

8 Views of Birds Eye Wall's Limited

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Introduction

8.1. This chapter summarizes BEW's views, given to us in written submissions and at hearings. It includes views submitted on behalf of VdBF-I on the market in Northern Ireland (see paragraphs 8.108 and 8.109). The statement of issues is reproduced in Appendix 2.1, and the statement of remedies is reproduced in Appendix 2.4.

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

Market definition and the terms of reference

8.2. BEW submitted that it would be wholly inappropriate to exclude scooping and soft ice cream from the terms of reference. The inclusion of these products was a conscious and deliberate decision by the DGFT who clearly felt that the Commission should look at all forms of competition in the impulse ice cream market. That conclusion was particularly appropriate in view of the recent growth in soft ice cream and the additional competition that had taken place from companies such as McDonald's which had led to loss of sales in nearby outlets. The fact that products were sold at separate retail locations did not prove or even indicate that they did not compete with one another; in many shopping and other areas, outlets selling wrapped impulse, scooping and soft ice cream would be found within a short radius. Products which were differentiated from each other could be effective substitutes, and the degree of differentiation within the wrapped impulse segment was almost certainly wider than between scooping and soft and their closest wrapped substitutes. BEW similarly regarded any amendment to refer to soft ice cream mix rather than soft ice cream as unnecessary, since it was interaction at the consumer level that was relevant, although it was perhaps appropriate to add soft ice cream mix to ensure that relevant data could be obtained from manufacturers.

8.3. BEW believed that competition at the margin with other impulse products did play a part in the overall constraints facing an impulse ice cream supplier, but was doubtful whether the degree of substitutability was strong enough to justify a claim that the relevant market was wider than impulse ice cream for competition law purposes. BEW regarded slush as included in the definition of ice cream in the terms of reference, which had parallels with products such as Solero Shots. It agreed that very few multipacks were purchased for immediate consumption, and so believed it unnecessary to revise the terms of reference in this respect.

Scale monopoly

8.4. BEW accepted that, as a manufacturer, it was likely to supply more than one-quarter of the reference products, but did not accept that the Commission had information on which to conclude that BEW had a scale monopoly in distribution. BEW believed that its share of the reference products in distribution from March 1999 (the launch of Wall's Direct) to the end of August 1999 was as low as 21 per cent. Asked whether BEW's scale monopoly in manufacturing could affect distribution of the reference products, BEW said it was slightly surprised that the question of a scale monopoly in distribution had been raised in the issues letter, but it accepted that if the Commission could show that BEW's distribution arrangements were steps taken to exploit (or an act or omission attributable to) a monopoly position in manufacturing, then the Commission was entitled to make findings on distribution.

8.5. However, BEW maintained that its strength in the market place had been established through the long-term development of strong brands and innovative products and by ensuring that it understood and met the needs of both its consumers and its customers. BEW laid considerable emphasis on the results of the Commission's two-wave consumer survey (see Appendix 4.1) as confirming a high degree of consumer satisfaction: nine out of ten consumers surveyed said that they were happy with the variety of ice creams available. BEW advocated that this should be borne in mind throughout the consideration of the issues and hypothetical remedies.

Complex monopolies

8.6. BEW did not accept that freezer exclusivity or the practice of retrospective retailer bonuses restricted, prevented or distorted competition. In BEW's view, outlet exclusivity was driven by retailers exercising their own choice and bargaining power and this practice had no anti-competitive effect. BEW did not accept that RRP's or its terms to distributors restricted or distorted competition. Nor did it accept that any complex monopoly in retailers' pricing practices could exist in favour of manufacturers.

Public interest issues

8.7. On Issue 1 (distribution) and Wall's Direct, BEW submitted that there was no evidence to suggest that lack of access to the local delivery vans contracted to BEW materially restricted the ability of other manufacturers to compete with it or of other distributors to compete with Wall's Direct. In circumstances where BEW had had an exclusive distribution network through dedicated distributors, other manufacturers had been nonetheless able to achieve the following weighted distribution penetration.

TABLE 8.1 **Manufacturer distribution for wrapped impulse ice cream weighted by ice cream turnover by outlet, 1996 to 1998**

	<i>per cent</i>		
	1996	1997	1998
BEW	92	93	93
Nestlé	45	44	51
Mars	69	60	62
Treats	9	11	12

Source: Provided by BEW from Nielsen audits of independent CTNs, multiple CTNs, independent grocers and filling stations (about 55 per cent of the total wrapped ice cream outlets).

So, for example, 62 per cent of outlets, weighted by the value of sales of impulse ice cream, distributed at least one Mars product. BEW added that in respect of the Barking operation within the M25, nobody had ever suggested that distributors needed access to BEW's local delivery vans to compete. In 1999, availability of other manufacturers' products had increased, as was shown by the Commission's own survey of retailers (see Appendix 4.2).

8.8. As a matter of principle, confirmed by recent EC case law (namely, the *Oscar Bronner* ruling of the ECJ which had strikingly close parallels with Wall's Direct and would be the legal test by which Wall's Direct would fall to be examined after 1 March 2000; see Appendix 2.2), access should only be required if Wall's Direct was an essential facility (like the national electricity grid), which it plainly was

not. It was therefore quite wrong to suggest that BEW's competitors must be able to use Wall's Direct (or any part of it) to compete with it. There was a fundamental policy objection to requiring a company to give its competitors access to its contracted-out distribution system. That would be unprecedented outside the field of natural monopolies. The Advocate General's Opinion in the *Oscar Bronner* case had indicated two reasons for not requiring such access (paragraphs 57 and 69 of the Opinion):

- (a) 'If access to a production, purchasing or distribution facility were allowed too easily there would be no incentive for a competitor to develop competing facilities.'
- (b) 'To accept *Bronner's* contention would be to lead the Community and national authorities and courts into detailed regulation of the Community markets entailing the fixing of prices and conditions for supply in large sectors of the economy. Intervention on that scale would not only be unworkable but would also be anti-competitive in the longer term and indeed would scarcely be compatible with a free market economy.'

BEW also said that interference in Wall's Direct would involve interference in its proprietary rights.

8.9. BEW said that, following the Commission's 1998 report and as a result of the undertakings given by BEW to equalize distributors' terms, it had become apparent that most of the dedicated distributors would either become unviable (if it ceased to pay to them the two additional incentives for the additional contractual services they had provided over and above physical distribution) or that equalization of terms would lead to a sharp drop in the level of retailer service and brand promotional activities which the dedicated distributors had provided. In consequence, there would be a sharp drop in volumes. BEW told us that it had considered four options in response to the Commission's report and the DGFT's requests for undertakings (see paragraph 3.16) in lieu of a further reference:

- (a) to maintain the dedicated distributors, but to increase the number of direct accounts, which was thought unlikely to be acceptable to the DGFT (direct accounts were accounts for which BEW acted as principal, took credit risk and invoiced the dedicated distributors acting as agents in delivering BEW products to those accounts);
- (b) to move to complete distribution by wholesalers, with national and larger accounts maintained as direct accounts, which BEW expected would lead to a [§§] per cent loss of BEW's market share and to a shrinkage in the size of the market;
- (c) an in-house operation for direct accounts (including some accounts previously classified as indirect, that is where the dedicated distributors acted as wholesalers, themselves bearing the credit risk) though this was thought unlikely to be acceptable to the DGFT; and
- (d) all distribution by wholesalers, with no direct accounts, expected by BEW to lead to a [§§] per cent loss of market share and significant shrinkage in the market.

These options were evaluated with regard to the following criteria: satisfying the DGFT; meeting BEW's objectives of getting product efficiently to retailers in good weather; negotiating freely with retailers; ensuring no increase in ongoing costs or other costs over the longer term, and no shrinkage in market share and market size; and meeting Unilever's objectives of maintaining freezer cabinet exclusivity and dedicated distribution. BEW considered that none of the options would have met the DGFT's proposals on freezer exclusivity, but option (d) would satisfy his other three concerns. Option (c), thought to meet only the DGFT's concerns as regards exclusive distribution, was preferred by BEW, but without any change in policy on direct accounts.

8.10. The Wall's Direct system had therefore been designed to comply with the 1998 undertakings (see Appendix 3.2) and to respond to customers' demands for increased levels of service for the benefit of consumers while maintaining a national service for national retailers. The latter service included:

- (a) a next-day delivery service seven days a week throughout the season;
- (b) simplicity and efficiency in ordering through a central call centre;
- (c) accuracy of order placing and delivery on time, in full and in good condition;

- (d) van selling covering around 25 per cent of outlets to ensure effective merchandising and speedy replenishment in areas of high density; and
- (e) a focused approach to point-of-purchase (POP) material and merchandising to ensure that the results of innovation and new products came to retailers' and hence consumers' attention.

