition.

6.232. The removal of RRPs in the ice cream market would adversely effect Treats' ability to compete in the absence of the removal of freezer exclusivity. In a market in which freezer exclusivity had been permitted to continue, Treats' main selling point had always been the provision of a better margin opportunity for the retailer than that offered by competitors. By definition, removing RRPs removed at a stroke Treats' main sales point and initiated less competition. The removal of RRPs would also create more cost within companies such as Treats as it would place more administrative time in advising retailers on a fair price for the product.

6.233. With regard to the remedies suggested in the issues letter, Treats submitted that BEW ought to be required to divest itself of the Wall's Direct operation, as it had too many vested and controlling interests in the market. On freezer exclusivity, Treats submitted that a partial removal of exclusivity would never work. Its management and control would add cost back to the manufacturer and would be impossible to enforce. Treats suggested that, once freezer exclusivity had been removed, BEW should sell the freezer to the retailers at the written-down book value of the freezer.

Treats' response to the remedies letter (see the statement of remedies, Appendix 2.4)

6.234. Treats commented on the statement of remedies (see Appendix 2.4). It said that it supported absolutely the Commission's findings and suggestions on how to address the issues. As a general point, the £10 million threshold seemed to be correct. Treats was clearly on the borderline between getting an exception or being classified inside the criteria. Either way this was not a concern, as Treats believed that any manufacturer with sales of lower than £10 million, or even slightly above, would not be in a position to provide a range or support a system which was capable of delivering to the market the necessary value and choice in every product sector or commercial package.

6.235. On freezer exclusivity, Treats had consistently through this and previous inquiries stated that the market required free, open and non-exclusive freezers. It would initially support a restriction on freezer exclusivity applying to all manufacturers having a turnover in impulse ice cream of more than £10 million. There was a widespread concern in the market that allowing only 40 per cent of the space as

open space was a compromise and would create a great deal of confusion. Furthermore, there was clearly a possibility that BEW might negotiate with (say) Nestlé to keep out smaller manufacturers. The policing of the 40 per cent would be a distraction to the main aim of developing a more comprehensive ice cream market for the food of the consumer. Treats suggested that an allowance of 40 per cent space as contestable should be a transitional position, with a view to a total release from freezer exclusivity by 2002.

6.236. On outlet exclusivity, Treats supported absolutely a prohibition for all manufacturers having a turnover in impulse ice cream of more than £10 million.

6.237. On discounts to retailers, Treats thought that non-volume-related discounts or bonuses should be banned for all manufacturers having a turnover in impulse ice cream of more than £10 million. The prohibition should also apply to unpublished price-related or other incentives. Treats thought that this solution should be extended through the chain to wholesalers at the same time.

6.238. On distribution, Treats thought that measures should be applied to all manufacturers with sales of impulse ice cream greater than £10 million. In Treats' view, an appropriate minimum level of discount for independent wholesalers would be closer to 17.5 per cent than 22.5 per cent. Treats totally supported a requirement that the relevant manufacturer be required to account separately for manufacturing activities and sales or distribution activities. It also supported the proposal that the relevant manufacturer be required to allow any other manufacturer or any distributor access to its distribution system, on annually published and non-discriminatory terms.

6.239. As to the definition of a 'national account' (see paragraph 5 of the remedies statement), Treats believed that this term should cover retailers who could genuinely show coverage across the entire UK with a retail shop number in excess of 200 outlets.

6.240. Treats considered that contact between the manufacturer and the retailer was healthy as in an ideal world the wholesaler was an extra cost in the value chain. The retailer and the manufacturer in reality needed to work in partnership with the wholesaler due to the nature of the product; and therefore if any restrictions were placed on this relationship, commercial transparency should still be maintained. The fairest arrangement would be to provide that contracts between distributors and the relevant manufacturers should be on annually published terms and be non-discriminatory.

6.241. With regard to a possible restriction on the use the relevant manufacturer might make of information provided to it by distributors, Treats thought that this should apply to BEW. Wall's Direct information was clearly in-house information which could be used to unfair competitive advantage in the year 2000.

6.242. Treats also commented that Nestlé had recently been seen to transfer business from local wholesalers to Brakes on advantageous commercial terms and some control in this area was needed.

6.243. Subsequently Treats added that there needed to be a very tight control on the remainder of the 40 per cent in freezers if that route were recommended by the Commission. It would be unfair if only one other manufacturer were able to do a deal with Wall's and duopolize the market and fill the remaining 40 per cent under agreement informal or otherwise with BEW.