

Part II

Background and evidence

3 Background to the reference

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Introduction

3.1. This chapter outlines previous Commission inquiries into ice cream and reports developments subsequent to the 1998 report on courses of conduct pursued by BEW in connection with the supply of wrapped ice cream.

Previous Commission inquiries into ice cream

3.2. The Commission carried out ice cream inquiries in 1979, 1994 and 1998.

The 1979 inquiry

3.3. The 1979 inquiry was a monopoly inquiry covering the entire ice cream market (ie both impulse and non-impulse). It found that the practice of outlet exclusivity, ie the supply of ice cream to retail outlets on condition that other suppliers' ice cream should not be stocked, was against the public interest. Outlet exclusivity was subsequently prevented by undertakings in 1982 given to the Secretary of State by the main suppliers of ice cream—Wall's and Lyons Maid—and other manufacturers.¹ The undertakings are set out at Appendix 3.1 and bound manufacturers not, except at the written request of the retailer, to supply ice cream and/or water ices to a retail outlet on terms which require, or would require, the retailer to take his supplies of those products for that outlet exclusively from them, whether such requirement was a condition of supply or of supply upon particular terms.

¹The following companies gave undertakings: Birds Eye Wall's Limited (Wall's) on behalf of itself and on behalf of Wall's Ice Cream Limited and Wall's Whippy Limited; J Lyons and Co Limited, Lyons Ice Cream Holdings Limited, Glacier Foods Limited, Lyons Maid Limited, Midland Counties Ice Cream Limited, Tonibell Manufacturing Co Limited, Bertorelli's Ice Cream Limited, Tastee-Freeze Limited, Mister Softee Limited, JFN (Mobile) Limited, Lyons Maid (Mobile) Limited, Cornish Cream Ice Company (1910) Limited, and BRUK Limited (referred to collectively as 'Lyons'); Ashford Creameries Limited; Calorval Limited; Camp Bros (Café) Limited; Creamery Fare Continental Ice Cream Limited; Criterion Ices Limited; Alex S Donald Limited; Ebor Ice Cream Company Limited; The Farmers Dairies (IOW) Limited; Fifti Ices; Franco Ices; Guilianotti Brothers (Holburn) Limited; Harvian Frozen Foods Limited; Hortons Ice Cream Company Limited; Martin's Dairies (Looe) Limited; Milk Marketing Board for Northern Ireland; Mor-Isis Products Limited; Northern Dairies (Ireland) Limited; Wm Pendletons and Sons Limited; Pollards Confections Limited; G Porrelli and Company Limited; Ross Foods Limited; B Sidoli and Sons Limited; J Thayer and Sons Limited; and Windsor Creameries.

3.4. The 1979 report also found various practices by Glacier (Lyons Maid) to be against the public interest, in particular the requirement that wholesalers of its products should not sell other suppliers' ice cream (exclusive distribution); that customers buying soft ice cream should also take a supply of hard ice cream (full-line forcing); and that mobile van franchisees should stock or sell only specified brands. (It should be added, however, that most of Glacier's distribution was carried out by its subsidiary, Alpine, which operated a dedicated service for Lyons Maid ice cream. This was not found to be contrary to the public interest.) As a result Glacier signed further undertakings concerning the terms of supply to certain wholesalers of soft ice cream mix, and franchise agreements with mobile van operators. Wall's and Glacier further gave undertakings concerning contracts and bonuses which bound them not, except at the written request of the retailer, to enter into an agreement for the supply of ice cream and/or water ices to a retail outlet unless it was capable of termination after the first 12 months by the retailer by one month's notice in writing; and not to operate any stepped or sliding scale bonus or discount scheme or arrangement which had or might have the effect of offering an incentive to a retailer not to exercise the rights of termination granted to him and not in addition to calculate such bonuses or discounts by reference to a period exceeding 12 months.

3.5. Finally, the 1979 inquiry considered freezer exclusivity, namely the supply to retailers of refrigerated cabinets on terms which prevent the retailer from using those cabinets to stock ice cream supplied by other suppliers. The Commission did not find freezer cabinet exclusivity in itself to be against the public interest, although it acknowledged that provision of exclusive freezer cabinets excluded other suppliers from a retail outlet which was too small for more than one freezer cabinet. The Commission believed that there were arguments in favour of allowing the practice of exclusive freezer cabinets to continue, in that suppliers might be unwilling to continue to provide at a nominal rent a cabinet that could be used for a competitor's products, and that if cabinets were no longer provided free the number of outlets selling ice cream might fall significantly. However, the Commission expressed the expectation that retailers who wished to buy their own cabinets might in the longer term find it easier and cheaper to do so than was then the case, and suggested that suppliers might offer cabinets for sale by hire purchase. The Commission also noted that on occasion suppliers were unable to meet their customers' requirements and therefore recommended that retailers should be permitted to stock and sell other suppliers' ice cream if the supplier which provided the freezer cabinet could not meet the retailer's requirements. This provision was subsequently incorporated in the contracts of the main companies for the supply of freezer cabinets.