BEW stated that these were all pro-competitive, resulting from an amalgamation of services that were available on the open market and should act as a spur to other manufacturers and wholesalers to improve the quality of their own service. Other manufacturers had seized the opportunities to find cost-effective, specialist ice cream distribution. More impulse ice cream was going through independent wholesalers than before, 52 per cent of BEW's recent sales from March to the end of July 1999 being through independent wholesalers. When asked about its assumptions in establishing Wall's Direct, BEW stated that it had put to the Unilever ICFE group two different scenarios. One scenario envisaged the volume of BEW business going through 'new wholesalers' (ie the ex-dedicated distributors) as declining to zero by 2002 (see Table 5.28); BEW stated that behind this assumption lay the view that new wholesalers would have been assimilated into the general class of wholesalers by 2002. BEW pointed out that these were working figures which were used to size Wall's Direct. They were not indicative of any intention of BEW that Wall's Direct would handle business of ex-dedicated distributors solely (that is, as opposed to the business of wholesalers or new business). In the shorter term, BEW had assumed that Wall's Direct would handle a level of business in 1999 equivalent to between 60 and 85 per cent of the volume of business that it had planned for 1999 would be handled by the ex-dedicated distributors (40 to 60 per cent of all deliveries to retailers). In comparisons BEW put to us of the costs of Wall's Direct with those of the ex-dedicated distributors, it assumed that the higher level of business (85 per cent of the business that it had planned would have been handled by dedicated distributors), or even 100 per cent (if Wall's Direct were to operate at the equivalent volumes as previously handled in total by dedicated distributors), would be handled by Wall's Direct. Asked about the service offered by independent wholesalers, BEW said that in the past it had gained enormous value from its dedicated distributor network. However, it had been disallowed by the Commission's 1998 report from rewarding the dedicated distributors for their particular services in any way which differentiated them from any other wholesaler.

8.11. BEW submitted that the operational requirements of Wall's Direct would make it impracticable to distribute other manufacturers' products. If general access to Wall's Direct were allowed (or to its distribution arm), it was hard to see how existing benefits could be achieved:

- (a) Short of the call centre taking all manufacturers' orders, there would be immense practical difficulties in consolidating orders accurately and efficiently. The picking procedures (where cases had to be picked from separate pallets) used at the distribution centres were not designed to cope with the increased number of different stock-keeping units (SKUs) that would result from storing other manufacturers' impulse ice cream product ranges.
- (b) If delivery vehicles had to wait to pick up various other manufacturers' products, particularly at cross-docks, given their practical and logistical complexities, the next-day delivery service would be unobtainable.
- (c) The increased number of drops required to service the increased number of outlets would put time constraints on the system, again jeopardizing the next-day delivery service. Similarly the timing of different orders for different ranges might not result in larger drop sizes.
- (d) The efficiency of Wall's Direct's van selling (which BEW described as 'the gold standard customer service') would be seriously compromised if full product ranges of other manufacturers were required to be carried on all vans. Even now those Wall's Direct vans were generally at full capacity. An increase in SKUs would effectively result in rationing of space and entail ongoing regulatory intervention because competing suppliers might well argue over the fairness of whatever rules were adopted to choose between competing brands.
- (e) The focused approach to POP and merchandising would be lost in a multi-brand system because there would be inevitable conflicts of interest over similar products from different manufacturers and the timing of launches and promotions.
- (f) Customer service competencies were developing rapidly with constant innovation. This would be unlikely to continue at the same pace if a manufacturer's incentive for innovating in this area were reduced by having to share these innovations with competitors.

8.12. In addition, BEW continued, there would be serious practical difficulties in attributing a value to each part of the Wall's Direct system and the system as a whole. There would be corresponding difficulty in arriving at an 'access price' for various manufacturers and distributors, particularly when Wall's Direct still had no track record and had been launched at some risk to BEW. There would also be administrative inefficiencies in determining, billing and collecting these access costs. BEW concluded that any obligation for general access to Wall's Direct would distort competition and damage the public interest. It would also ensure the demise of the existence of independent ice cream wholesalers, to which great importance was attached by the Commission and a number of third parties.

8.13. We asked BEW about the importance of maintaining the Unilever policy of exclusivity in distribution, as evidenced in its submission to Unilever's ICFE group in Rotterdam in November 1998 where the combination of freezer exclusivity and distribution exclusivity was referred to as being 'all about owning the point of purchase and the customer relationship'. BEW stated that the exclusivity of its distribution arrangements was of fundamental importance for Unilever in order to satisfy customer needs. It added that, had it moved to a non-exclusive distribution system, it estimated that it would have lost [20] per cent of its volume; that assumption was based on Unilever's experience in two regions of Belgium (Brussels and Leuven) where a system of increased visibility, increased availability and better logistics services had replaced the previous 48-hour delivery system and some distribution by wholesalers. BEW told us that it believed that if distribution were left entirely to wholesalers, levels of service would be uneven, particularly for national accounts. It hoped that Wall's Direct by offering a uniform and high level of service would be able to grow the market. Wall's Direct was exclusive to BEW in so far as the integrated whole was exclusive to BEW, but all of the component parts were used or could be used by others.

8.14. BEW made the following comments on the hypothetical remedies contained in the statement of issues which proposed that a manufacturer should not be allowed to maintain any in-house, sub-contracted or exclusive distribution system:

- (a) They were unnecessary given the availability of alternative distribution methods.
- (b) They would destroy many of the benefits of Wall's Direct to the detriment of retailers and consumers.
- (c) They would diminish the incentives for competitors to develop competing systems of distribution, thus restricting long-term competition.
- (d) They would discourage manufacturers from investing in greater efficiency and quality of service in ice cream and other industries.
- (e) They would constitute an incursion into the right to choose trading partners and to dispose freely of property.
- (f) They were contrary to EC jurisprudence on essential facilities.

8.15. Wall's Direct did seek customers by actively promoting the new service and by seeking to persuade them of the quality of the service it could provide but there was nothing anti-competitive in actively encouraging the use of Wall's Direct. It was not BEW's policy to make untrue statements about Wall's Direct or stock allocation in peak summer periods, for sales staff to pass themselves off as wholesalers or for third parties' freezers to be forcibly removed. On the contrary, BEW took such issues extremely seriously and confirmed to the Commission that if any specific allegations to this effect were found to be true, it would take appropriate disciplinary action. On specific allegations made by the ex-dedicated distributors (see paragraphs 7.2 to 7.102):

- (a) BEW had made a one-off, introductory, promotional offer for Wall's Direct which lasted only four weeks from the date of launch, entirely in line with industry practice on the launch of an entirely new distribution system. It was far from excessive and did not in any way distort retailers' purchasing following the short introductory period. There had been no further promotions limited to purchases through Wall's Direct. The suggestion that this had materially restricted other distributors' ability to compete was therefore unfounded.

- (b) There were very few individuals previously employed by dedicated distributors and now employed by BEW's contractors. All had already terminated their contracts (or had had their contracts terminated), and had applied independently to the (new) local distribution contractor. In the circumstances it would have been discriminatory for those new employers not to take advantage of such eminently well-qualified applicants.
- (c) In the past BEW did not offer or guarantee a 24-hour delivery service to dedicated distributors, but a 48-hour lead time. It did, however, quite frequently deliver to them within 24 hours where they were getting short of stock. This year, for ex-dedicated distributors, as with other wholesalers, in the event of sudden demand BEW had indicated that it would make efforts to achieve 24-hour delivery for full trunker loads (that is, a full-size distribution lorry taking 26 pallets). These trunker loads generally took 48 hours. It was not relevant to make a comparison of delivery lead times to wholesalers with that to retailers via Wall's Direct; the former had much larger storage capacity than the latter. Wall's Direct had to have overnight delivery service to enable it to comply (at least through cross-docks which had no storage capacity) with its next-day delivery obligations. In one respect ex-dedicated distributors were now better off than before because, whereas in the past they had to take minimum orders of a number of pallets (larger dedicated distributors were required to take full trunker loads in summer), they could now order minimum loads of 50 cases (much less than one pallet) for their scheduled twice-weekly deliveries. From a financial, cash-flow and stock-keeping point of view, this was a major benefit to the ex-dedicated distributors compared with their previous order requirements.
- (d) BEW's initial base for contacting (by way of welcome calls made before 1 March 1999) potential customers for Wall's Direct comprised its own records of direct accounts and its records of outlets with BEW's refrigeration. Following expiration of the dedicated distributor agreements at the end of February 1999, information on indirect accounts delivered by dedicated distributor was added to the database. BEW had openly reserved this right in the dedicated distributor agreement in order to ensure that BEW could ensure continuity of delivery service if, for any reason, the dedicated distributor was no longer able or obliged to deliver. BEW did not see how this in any way restricted an ex-dedicated distributor's ability to compete with Wall's Direct particularly as the ex-dedicated distributor would clearly have had the closer contact with the customer. BEW had also used information on outlets with its freezers. In so far as information was acquired on an ongoing basis from claims for discounts and/or bonuses, for wholesalers and retailers, although BEW was entitled to use such information for any purpose, this had not been supplied to or used by the call centre as a basis for prospecting new Wall's Direct accounts. It was anticipated that such prospecting would be done by using published sources (for example, *Yellow Pages*), or by 'buying in' databases.
- (e) BEW actively encouraged the use of Wall's Direct, but not by unfair practices. It did not accept that this restricted other distributors' ability to compete.

8.16. BEW acknowledged that Wall's Direct did seek customers by actively promoting the new service and by seeking to persuade them for the quality of service it could provide. The field sales forces also promoted Wall's Direct but this was not their primary function which was to promote sale of BEW's products irrespective of the means of distribution. We put back to BEW after the issues hearing a substantial number of retailer witness statements which the ex-dedicated distributors had obtained. In relation to unwanted calls, BEW said that there had initially been some instances of retailers receiving frequent calls, due to errors at the call centre, but this was no longer the case; and staff, who sometimes introduced themselves as Wall's, now introduced themselves clearly as 'Wall's Direct' to avoid confusion. BEW pointed out that a number of the cases predated Wall's Direct, but referred to the operation set up at short notice in 1998 ('Walls N&C') to supply in the areas served by the two ex-dedicated distributors who chose to act as independent wholesalers in that year. BEW said that other cases resulted from initial 'teething problems' or retailers' misunderstanding of the service provided by Wall's Direct; in other cases it was clear that the retailers had ended up perfectly happy with the current position; and in remaining cases, unconnected van salesmen had been mistaken for Wall's Direct van salesmen despite the latter's distinctive uniform. Altogether these cases represented a totally insignificant proportion of Wall's Direct's contacts with customers.

8.17. We asked BEW to comment on a study carried out for Mars by a consultant (see paragraphs 4.11 and 6.42) about distribution costs. This study showed that the cost per call would fall from £10.95 to £7.17 if 4.11 and 6.42 the number of outlets served by a distributor in one particular area increased from

250 to 1,000. BEW commented that this study showed that with the current proportion of about one-third of its sales through Wall's Direct, independent wholesalers (including ex-dedicated distributors) were able to compete on the basis of near-optimal distribution costs.

8.18. We noted that some of BEW's promotional material appeared to stress the greater availability of its products in good weather; for example, an advertisement in *In Touch*, the Bridewell journal, for July 1999 gave details of the Wall's Direct service under the heading 'Walls: Severe weather warning. Don't be caught out—call the experts' and read: 'Wall's Severe Weather Warning: Call Wall's Direct: does your distributor compare with this service?' BEW commented that Bridewell was keen to have continuing publicity for Wall's Direct although Bridewell members had a free choice of which distributor to use.

8.19. In so far as any of the above allegations was correct (and most were not), BEW did not believe that the actions had in any way impaired other distributors' competitiveness. The 1998 report had sought to stimulate greater competition within wholesaling. That had undoubtedly occurred with:

- (a) the availability of BEW's discounts and bonuses to retailers irrespective of supply source;
- (b) the accessibility of all the former dedicated distributors for wholesaling activities; and
- (c) the introduction of Wall's Direct.

There was nothing sinister about a manufacturer itself introducing competition on quality of service into wholesaling, provided the steps taken to compete were proportionate and not predatory. Therefore, there were no practices engaged in by BEW which restricted competition. On the contrary, they were pro-competitive. New opportunities were being taken up by manufacturers like Nestlé, Treats and others and there had been a major opening up of the wholesale distribution function.

8.20. On the issue of wholesalers' terms being below distribution costs, BEW stated that wholesalers, including ex-dedicated distributors, were now an established and important part of the distribution channel for wrapped impulse ice cream. Normal market disciplines would ensure that BEW provided those distributors with terms that would retain their incentive to stock its products: since a substantial number of customers showed a preference for taking delivery via wholesalers, BEW had no incentive to harm them or frustrate customers' requests, and there was also competition between manufacturers to secure the loyalty and custom of distributors.

8.21. In any event BEW believed that the terms it gave to distributors should reflect the cost of an efficient distributor. Wholesalers' growth targets had been set at a more generous level than in 1998 to take account of the introduction of Wall's Direct. Ex-dedicated distributors could achieve the maximum bonus if BEW's sales increased at the 33 per cent target for BEW for the year, if Wall's Direct's market share were equivalent to the bottom end of its projections (60 per cent of the volume that it had planned for 1999 would otherwise have been handled by the ex-dedicated distributors) and if the ex-dedicated distributors retained indirect rather than direct accounts. If distributors received the maximum target payments, their remuneration would be about £2 a unit or a margin of 19 per cent of list price (GSV). Since retailers were now able to get their bonus terms on purchases from wholesalers, this margin (unlike those from Mars and Nestlé) would not now need to be shared with retailers. BEW added that it had had to decide on an essentially arbitrary level in 1999, and that a more systematic approach to sales growth targets would be adopted next year.

8.22. BEW said that it was not currently permitted to differentiate its wholesale terms (except for certain large wholesalers). It took the view that it could not, therefore, whilst complying with the 1998 undertakings, discriminate in its terms between general wholesalers and former dedicated distributors. As £1.06 per unit (increased by the RPI to £1.10 in 1999) had been specified in the undertakings as the standard distribution dedication, it had effectively been sanctioned by the DGFT.

8.23. On the issue of wholesaler terms being below the distribution costs of Wall's Direct, BEW submitted that the nature of the differences between multi-brand wholesalers and an integrated ice cream distribution system, such as Wall's Direct, made it very difficult to compare terms, since they were not providing the same service. BEW had no way of controlling, for example, whether a wholesaler provided next-day delivery or van selling. On the basis of BEW's assumptions and budgeted costs, the published standard distribution deduction of wholesalers' terms would not be lower than the average distribution

cost element of Wall's Direct when the operation had become established. That did not indicate that wholesalers' ability to compete was adversely affected and early evidence from the 1999 season suggested that multi-brand wholesalers were playing a very prominent part in the market. The viability of such wholesalers would also depend on the package of terms offered by BEW and manufacturers of other brands. However, towards the end of the inquiry, BEW acknowledged that it might have underestimated the effect on independent wholesalers of the transition to the Wall's Direct system and that the structure of its terms, including the balance between the standard distribution deduction and year-end targets payments, might be addressed to help their cash flow in the future.

8.24. The DGFT had agreed the amount of BEW's standard distribution deduction in November 1998 in full knowledge of the Commission's desire (expressed in the 1998 report) that viability be established for wholesalers. BEW submitted that the hypothetical remedy suggested in the issues letter to supply all distributors on economically viable terms would be anti-competitive, complex and unnecessary. If terms were raised across the board, that would increase costs and encourage inefficient wholesalers. A further possible remedy to separate and not discriminate between the supply to any in-house sales or distribution activities and other distributors would eliminate a vital element of competition and choice between these two distinctive modes of distribution and was likely to be costly and difficult to monitor; furthermore that had been specifically rejected by the Commission in 1998 as disproportionate except in the case of an essential facility. As also noted above (see paragraph 8.4), Wall's Direct might not even be a scale monopoly distributor, and could not on any reasonable analysis be described as an essential facility. In a market where BEW faced competition from several major and well-resourced branded goods suppliers, such entry-assistance regulation was not necessary, and the reforms of BEW's distribution system recently introduced had created more opportunities for third party brands than had existed previously.

8.25. With regard to ex-dedicated distributors, BEW told us that it had not taken any action to deprive them of their ability to handle direct accounts.¹ Very few indirect accounts had transferred to being direct accounts (and some direct accounts had moved to become indirect accounts). BEW said that ex-dedicated distributors were in the same position as other wholesalers, whereby retailers with terms negotiated with BEW or on standard bonus terms offered by BEW were free to choose to have their deliveries from any source and retain their terms. As to the complaint that ex-dedicated distributors had now to bear the credit risk of servicing direct accounts (as did all other wholesalers), they were no longer BEW's agents for delivery to these accounts, and it would be inappropriate for BEW to bear the credit risk. BEW provided us with details of 50 accounts with sales in 1997 of £480,000 (1.1 per cent of dedicated distributors' sales to indirect accounts in that year) which had been reclassified to remove historical anomalies, but said that it was unable to provide details of all other accounts that might have changed from indirect to direct because it did not track such changes but believed there were very few.

8.26. With regard to the point that BEW had not recognized ICW as a buying entity exempt from the undertakings, BEW said that it was unable without breaking its undertakings to offer non-standard terms to a stand-alone entity with no track record of buying £7.5 million of BEW's frozen food and ice cream products in 1997/98; this was not an action or omission attributable to BEW. BEW had told the ex-dedicated distributors that it was policy not to recognize buying groups for the purpose of negotiating terms. BEW commented that this had been against a background in which it was understood that the discussion concerned a loose alliance, equivalent to a buying group, and not a formally constituted company. We asked BEW whether it had considered requesting a relaxation of the undertakings. BEW said that it had not and it believed that the DGFT would not have allowed this.