The 1994 inquiry

3.6. The Commission's inquiry (the report being published in 1994) was a monopoly inquiry into the supply of ice cream intended for immediate consumption but limited to the issue of freezer exclusivity. On that occasion the Commission found that freezer cabinet exclusivity appeared to pose less of a restriction on supply than it had done in 1979. The Commission said that retailers had several options available. First, they could acquire their own freezers, in which case they could generally purchase ice cream at lower prices, reflecting extra bonus payments. Second, they could add second freezers where space permitted. On the basis of a survey of independent retailers, as many as 80 per cent of retail outlets had a non-exclusive freezer or scope for a second freezer. The Commission also felt that there were no restrictions on other suppliers making their ice cream widely available through provision of freezers and that investment in developing the market in such a way should not be deterred. There was no evidence of excessive profits being made, and recent trends in the market suggested that competition had been effective, irrespective of any effects of exclusivity. Although the need to offer freezers represented a cost of entry, similar to other costs such as advertising, the Commission did not think it constituted a barrier to entry in those specific circumstances (including the differential terms available to retailers not taking a manufacturer's exclusive freezer). Consumers were found to have a choice of more than one manufacturer's product in at least half of retail outlets, and were also able to choose between different retail outlets; consumer choice was not, therefore, thought to be adversely affected.

3.7. The 1994 inquiry did not extend to distribution arrangements. In the 1979 report, the then practice of Lyons Maid of requiring that certain wholesalers of its products should not sell the goods of other suppliers was found to be against the public interest (see paragraph 3.4). At that time Wall's used in-house distribution arrangements, but subsequently in the early 1980s BEW (having come into existence in 1981) franchised distribution to 38 exclusive concessionaires, later described as dedicated distributors. These concessionaires were independent companies, several of which had been established by former BEW employees, undertaking distribution activities outside the M25 area solely for BEW. In 1992

concessionaires distributed approximately 63 per cent (and in 1995 approximately 60 per cent) of BEW's wrapped impulse ice cream by volume. Within the M25, BEW continued to distribute its products direct; BEW's remaining sales were distributed through Wall's liveried mobilers and independent mobile retailers, through wholesalers and direct delivery to a few national accounts. However, despite the limitation in the terms of reference for the 1994 inquiry, the Commission received a substantial amount of evidence on distribution arrangements. The Commission commented in its 1994 report that BEW's arrangements appeared to have some similarities to those of Lyons Maid on which the 1979 report had commented, but it was open to the Commission to consider those arrangements only in so far as they related to the issue of freezer exclusivity.

The 1998 inquiry

3.8. In May 1995, Mars complained to the OFT that BEW's exclusive distribution system was an anti-competitive practice. In January 1997, the OFT reached the preliminary view that BEW's distribution system was anti-competitive. In June 1997, BEW agreed in principle to give undertakings that met most of the OFT's concerns but did not offer to withdraw its practice of offering favourable discounts to dedicated distributors, who distributed only BEW's ice cream and under their contracts could not sell other manufacturers' products without BEW's consent. The OFT concluded that BEW had foreclosed the market to other wholesalers, and therefore to other manufacturers, because it had discriminated in the dedicated distributors' favour by (a) refusing to supply independent wholesalers; (b) supplying dedicated distributors on more favourable terms; and (c) paying bonuses to retailers which were conditional on them purchasing from dedicated distributors only. On 22 December 1997 the DGFT referred the matter to the Commission under the Competition Act 1980.

3.9. The Competition Act inquiry was limited by the terms of reference to four practices allegedly pursued by BEW in relation to the supply of wrapped ice cream intended for immediate consumption during the period of 12 months to the date of the reference. The four practices were:

- (a) the refusal to supply wrapped ice cream to wholesalers who were not dedicated distributors;
- (b) the refusal to supply wrapped ice cream to wholesalers who were not dedicated distributors except:
 - (i) on contractual terms less favourable than those on which BEW supplied wrapped ice cream to dedicated distributors; or
 - (ii) with other benefits less favourable than those which BEW conferred upon dedicated distributors, but excluding the refusal to supply wrapped ice cream for resale to retailers who supplied wrapped ice cream from mobile vans; and
- (c) the granting of discounts to retailers who purchased BEW wrapped ice cream from dedicated distributors but not to retailers who purchased BEW wrapped ice cream from other suppliers.

3.10. The conclusions of the Commission were that there was no evidence that practice (a) had been pursued in the relevant period, but each of the other three practices, ie (b)(i), (b)(ii) and (c), had been pursued and restricted and distorted competition between wholesalers, by reducing the ability of wholesalers who were not dedicated distributors to compete to supply BEW's wrapped ice cream; each practice also restricted and distorted competition between manufacturers; and each operated, and might be expected to operate, against the public interest. The Commission noted (see paragraph 2.83 of the 1998 report) that BEW, by reducing the ability of wholesalers who were not dedicated distributors to compete to supply BEW's ice cream, in turn adversely affected the ability of those wholesalers to compete to supply non-BEW products, in so far as their inability to supply BEW's product (the leading brand) meant that their overall drop sizes would be smaller and their unit costs higher. The Commission concluded that by distorting competition between distributors, the effect of the practices was also to distort competition between manufacturers who depended upon the availability of efficient distribution of a product with the particular characteristics of wrapped ice cream.