8.27. On differences in the terms of supply to mobilers, BEW said that its terms to distributors who sold to mobilers were the standard published distributor terms. If distributors supplied proof of sales to mobilers at a discount, they would also get a further discount of up to 17.5 per cent. Given the limited number of franchised mobile retailers (only 6 per cent of the total number of vans), and their even more limited share of UK impulse ice cream sales, BEW believed this issue to be *de minimis* and that any additional discounts given to Wall's franchised mobilers (for example, the business plan payment, designed to encourage fleet operators to invest in their business) did not adversely affect competition but rather benefited the public interest. The granting to mobiling franchisees of an exclusive territory (or exclusivity for certain events) in no way prevented non-liveried vans from operating in that territory (or at that event) and selling BEW's ice cream, and although such franchisees agreed not to stock competing products or to advertise to seek customers outside their respective territories or engage in competing

¹BEW stated that its definition of 'direct' and 'indirect' accounts had changed since 1998; see glossary.

franchise operations in the relevant territory, they were free to make sales if requested to do so. The arrangements were intended to incentivize franchisees to concentrate their efforts on a particular territory and maximize the availability of BEW's products and develop sales from liveried mobile vans within the territory.

8.28. With regard to the arrangements for the payment of retailer bonuses and discounts, BEW stated that since the 1998 undertakings retailers had been able to claim their year-end and seasonal bonuses on all purchases (including if a retailer changed from a BEW exclusive freezer to an industry freezer mid-season) and there were no problems in this area. As to off-invoice discounts, the manner in which this undertaking had been implemented in the limited time available did not restrict or distort competition. Systems had been put in place in relation to off-invoice discounts for direct accounts, but had to be processed manually and delays had initially occurred: BEW believed it would not have been possible to make its procedures with respect to direct accounts any simpler than they were, and retailers were not disadvantaged. If anything direct accounts got a cash-flow advantage where (as in most cases at present) BEW invoiced as agent for the wholesaler. Asked about the effect on wholesalers, BEW said that in principle it wished to levy a charge for invoicing and had reserved itself the right to do so, but in fact it had waived this charge for this year. BEW added that it did insist on invoicing some retailers supplied by independent wholesalers, in order to preserve the confidentiality of off-invoice terms to those retailers.

8.29. The change to the definition of direct accounts in 1999 had no adverse effect whatsoever on the earnings potential of the ex-dedicated distributors but reflected the fact that any wholesaler could supply accounts with off-invoice terms offered by BEW and that that account would, with regard to the effect of distribution arrangements on manufacturers' costs, retain its terms. Asked about whether wholesalers could earn year-end target payments on direct accounts, BEW confirmed that they could not do so.

8.30. With regard to the effect of distribution arrangements on manufacturers' costs, BEW submitted that the introduction of Wall's Direct had created new opportunities for other manufacturers to find cost-effective, specialist ice cream distribution which they had seized. More impulse ice cream was going through wholesalers than before. Wall's Direct was a source of competitive advantage to BEW due to the greater responsiveness that a dedicated service could deliver. BEW ought not to be forced to share it with its competitors as they too had ample opportunities in the new competitive environment to seek similar competitive advantage.

8.31. On Issue 2 (freezer exclusivity), BEW submitted that freezer cabinet provision was the preferred form of doing business by a very large number of retailers and was entirely at the retailer's option and terminable upon (in effect) no notice. Asked about the point made by the ex-dedicated distributors that 28 days' notice to terminate a cabinet agreement was required and that retailers did not have the right to move or remove cabinets, BEW said that it had been necessary to make terms clear to the ex-dedicated distributors in 1999. In previous years they had had authority to remove cabinets. From March 1999 they no longer had this authority, but were continuing to move cabinets without the retailer even giving notice to BEW. In practice, cabinets could be removed at very short notice but this had to be done with BEW's authority because the cabinets were its property. Retailers had the right to move cabinets within a shop but not to remove them. Freezer cabinet exclusivity did not act as an entry barrier, as could be seen from the weighted distribution achieved by BEW's main competitors.

8.32. As for cost of entry, it was wrong to single out freezer cabinet costs as a crucial factor affecting manufacturers' profitability and ability to compete, because other costs dwarfed those for freezer cabinet investment. The ability to compete effectively was not necessarily dependent on having the financial resources to provide large numbers of exclusive freezer cabinets. The large manufacturers undoubtedly had the necessary resources; over half of smaller outlets (on the basis of the Commission's 1998 survey) had their own freezers; and a number of smaller manufacturers and distributors could and did provide freezers.

8.33. On space in smaller outlets, BEW said that it had argued in 1993 that available space and resources rarely acted as constraints on retailers, who were in the majority of cases not prevented from installing a competing manufacturer's freezer cabinet or purchasing their own cabinet. The Commission's 1994 report had accepted that argument. Since then even more retailers had exercised their choice to install more than one freezer or to have a non-exclusive freezer, the number of outlets with only one cabinet which was a BEW cabinet had declined, the number with their own cabinet had gone up and those selling two or more brands had gone up. Consequently, the weight of evidence indicated that the Commission should not go back on its 1994 verdict. The growth of garage forecourt

chains and multiple CTN chains with increased resources and bargaining power, and a corresponding decline in independently-run outlets, also rendered less and less credible the claim that retailers were denied free choice of which products to stock. Freezer space was also rarely an issue in independent grocers and local convenience stores which would invariably stock frozen foods as well, and many independent CTNs had room for more than one freezer: with the increase in variety of freezer types, the ability to install more than one cabinet had also increased. In those few outlets with genuine space constraints, or which preferred to use the space for more profitable products, the question was more whether they would stock ice cream at all were they not supplied with a free, maintained cabinet.

8.34. In 1994 the Commission had concluded that freezer cabinet exclusivity was not inhibiting consumer choice and no evidence had been produced which would alter that conclusion or to warrant the suggestion that overall sales would increase if freezer cabinet exclusivity were ended. Indeed, such evidence as there was, including the Commission's survey in 1993, suggested that consumer choice would be more restricted in the absence of exclusive freezer cabinets.

8.35. As to the viability of niche or part-range suppliers, BEW submitted that a part-range supplier had different challenges in the impulse ice cream market, but there were a number of proven options for success such as to strike an alliance with another part-range supplier, to sell products in different outlets from the established supplier, or to encourage retailers to take an extra cabinet or buy their own. The key was a novel and distinctive consumer proposition that met a consumer need. Exclusive freezer cabinets were not a material hindrance.

8.36. On developments since 1994, the Commission had concluded in 1994 that freezer cabinet exclusivity was not adversely affecting prices and was not diminishing innovation or efficiency. The number and proportion of non-exclusive freezers had increased between 1994 and 1998. The Commission had commissioned a survey in 1998 which had found that 52 per cent of smaller independent CTNs and convenience stores had an industry freezer (up 5 per cent from 1994), 34 per cent had more than one freezer (up 8 per cent) and 56 per cent were stocking more than one brand range. Subsequently, the Commission's 1999 retailer survey (see Appendix 4.2) showed that 66 per cent of retailers were stocking more than one brand. Lack of profitability of any other manufacturer might result from a failure to develop innovative products and brands for which there was strong demand, a failure to invest in effective distribution, ineffective marketing, bad weather in particular years or a combination of these: BEW had itself had to invest long term to achieve profitability.

8.37. BEW's market share of the wrapped impulse sector had risen slightly since 1994 but this was largely driven by brand popularity and meeting demand. There was no evidence that market share was protected by freezer exclusivity: the dramatic fall of Lyons Maid's market share in the 1980s proved the contrary. The increase in number of BEW cabinets related to the development of the market in terms of outlets and the availability of impulse ice cream as a whole. Competition had not been distorted by an increase in the size of BEW's cabinets because their average floor space and capacity had fallen between 1992 and 1999. BEW had no policy of forcibly removing competitors' freezer cabinets from outlets, nor did it have a policy of offering incentives specifically designed to persuade retailers to abandon their own freezer cabinets in favour of BEW freezer cabinets. Clearly it did try to obtain the optimal position for any freezer it installed, but this was a matter for the retailer.

8.38. BEW submitted that its failure positively to support shared industry freezer cabinets did not distort competition. BEW believed it healthier for manufacturers to compete vigorously in the supply of freezers rather than have to reach arrangements with retailers or competitors on industry cabinets: in addition industry cabinets (on the Mars model) were likely to increase administration costs and create inefficiencies. BEW added that it was long-standing Unilever policy not to support industry freezers. In Unilever's view, putting money into an industry freezer where the manufacturer had no influence over what was stocked in it was not an efficient way of using the company's capital. Unilever believed that it ought to be able to determine what went into its property. In BEW's view, freezer exclusivity in no sense foreclosed the market.

8.39. BEW disagreed with the proposition that freezer exclusivity affected competition between distributors. It emphasized that retailers with BEW exclusive freezers could still acquire BEW products from any distributor. We put to BEW a few complaints that retailers were still being misled in this respect. BEW said that retailers' rights to acquire products from any source had been extensively publicized since the 1993 inquiry, and BEW's sales force had been clearly instructed not to suggest to retailers that they had to use Wall's Direct to stock BEW exclusive freezers.

8.40. BEW submitted that the hypothetical remedy of prohibiting freezer exclusivity would have a number of effects adverse to the public interest:

- (a) retailers would be denied the freedom to choose how to obtain a cabinet;
- (b) the overall cost of cabinet provision would rise and those costs would find their way to the consumer in higher retail prices and/or less availability;
- (c) marginal outlets would stop selling ice cream and it would be more difficult to persuade new outlets to take the risk of stocking ice cream for the first time;
- (d) retailers would have to bear the risk of bad weather years;
- (e) there would be a likelihood of deterioration in the quality of freezers, product presentation and point-of-sale material;
- (f) smaller regional suppliers and niche suppliers would be likely to be damaged;
- (g) manufacturers and others with cabinet fleets would suffer some form of expropriation, for no good reason; and
- (h) the hypothetical remedy of 'gifting' access to established cabinet fleets to competitors would fly in the face of recently established EC law, namely the *Oscar Bronner* judgment.

8.41. On Issue 3 (pricing and terms of supply), BEW said that there were only limited practices which could be regarded as linking the terms for supply of reference goods to the supply of other products. The first of these stemmed from the scope of the 1998 undertakings, which exempted wholesalers who purchased ice cream and frozen foods above the specified value of £7.5 million worth of business with BEW in the previous financial year. Other practices were strategic payments to wholesalers for achieving target proportions of sales of key products, and the non-manufacturer deduction to franchised mobilers (ie the additional margins to mobilers who did not manufacture and sell their own impulse ice cream). There was only one other possible instance, which was *de minimis*. In this instance, the terms offered to one medium-sized national account (a multiple convenience store) were based on purchases of ice cream and other frozen foods. BEW also said that the terms for supply of impulse ice cream had been linked to the supply of take-home ice cream, and the terms of certain categories of impulse products had been linked with the supply of others, for example linked terms for scoop and wrapped products.

8.42. On discounts and bonuses, BEW submitted that the primary purpose of granting discounts was, as in any business, to encourage and incentivize the retailer to sell more BEW impulse ice cream. Standard year- or season-end bonuses were common in the industry and were a facet of competition rather than restricting competition. The same was true of non-price incentives such as sponsorship. In the absence of evidence showing that the levels of support were predatory and not justified for their promotional benefits, these terms had no adverse effect on competition or the public interest.

8.43. A business model that based pricing decisions on some cost-plus formula was completely inappropriate for the impulse ice cream industry. Nor could it be inferred that low profitability in one channel suggested some predatory intent by BEW. All channels contributed to overheads; but the leisure channel demanded very substantial terms for the high visibility offered.

8.44. BEW submitted that the hypothetical remedy to prohibit differential terms was unwarranted as BEW was already subject to price control in respect of distributors; and any price differential for retailers resulted from market forces, stemming from the different bargaining power of different retailers. In BEW's view, that remedy would:

- (a) prevent BEW from competing by imposing an inappropriate 'cost-plus' blueprint;
- (b) distort competition between manufacturers by preventing them from competing fully on price;
- (c) distort competition between retailers by preventing them from exercising their bargaining strength;
- (d) damage retailers who might otherwise negotiate better terms;

- (e) reduce the potential for retail price competition by reducing retailers' scope for improving their terms; and
- (f) hinder promotions at retail level.

8.45. BEW argued that there was no evidence, for example from the Commission's small retailer survey, that its discount and bonus structure affected retailers' decisions of what brands to stock. BEW noted that some 14 per cent of respondents stated that BEW's bonuses and discounts did affect their choice of products to stock, but most of those stocked more than one manufacturer; only 1 per cent of retailers were both exclusive to BEW and said that discounts and bonuses were a main factor in stocking BEW's products.

8.46. On Issue 4 (outlet exclusivity), we noted from BEW board papers that it had a strategy to target the leisure sector, motorway service stations and multiple CTN chains, due to their high visibility, and also to seek exclusive deals wherever possible at the retailers' request. We also saw case studies which indicated that BEW offered better terms in return for exclusive deals (see paragraph 4.79(b)). BEW submitted that bidding in response to customer requests for an exclusive deal was another instance of competition driven by retailers. It was simply a manifestation of vigorous competition and could not be described as a distortion of competition between manufacturers. As the supplier of the leading brand, BEW had a good record in winning those auctions but was pressed hard to do so, and it lost a fair number to its competitors. BEW's exclusive outlet agreements only accounted for less than 4 per cent of the estimated total impulse ice cream market (7 per cent of BEW's sales) and did not restrict competition in any material way. It was not BEW's policy to refuse to supply if an outlet wished to stock other manufacturers' products and BEW was unaware of any instance of any of its extended sales force having threatened to do so.

8.47. BEW submitted that the granting to mobiling franchisees of a territory (or certain events) in no way prevented non-liveried vans from operating in that territory (or at that event) and selling BEW's ice cream, and although franchisees agreed not to stock competing products or to actively seek customers outside its territory or to engage in a competing franchise operation in the territory, they were free to make passive sales. The obligations were intended to incentivize franchisees to concentrate their efforts on a particular territory and maximize availability and develop sales from liveried mobile vans within the territory. As recognized by the EC franchising block exemption, such agreements had a number of public interest benefits. Moreover, given the limited number of BEW's franchised mobile vans, these agreements did not have any appreciable effect on competition, particularly in a channel where the costs of entry were very low.

8.48. BEW submitted that the hypothetical remedy to prohibit outlet exclusivity would bring no improvement in the quantity or intensity of competition and it was doubtful if it would have much impact in practice.

8.49. On Issue 5 (advertising and promotional expenditure), BEW submitted that its media advertising expenditure on impulse ice cream, at around 7 per cent of revenues, was very close to the average in the impulse sector. It did not benefit from confectionery advertising in neighbouring markets as did Nestlé and Mars, nor did its level of advertising distort competition with the other major manufacturers of impulse ice cream.

8.50. On Issue 6 (retail prices), BEW submitted that retail price competition for impulse ice cream was muted but that that was true across most impulse categories and most convenience outlets. It was difficult to see how an alleged lack of retail price competition between retailers could be attributed to a lack of competition between manufacturers. BEW did not believe current retail price levels were attributable to RRPs; retailers did not uniformly adhere to them, but priced according to their perception of what the market would bear in the locality in which they operated. In the absence of RRPs, retailers would be likely to use traditional margins, or obtain guidance from suppliers or distributors. Premium pricing was almost uniformly prevalent in leisure and certain other categories of outlets for other impulse products.

8.51. No evidence had been produced to show that retail price competition increased in non-exclusive and industry freezers. The market for non-impulse ice cream undoubtedly had a different dynamic from the impulse market, but the same was true for many other products sold in both channels and related to competition between the multiple grocers, the presence of own-label products, and the different consumption and purchasing habits of consumers. BEW cited a study prepared for the inquiry

by Professor Patrick Barwise, which argued that it was not possible to draw lessons for the impulse ice cream sector from the non-impulse grocery sector. (See paragraph 4.107.)

8.52. There was no evidence that any action on BEW's part in relation to retail prices was having an adverse effect on the public interest. The hypothetical remedy to prohibit RRP's would not have any beneficial effect and might lead to retail prices rising to the detriment of consumers.

8.53. We noted that in BEW's board papers its prices in the UK were described as expensive compared with elsewhere in Europe. BEW subsequently submitted a NERA paper on European prices which demonstrated that UK prices were in line with those in the rest of the EU. We also noted in BEW's board papers that [*Details omitted. See note on page iv.*]. BEW stated that [*Details omitted. See note on page iv.*]. BEW added that subsequent instances of products not being available from distributors elsewhere in the EU reflected shortage of a particular product Europe-wide.

8.54. On Issue 7 (combination of practices), BEW argued that each practice was discrete and should be looked at on its merits. It had seen no evidence to support the Mars 'interlocking web' theory of practices, whereby the sum of two practices was alleged to be greater than the component parts, or that one practice reinforced the effects of another. The arguments about linkages between distribution and cabinets had been further weakened by the changes that had taken place since the 1998 report. The individual practices outlined separately in the issues letter had either not been engaged in, did not restrict competition or had public interest benefits. Any combination of practices engaged in did not restrict competition against the public interest.

8.55. We asked BEW to comment on the implications of recent EC decisions and the litigation before the ECJ and the Court of First Instance (CFI) in Luxembourg (see Appendix 2.3). BEW noted that the Irish High Court ruling that Unilever's freezer exclusivity arrangements in Ireland did not contravene EC competition law still stood; the ECJ's decision was still pending but the President of the CFI had suspended the European Commission's decision that there had been a breach, pending final judgment. BEW said that against that background there was no basis for saying that cabinet exclusivity (even in Ireland) was incompatible with EC law, as the Irish High Court's decision in favour of the Unilever subsidiary still stood and the European Commission's decision has been suspended by the CFI. BEW further argued that if the Irish cases were resolved in favour of HB Ice Cream Ltd (HB) (Unilever's Irish subsidiary), then *a fortiori* BEW's cabinet arrangements in the UK were compatible with EC law: in essentials the cabinet agreements in the UK were no different from those in Ireland, there were fewer industry cabinets in Ireland than in the UK, and there was a greater proportion of small outlets in Ireland with, arguably, no room for more than one freezer cabinet. BEW further argued that the implication of freezer exclusivity being compatible with EC law was that it would be compatible with the Competition Act 1998. BEW further argued that even if the Irish cases were resolved against HB it would not necessarily follow that cabinet exclusivity in the UK, in different market conditions, was incompatible with EC law.