3.11. In the 1998 report the Commission recommended that BEW be required to supply wholesalers on the same terms as dedicated distributors from 1 March 1999, and that those terms should be fully transparent; that BEW should not offer any discounts to retailers available only on purchases from

dedicated distributors; and that BEW should not increase the remuneration of those dedicated distributors who delivered ice cream to customers invoiced directly by BEW. The Commission commented that it realized these remedies might mean that BEW could continue with certain aspects of the courses of conduct, but did not believe it desirable or practicable within the scope of the reference to deal with other types of benefit to dedicated distributors that had been identified. The Commission also concluded that, given the interlocking effects of other aspects of the market that fell outside the terms of reference, the measures proposed could not comprehensively remedy the adverse effects of the practices considered.

3.12. In February 1998 BEW announced revised financial terms to its dedicated distributors, in response to which two of the 31 dedicated distributors, Coldstream (Ice Cream & Frozen Foods) Ltd and King Bros (Lady Lodge) Limited, elected to act as independent non-exclusive wholesalers. The terms offered by BEW to its dedicated distributors were still, however, higher than those offered to many other wholesalers.

Developments since the 1998 report

The 1998 undertakings

3.13. Following the 1998 report, the OFT negotiated undertakings with BEW which were signed on 26 November 1998. The full text of the undertakings is at Appendix 3.2. The undertakings required BEW to supply all wholesalers and dedicated distributors on standard terms and to publish its standard terms of supply. BEW was prevented from offering discounts to retailers on condition that they purchase ice cream only from dedicated distributors, or from imposing any requirements on other wholesalers or retailers which would have the same effect. The undertakings also prevented BEW from offering discounts to wholesalers depending on the volume of wrapped ice cream purchased, and implemented the Commission's recommendation that BEW should not increase the level of remuneration for delivery to its direct¹ accounts above 15 per cent of the GSV. An exception to these terms was made for wholesalers whose purchases of BEW products during the previous financial year exceeded £7.5 million. BEW indicated to the OFT which wholesalers were likely to fall into this category based on year to date 1998 sales figures at the time of the discussions. The OFT told us that its concern was primarily to avoid better terms being made available to distributors who remained in effect dedicated to BEW. The undertakings took effect on 1 March 1999.

BEW action

3.14. On 25 November 1999 BEW terminated its agreements with the dedicated distributors, the termination taking effect on 28 February 1999. On 1 March 1999 BEW launched its own distribution system called Wall's Direct, which is described in Appendix 3.3. BEW published in *The Grocer* on 6 February and in *CTN* on 4 February 1999 its terms for wholesalers, increasing the standard distribution deduction from £1.06 to £1.10 per unit. The undertakings required BEW to offer to retailers the same discounts whether they were supplied by dedicated distributors or by wholesalers. BEW told us that it was complying with that undertaking by ensuring that all retailers would be able to receive the same discounts and bonuses from BEW regardless of their distribution source. Subsequently BEW sought permission from the OFT to vary the standard distribution deduction for wholesalers delivering to retailers in the north of Scotland. The OFT agreed a variation to £1.48 per unit, backdated to 1 March 1999.

OFT investigations leading to the present reference

3.15. During the 1998 inquiry, concerns about the industry which were beyond the scope of the reference were expressed. These included the exclusivity of the dedicated distributors, freezer exclusivity, the perceived threat that BEW might take its distribution in-house, and the recent change in contract terms introduced by BEW for dedicated distributors and wholesalers. The Commission suggested in the report that if the DGFT believed the matters giving rise to these concerns were or might be distorting competition and were not being resolved, then he should give immediate and serious

¹On the definition of 'direct' and 'indirect' accounts, see glossary.

consideration to whether a wider review was necessary, using the monopoly provisions of the Fair Trading Act.

3.16. In response to the wider concerns noted in the 1998 report, the DGFT sought additional undertakings to lift the restriction on dedicated distributors and mobiling wholesalers from carrying the products of other manufacturers; to allow some space for other products in exclusive freezers installed in retail outlets with no other freezer capacity; not to engage in differential pricing for supplies direct to retailers except for externally determined factors such as volume; and to undertake not to bring more of its existing distribution in-house. BEW declined to give such undertakings on the grounds that:

- (a) no further investigation had been undertaken as to whether any of these practices were anti-competitive; and
- (b) the timing of the DGFT's request was particularly inopportune given that freezer exclusivity was now under consideration by the CFI and ECJ.

3.17. The DGFT made a monopoly reference to the Commission under the Fair Trading Act on 22 December 1998. The DGFT said in a press release that the undertakings given by BEW following the 1998 inquiry would improve competition, but obstacles still seemed to remain to a fully competitive market for impulse ice cream. Overall, this was a problematic sector which required a thorough and wide-ranging review.