8.56. BEW went on to submit that (a) the results in the EC Courts might very well be that, as a matter of EC law, cabinet arrangements in the UK did not infringe Articles 81 and 82 (as now renumbered) or thus the Chapters I and II prohibitions in the Competition Act; and (b) it would be unfortunate and inappropriate if findings in this inquiry were inconsistent with the new legislation. BEW said that this militated in favour of caution. If adverse findings were made in respect of cabinet exclusivity and remedies imposed, there would be a national decision conflicting with EC law and the Competition Act 1998.

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

8.57. BEW submitted a response to the remedies letter (see the statement of remedies, Appendix 2.4). At a hearing, BEW made the following general points. The results from the Commission's second wave 1999 consumer survey very much reinforced the results from the first wave survey, and nine out of ten consumers found the ice cream product that they wanted. Of the one out of ten who did not manage

to find the product that they wanted, the most frequent reason was that the product was out of stock at the particular outlet where they were looking. That showed that good distribution was absolutely crucial for consumer welfare in this area.

8.58. If consumer satisfaction was so high, BEW wondered why there was a need for any remedies, let alone some of the very far-reaching hypothetical remedies proposed. It did not believe that these hypothetical remedies promoted consumer welfare but they seemed to seek to protect competitors and a particular group of distributors.

8.59. BEW said that it was unable to understand the reasoning behind some of the provisional public interest findings and conclusions drawn by the Commission would be based on some very serious misunderstandings of fact.

8.60. BEW was concerned that the focus of attention had been almost exclusively on interpretation of BEW's intention, as deduced from a single presentation which it made to its business group, the ICFE group, and complaints that ex-dedicated distributors had made about the Wall's Direct system rather than the effects of the Wall's Direct system in the market place. Its intention had been, and was, to preserve some form of effective distribution system which was dedicated to BEW's own Wall's products, because it believed strongly that this had real consumer benefits in terms of availability and service.

8.61. Its intention was emphatically not to destroy independent wholesalers. It may have underestimated the effect on the ex-dedicated distributors of such a speedy transition from one system to another, but that was forced on it by the undertakings which it gave after the 1998 inquiry, and it had had very little time to implement these changes in the market place. The effect on the ex-dedicated distributors of the loss of some of the cash-flow advantages that they enjoyed as part of the Wall's dedicated distributor network may also have been something that it underestimated, but the impact on the ex-dedicated distributors was a side effect, not part of the rationale for the changes that it had made in setting up Wall's Direct.

8.62. The effects of the changes in the whole of the distribution system in 1999 (coming as they did as a result of the 1998 undertakings) were becoming ever clearer. Data from March 1999 to the end of August 1999 showed that 52 per cent of BEW's products were now going through independent wholesalers, all of whom could carry Wall's ice cream and any other ice cream that they cared to. That was two and a half times the level of BEW's sales which went through independent wholesalers in 1998. This had clearly created massive new distribution opportunities for other brands.

8.63. BEW was also concerned that very little consideration appeared to have been given to wholesalers who were not ex-dedicated distributors, and they were in the majority. Other wholesalers, not ex-dedicated distributors, appeared to be perfectly viable and happy with the situation in terms of trading with Wall's ice cream and other ice creams. That combined with the relative lack of retailer witness statements showed conclusively that Wall's Direct was not being operated in an aggressive or a predatory fashion. It was not BEW's intention to use Wall's Direct to drive other people out of business.

8.64. In that context there had been a lot of attention given to two recent failures of ex-dedicated distributors. BEW believed that much of this was due to the shock of moving from a relatively cushioned position as a dedicated distributor for Wall's ice cream to a competitive wholesaling environment where BEW's own 1998 undertakings prohibited it totally from favouring these ex-dedicated distributors. They must be dealt with on a completely even basis. Some of the ex-dedicated distributors had structural difficulties and inflexible cost bases. Others had cash-flow problems because they did not keep enough working capital in their businesses. They always believed that they could finance the business from a base of Wall's ice cream, and did not need to finance it themselves.

8.65. All of these effects had been greatly exacerbated by a very poor year in 1998, one of the poorest in the last ten years.

8.66. On the subject of the two individual companies which had gone into liquidation, BEW offered to discuss a structured repayment programme with Icetag, but this offer was not taken up by it. It offered a similar meeting to Midlands but it had no response at all from it. BEW was also, of course, a major creditor now to both of these failed businesses.

8.67. BEW believed that regulatory control of distributor terms would be an absolute nightmare. It would not be right to try to petrify and ossify the current structure of distribution and prevent it from changing ever again as a result of market forces. BEW believed that it would also be completely unnecessary. It was not appropriate to impose a British Telecom-type regime on distribution in a relatively small branded goods industry in which there was plainly ample room for competition to exist between alternative distribution systems. Even some of BEW's traditionally severest critics seemed to have realized that the excess of regulation which could be proposed as a result of this was vastly in excess of the needs of this type of industry.

8.68. BEW was appalled by Mars's declared wish to scrap Wall's Direct in its entirety. This was a system which the ex-dedicated distributors themselves admitted had been highly beneficial to retailers, and it was a crucial part of its Wall's ice cream brand and service proposition. It had already been forced to scrap one system, the dedicated distributor network, which was the result of 10 to 15 years' work with over 30 businesses. It had to scrap that at very short notice following the 1998 inquiry and the undertakings given by BEW in 1998. It said it found it almost inconceivable that the Commission could be contemplating scrapping another system only a year later.

8.69. On freezers, the Commission's provisional conclusions were totally inconsistent with the 1979 and 1994 reports. There appeared to be no evidence which justified reversing the conclusions of those two earlier reports, but much evidence to confirm these. Compared with the situation in 1994, Mars and Nestlé both had weighted distribution which had increased. There were now more retailer-owned freezers and there were more retailers stocking two or more brands. The weight of evidence from the Commission's own surveys was absolutely overwhelming, yet there was no explanation as to why the Commission was now proposing to reverse its previous position.

8.70. BEW also believed that some of the proposed remedies were inconsistent with existing EC law, and might prove also to be inconsistent with the judgment in the *Masterfoods v H B Ice Cream* case in Ireland. The Irish case revolved around an attempt by Mars to encourage retailers to break the terms of their agreements with HB and Unilever. The proposed hypothetical remedies on freezer exclusivity, if they went ahead, would permit just the sort of freeriding which the Irish High Court continued to prohibit by permanent injunction.

8.71. Finally on terms to retailers there was no quantitative analysis of, first, the effects of the year-end bonus or, secondly, the effects of other discounts and incentives which were offered. The Commission's retailer survey undertaken by Research International (see Appendix 4.2) dealt with year-end bonuses, but most retailers who were saying that it deterred them from stocking other brands did stock, in fact, several brands. This survey also showed that only 1 per cent of retailers who were surveyed who stocked only Wall's ice cream said that the discounts affected their choice of brands. There was no independent analysis of the effects of other retailer incentives.

8.72. The remedies being discussed were unprecedented, in particular published non-negotiable terms and also publishing of incentives and the inability to deal at all with retailers. BEW believed that such remedies would stifle competition and would also guarantee never-ending regulatory interference at the normal commercial interface between a supplier and a customer.

8.73. BEW believed that it should not be the subject of remedies which affected fundamental commercial freedoms. It did not believe that BEW should be singled out in such a way that it became a sitting duck target for its competitors. It did not believe either that the Commission should allow anything to happen which would alienate the nine out of ten consumers who were satisfied with the situation that they found today in the impulse ice cream market.

8.74. On the specific proposals, BEW submitted that the provisional public interest conclusions and hypothetical remedies infringed certain well-established principles of administrative law of legality, rationality and fairness. As regards the principle of legality, some remedies would be ultra vires the powers of the Secretary of State in Schedule 8 of the Fair Trading Act; others would infringe the principle of proportionality, which required that remedies be limited to the minimum indispensable to address the alleged mischief; other remedies appeared to disregard principles of EC law; and the Commission was not being consistent on freezer exclusivity (in the light of its 1979 and 1994 conclusions).

8.75. As regards the principle of rationality, BEW submitted that the provisional conclusions on the intention behind, and result of, the launch of Wall's Direct were perverse. As regards the principle of

fairness, BEW submitted that the conclusions had not been adequately explained. It had sought clarification of the facts and reasons on which the provisional public interest findings rested. This had been refused. BEW submitted that, in the light of that refusal, it could not meaningfully comment on the Commission's provisional public interest findings. It did, however, submit in August 1999 a paper by NERA entitled 'Foreclosure, opportunities and market outcomes in the impulse ice cream market'. This paper examined the empirical evidence available at that stage of the inquiry and concluded that it militated strongly against any of the four provisional adverse findings which the Commission had made. It argued that BEW's brand share was attributable to successful competition on its merits rather than to protection afforded by anti-competitive practices.

8.76. BEW stated that, generally, it did not believe that any remedies were necessary or appropriate. However, it had set that belief aside and focused on issues of vires; practicability; cost; effects on competition; appropriateness and proportionality; and timing.

8.77. On freezer exclusivity, BEW argued that its market share did not, of itself, give any indication of whether freezer exclusivity inhibited competitors' access to distribution. The achievement of Mars and Nestlé of weighted distribution in excess of 60 or 70 per cent in all areas of the trade except the CTN sector, coupled with gains in distribution achieved over the past 12 months, could not have occurred in a market where exclusive cabinets foreclosed access.

8.78. On the proposal that BEW be required to allow 40 per cent space in its freezers to be contestable by all manufacturers, BEW made the following points:

- (a) This remedy would put BEW at a competitive disadvantage.
- (b) If BEW provided cabinets as now, the 40 per cent contestable space would be likely to go to its competitors as retailers might form the impression that they were not allowed to stock BEW products in more than 60 per cent. This could not be justified without compensation, which BEW estimated at around £5 million.
- (c) Marginal retailers might not justify investment by manufacturers or distributors in cabinets, and would be likely to stop selling ice cream.
- (d) If retailers were charged some form of rental, this would be unpopular and inefficient and over time might lead to retailers not taking BEW freezers or selling ice cream.
- (e) If BEW were to offer its freezer cabinets for sale to retailers, this would be unpopular (as it was in Ireland) and BEW would suffer substantial loss on book value. Quality of freezers would fall and competition would be distorted in favour of other manufacturers.
- (f) This suggested remedy of requiring that 40 per cent of the space in freezers be contestable would adversely affect retailers, distort competition between manufacturers, raise costs and lower the quality and scope of retail distribution.
- (g) The remedy would be particularly disproportionate if applied in Northern Ireland where Dale Farm had a similar market share to Unilever and Mars's products were distributed by Dale Farm.
- (h) Monitoring such a regime would cause substantial problems for both BEW and the OFT.
- (i) The remedy would be disproportionate if applied to retailers who had their own cabinets or had two or more cabinets in the outlet.

8.79. On the proposal that freezer exclusivity by BEW be completely prohibited, BEW took the following view:

- (a) Complete prohibition would have all the damaging effects of partial prohibition, with aggravating effects. Competing manufacturers could take over the freezer cabinets.
- (b) Such a remedy would virtually write off the value of the cabinet fleet.

- (c) There would still be monitoring difficulties for the OFT, and probably complaints in situations where BEW products were given the most space in a freezer.
- (d) Such a remedy would be contrary to the *Oscar Bronner* judgment (see paragraph 8.40).

8.80. On the suggestion that complete or partial freezer exclusivity be implemented for all major manufacturers, BEW took the following view:

- (a) Retailers would be denied choice if no leading manufacturer could offer them a free-on-loan, maintained exclusive cabinet.
- (b) If retailers had to rent or purchase freezer cabinets, costs of freezers would rise and eventually this would result in higher prices to consumers.
- (c) The market was likely to contract appreciably.
- (d) The quality of freezers would deteriorate.
- (e) BEW would still subsidize its competitors because it had the largest freezer cabinet fleet.

8.81. In the remedies statement, we asked if there should be restrictions on the display area which should be permitted. BEW considered that, where the manufacturer owned the freezer, that manufacturer should be permitted 100 per cent display space, but added that any guest space was likely in time to result in a more or less open cabinet.

8.82. On the proposal to prohibit outlet exclusivity for BEW only, BEW's view was that:

- (a) Outlet exclusivity probably accounted for under 5 per cent of the total market.
- (b) A prohibition on BEW alone would be discriminatory.
- (c) Retailers would dislike a prohibition and prices to customers would rise.
- (d) There would be uncertainty with regard to existing agreements.

8.83. On the suggestion that an outlet exclusivity prohibition be applied to all manufacturers, BEW's view was that :

- (a) That would still be disproportionate.
- (b) Retail prices would rise.
- (c) Major regional suppliers should be included.

8.84. BEW stated that the suggestion in the remedies letter of partial exclusivity in outlets (up to 60 per cent of freezer capacity) would differ little from an outright ban on outlet exclusivity.

8.85. On discounts and other terms to retail outlet controllers, BEW submitted that this remedy, if applied to BEW alone, would result in a serious and unprecedented distortion of competition in the impulse ice cream market. Larger retailers would lose the freedom to negotiate discounts and bonuses. However, moving from a sliding scale to a stepped scale for the year-end bonus would probably be feasible.

8.86. BEW submitted that it ought to be able to charge different prices to customers in channels with markedly different cost structures, for example mobilers or seasonal outlets; otherwise there could be a reduction in the number of these outlets.

8.87. On the proposal that restrictions on terms should apply to all manufacturers, BEW submitted that this would eliminate price competition between manufacturers and that over time prices to retailers would become higher than they would have been with free bargaining.

8.88. As to restrictions on unpublished price-related or other incentives, BEW submitted that this remedy would make its sales activity virtually redundant and lead to a contraction in the market. If the remedy were imposed only on BEW, competing manufacturers would have a free rein. All promotional activity would be stifled and the remedy was extremely disproportionate.

8.89. BEW stated again that it did not have a scale monopoly in distribution (see paragraph 8.4). BEW acknowledged that the Commission might make findings about BEW's distribution arrangements in view of its scale monopoly position as a manufacturer, provided it could be shown that BEW's distribution arrangements were steps taken to exploit (or acts or omissions attributable to) a monopoly situation in manufacturing. BEW submitted that the lack of evidence that Wall's Direct had been set up with an anti-competitive intention made it hard to conclude that this was a step taken 'to exploit' a monopoly situation. BEW submitted that the Commission's highly interventionist hypothetical remedies were disproportionate because Wall's Direct delivered to retail outlets only 21 per cent of the reference products—unlike British Gas which had control over all routes of distribution.

8.90. On a proposed requirement that BEW supply independent wholesalers on economically viable terms, BEW made the following points:

- (a) The remedy was unnecessary and overly prescriptive. From March to August 1999, wholesalers accounted for around 52 per cent of the sales of BEW's reference products. Market forces would ensure that they were not under-remunerated.
- (b) Price control was an intrusive remedy normally used to limit excessive pricing. Dedicated distributors earned 18.2 per cent of GSV in 1997 and 16.4 per cent of GSV in 1998 (when there was poor weather). In 1998, up to 7 per cent of GSV of dedicated distributors' terms were for additional services which they were not now required to provide. In 1997, regional wholesalers' terms averaged 19 per cent of GSV of which, if they had paid the same percentage as BEW paid on average in bonus to indirect accounts in 1998, they would have had to share at least 7 per cent with retailers. Their net remuneration, therefore, would not have exceeded 12 per cent.
- (c) It was not right to take Wall's Direct as a benchmark. It operated to different contractual service levels from wholesalers. The sales force serviced all outlets. It had to provide an integrated service throughout almost the whole country.
- (d) Unit costs would vary according to volumes; drop sizes; region; product mix; weather. It was better to allow market forces to find the correct equilibrium.
- (e) The remedy would increase distribution costs. Eventually consumers would pay more.
- (f) If BEW's wholesale margins were increased, other manufacturers would probably have to increase theirs with adverse effects on their profitability.
- (g) Complex cost calculations would need to be repeatedly carried out; the OFT would be reluctant to undertake this.

8.91. On the proposal for separate accounting for a distribution subsidiary, BEW submitted that:

- (a) The 1998 report rejected this.
- (b) In practice, it was not possible to separate manufacturing and distribution.
- (c) A requirement not to discriminate would mean that probably service levels would decline to the lowest common denominator.
- (d) Computing the Wall's Direct costs would be an unnecessary burden.

8.92. On the proposal that other manufacturers be allowed access to Wall's Direct, BEW stated that that remedy was inappropriate except in the case of utilities or essential facilities, and that that view was supported by the *Oscar Bronner* judgment (see paragraph 8.8). Mars's attempt to distinguish the *Bronner* case, by arguing that it was not a facility at all, was acutely formalistic. There would be practical difficulties with this remedy (see paragraph 8.11); and real problems in setting a fair access charge.

8.93. As to whether there should be a limit on the percentage of BEW's products which could be sold through Wall's Direct, BEW submitted that this would be ultra vires. Irrespective of the power to impose such a remedy, BEW believed that an effective cap on Wall's Direct share of ice cream distribution would be fundamentally anti-competitive because it would suppress retailer choice as to how to have products delivered. BEW also had difficulty in seeing how it could be made to work in practice other than by imposing an absolute cap on sales (rather than a percentage), which would be wholly arbitrary. Once the cap for the season had been reached, BEW would effectively have to turn customers away and mothball the operation for the rest of the season.

8.94. On the proposals for controls on contracts between manufacturers and retail outlet controllers, BEW commented that:

- (a) This was a startling proposal unprecedented in the history of the Fair Trading Act.
- (b) A requirement to sell only through wholesalers and not to deal directly with retailers was wholly disproportionate.
- (c) Wholesaler service was patchy and BEW would have no means to ensure better service.
- (d) In any event, this would be ultra vires.
- (e) Mars had been disingenuous about the degree to which it offered lower terms on confectionery in order to obtain better representation for ice cream in retail outlets.
- (f) The suggestions on the conditions to be met concerning arrangements between the manufacturer and distributors seemed to be a variant of the proposal to allow other manufacturers access to Wall's Direct.

8.95. On the proposal that a restriction be placed on the use which the relevant manufacturer could make of information provided to it by distributors, BEW submitted that this would be ultra vires and unnecessary.

8.96. On the suggestion that BEW should be prevented from enforcing any existing agreement which did not comply with a prohibition, BEW submitted that this would lead to a chaotic situation because time was needed to put in place alternative arrangements.

8.97. We asked BEW to comment on the following definition of a 'national account' (in the context of a hypothetical remedy to exempt national accounts from the ban on direct contact between manufacturers and retailers):

National accounts are accounts owning at least 50 retail outlets and which collect the reference products directly from BEW or to whose warehouses BEW delivers direct, with delivery to individual retail outlets the responsibility of the national accounts, and subject to sales to national accounts not exceeding 5 per cent of BEW's total sales of the reference products.

BEW said that such an exception was of little relevance given the damage that such a ban would entail. Most customers, BEW said, saw the benefit of specialist distribution services. However, BEW added that if the Commission were to recommend a hypothetical remedy which permitted distribution only through wholesalers, it would wish, in framing any undertakings that might follow, to allow direct delivery to national accounts to continue.

8.98. Further to the remedies hearing, BEW put a submission to us on possible options for remedies, notwithstanding its opinion that the consumer, retailer and market evidence suggested that no remedies were necessary.

8.99. BEW made a proposal for one-off freezer cabinet transfer. It suggested a one-off transfer of ownership (free of charge) of 3,000 BEW display cabinets of 1 cubic metre or less to small independent retail outlets which currently held that cabinet as their only display cabinet. The outlets chosen should have turnover at GSV of less than £1,050, for 1999, in Wall's products on back-of-price-list terms, ie on standard rather than on seasonal or negotiated or other terms; cover a representative geographic spread; and have cabinets less than eight years old. The transfer would be accompanied by the provision of free

maintenance by BEW or its agents, for example Total Refrigeration, for two years. BEW would undertake not within two years of transfer to replace the cabinet transferred with a BEW exclusive freezer. Should the cabinet transferred break down beyond repair within the two-year period it would be replaced, at BEW's expense, with a similar cabinet for non-exclusive use.

8.100. BEW said it had determined that in the poor weather year of 1998 there were 6,377 outlets with a turnover of less than £1,050 at GSV which were on the back-of-price-list (ie standard) bonus scale and had one BEW display cabinet that was less than eight years old. In addition there might have been a few outlets that also fulfilled these criteria and had a second cabinet that was used solely for storage. Some of these outlets might have had a second cabinet that had been supplied by another manufacturer or distributor or was self-owned. However, on the assumption that there were relatively few such outlets, this proposal would result in a reduction of about 50 per cent in the number of low turnover outlets, on 1998 figures, which had only one cabinet exclusive to BEW's wrapped impulse ice cream products.

8.101. BEW noted, in putting forward the proposition for one-off cabinet transfer, that this covered some 50 per cent of those small outlets which currently had only one BEW exclusive cabinet and which, for space or economic reasons, were the only outlets where it might be arguable that there was any foreclosure.

8.102. BEW proposed a rebalancing of its terms to distributors. This proposal would have the following elements:

- (a) The unit payment for the distribution of wrapped impulse ice cream would be increased to incorporate a guaranteed element for selling activity and business development. Based on 1999 prices, BEW proposed adding a guaranteed element of £0.25 for selling and business development to the standard distribution deduction per unit of £1.10, giving a distribution and selling deduction per unit of £1.35.
- (b) A year-end target for sales growth from 0 to 4 per cent of net invoice value (GSV less the distribution and selling deduction) would be offered on all sales to both direct and indirect accounts based on the previous year's performance (rather than, as now, offered on sales to indirect accounts only).
- (c) As agreed with the OFT, the standard distribution deduction might be increased for remote areas of the country. The only current exception was northern Scotland where the OFT had recently agreed a standard distribution deduction of £1.48. The distribution and selling deduction in this region would therefore be £1.73 per unit.
- (d) The distribution and selling deduction would be increased in line with the RPI, as per the current undertakings.
- (e) BEW would offer a pre-season fill if, after analysis, it believed that this was logistically possible, ie that it could provide this to all wholesalers on an equitable basis.
- (f) The proposals above would not apply to distributors who purchased more than £7.5 million of BEW frozen food and ice cream products at GSV in the previous financial year.
- (g) BEW's terms to retailers would continue to be available regardless of the source of supply.

8.103. BEW stated that this proposal rebalanced and simplified its terms to distributors. The off-invoice element of the terms would in consequence be increased by over 20 per cent and the three year-end target scales would be replaced with one scale relating to all sales, not just to sales to indirect accounts. Distributors would benefit through more even cash flows through the year, simpler income management and the consequent reduction in risk. BEW pointed out that its Barking operation accounted for just under half (47.7 per cent) of its sales within the M25 in 1998. This suggested that the share of sales of Wall's Direct would probably settle at around its current level of 36 per cent (given that the dedicated distributors had never operated within the M25). Barking, which had been in operation for over 20 years, had never attracted criticism; so this ought to give the Commission some comfort in relation to

Wall's Direct. If necessary, Wall's Direct's share could be reviewed again by the OFT in two or three years' time.

8.104. BEW further submitted that if the abandonment of outlet exclusivity were to go ahead, this ought to apply to all manufacturers, and that all existing agreements, many of which had an element of unamortized investment, should be allowed to expire in their normal course.

8.105. During the course of the inquiry, BEW made a number of public statements which suggested that the level of employment in BEW or its contractors (2,000 in total) could be put significantly at risk by our proposals for hypothetical remedies. BEW indicated that this estimate had been made on the following assumptions: Wall's Gloucester factory had 1,150 employees; BEW employed sales personnel amounted to 100 employees; Wall's Gloucester factory had 400 seasonal employees; Wall's Direct contractors had some 500 employees.

8.106. BEW submitted to us market research carried out on its behalf by BMRB International Ltd. This research was conducted in the middle of August (12th to 18th) and showed that of those who had eaten wrapped impulse ice cream in the last month, 92 per cent were satisfied with the choice of ice cream available and 88 per cent could buy the ice cream they wanted. Analysis of the detailed results showed that provision of a good range was critical to satisfaction, that there was no dissatisfaction with price, and that Wall's products had the highest brand awareness. BEW told us that it was pleased that all the market research exercises continued to confirm the very positive consumer choice available in the current market situation and trusted that this would be taken into account in the Commission's final reflections.

8.107. At a late stage in the inquiry, we asked BEW if it wished to comment on an NOP survey carried out for Mars (see paragraph 4.19). BEW said that it did not wish to comment as it did not consider the two questions asked to have elicited any relevant information.

8.108. We also asked BEW to indicate the grounds on which it considered that Northern Ireland should be treated as a separate market in this reference. BEW said that the key features which it saw as setting the Northern Ireland market apart from the rest of the UK were:

- (a) The key point was the difference in market share. Unlike the rest of the UK where BEW enjoyed a market share considerably greater than any of its competitors, in Northern Ireland VdBF-I and Dale Farm had broadly similar market shares. Dale Farm's share was 39.8 per cent; VdBF-I had 40.9 per cent (1998 figures).
- (b) Northern Ireland as a region was physically separate from the rest of the UK and had a history of strong local business and businesses which were unique to Northern Ireland.
- (c) Distribution in Northern Ireland was organized differently from the rest of the UK, with more reliance on van selling and fewer wholesalers and distributors.
- (d) Further, in respect of distribution, Wall's Direct did not operate in Northern Ireland.
- (e) Outlet exclusivity did not exist to any great extent in Northern Ireland, if at all. Further, VdBF-I did not have any exclusive agreements.
- (f) There was not a significant franchised mobiler trade in Northern Ireland.
- (g) Outlets in Northern Ireland were, in general, smaller and more disparate and there were fewer multiple chains.

8.109. For all these reasons VdBF-I and BEW together considered that there were sufficient differences in the regionally separate Northern Ireland market from the rest of the UK to justify this region being treated as a separate market in this reference.

8.110. Lastly, BEW made a submission that there were a number of trade description and food safety issues that needed to be considered in the context of recommending any remedy in reaction to scooping cabinets. These issues were:

- (a) A retailer who filled (say) four out of ten chambers of a Carte d'Or branded scooping cabinet with Häagen-Dazs ice cream would be applying a false trade description to the Häagen-Dazs product.
- (b) To allow other manufacturers' products to be put in a scooping cabinet with BEW non-wrapped products could, if these other products were in any way contaminated, expose BEW to a criminal offence under the Food Safety Act.

8.111. As a result of the two points raised in paragraph 8.110, and since the number of scooping cabinets was *de minimis* in the context of the total number of all manufacturers' cabinets, BEW submitted that any remedy which the Commission might consider in relation to freezer exclusivity should not extend to scooping cabinets.

P G CORBETT (*Chairman*)

D HAMMOND

P MACKAY

D NEWBERY

J RICKFORD

P A BOYS (*Secretary*)

21 September 1999