

2 Conclusions

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The reference

2.1. On 3 February 2000 the DGFT referred to the Commission for investigation and report (under the monopoly provisions of the Act) the supply of fresh processed milk to middle-ground retailers in Scotland. We were asked to report by 2 November. Our terms of reference are at Appendix 1.1.

Fresh processed milk in Scotland

2.2. Fresh processed milk is one of a number of products made from the raw milk collected from farms. About half the raw milk produced in Scotland is processed and packaged for consumption as liquid milk and cream. The great bulk of this milk is sold fresh, although a small proportion is sold as sterilized or long life (UHT). The raw milk not used for these purposes is turned into other dairy products, mainly butter, cheese and milk powder, or used in the manufacture of foods, such as chocolate, biscuits and ice cream.

2.3. Scotland—and the UK as a whole—is substantially self-sufficient in fresh processed milk. Although the UK's quota for raw milk production under the Common Agricultural Policy does not match the country's requirements for dairy products, the shortfall is met by importing more easily storable items such as butter, cheese and UHT milk. The demand for fresh processed milk is satisfied almost entirely from UK farms.

2.4. Over the past few years, producers in Scotland have been providing around 1.2 billion litres of raw milk annually (about 8.3 per cent of the UK total). We have been told that, in 1999/2000, just over 54 per cent was bought for processing as liquid milk. Some milk produced in Scotland is sold south of the border and, in turn, Scottish plants process a small amount of milk produced in England.

2.5. For many years, the collection and sale of raw milk throughout the UK was a statutory monopoly. In Scotland, this was conferred on three milk marketing boards (MMBs): the Scottish MMB (SMMB) for the central and southern regions, the North of Scotland MMB (NSMMB), and the Aberdeen and District MMB. In each area a committee, on which the MMB and the processors had an equal say, set prices which varied according to the raw milk's end-use. By the early 1990s it was becoming clear—not least because of the UK's membership of the EC—that these arrangements were no longer sustainable, and the Government announced that it intended to change them. After a period of consultation and negotiation a new regime came into force. In November 1994 the three Scottish MMBs were succeeded by voluntary farmers' co-operatives: Scottish Milk Limited (Scottish Milk) (in the former SMMB area), the North of Scotland Milk Co-operative Society Limited (NSMCSL) and the Aberdeen Milk Company Limited (AMCo). NSMCSL retained its processing capacity (Claymore Dairies (Claymore) in Nairn), as did AMCo (the Twin Spires creamery, in Aberdeen). However, the milk processing operations of the SMMB were hived off into a separate company, Scottish Pride Holdings plc (Scottish Pride).

2.6. Most of the milk supplied to processors now is sold on the basis of individually negotiated contracts that typically run for six or twelve months. Prices for raw milk in Scotland, and in the rest of the UK, have been falling in recent years and are now considerably lower, in real terms, than they were in the era of the MMBs. The price differential between milk bought for processing for the liquid market and that used for other purposes has also fallen—although there is still a premium for the higher standards of service and freshness that the liquid market requires.

2.7. Not all the farmers who had supplied the three Scottish MMBs chose to join their successor bodies in 1994, and there have been further changes in membership since. Some farmers have grouped together in new independent co-operatives, and others have entered into direct supply relationships of various kinds with processors. That said, Scottish Milk is still the largest supplier of the raw milk produced on Scottish farms. In northern Scotland, the NSMCSL became the North Milk Co-operative Ltd (NMC) in November 1998. It subsequently split in two. The former member farms on Orkney now send their milk to the Kirkwall creamery, where it is turned into cheese, while most of the former members on the mainland sell milk to Claymore in Nairn, where Express acquired a 51 per cent controlling interest in December 1998. In the Aberdeen area, AMCo has been bought by Wiseman which now takes

milk direct from the farms that used to make up the co-operative. Its Twin Spires processing plant, which was used mainly for making butter and milk powder, has been closed.

Retailing milk in Scotland

2.8. In Scotland, as in the rest of the country, fresh milk processors sell to two broad categories of customers: to non-retailers, such as the NHS, local authorities, the Ministry of Defence, schools, caterers etc, and to retailers. Our inquiry is concerned only with supply to the latter. Detailed descriptions of the various types of retailer are set out in the glossary, but they can be divided into three main categories.

2.9. The first and most important is the major supermarkets—supply to the largest of which, ASDA Group Ltd (Asda), Marks and Spencer plc (M&S), Safeway plc (Safeway), Sainsbury's Supermarkets Ltd (Sainsbury), Somerfield plc (Somerfield), Tesco plc (Tesco) and their subsidiaries, is excluded from our terms of reference. It is the biggest single category and accounted for 48 per cent of household sales of fresh milk in Scotland in 1999/2000. This category is continuing to grow, at the expense of the others.

2.10. Supply to the second category, doorstep deliverers, is also excluded from our terms of reference. It accounted for around 10 per cent of household sales in Scotland in 1999/2000. This form of milk retailing is in long-term decline. The drift away from milk rounds began earlier in Scotland than in England, and has gone much further.

2.11. The third category—supply to which is the subject of our inquiry—is the middle-ground retailers (described in greater detail in Chapter 4). They accounted for the remaining 42 per cent of Scottish household sales in 1999/2000. The character of this category is changing, as more stores become part of wider groups or buying organizations. Examples are: Spar, which is growing at the rate of around 30 stores a year—it has 386 Scottish shops now, and hopes to reach 500 by 2005—Alldays plc, which had 70 Scottish stores five years ago—trading under its Alldays Stores Limited subsidiary (Alldays)—and now has 150; Morning Noon & Night Ltd (Morning Moon & Night), which opened its first store in 1991 and now has over 40; Londis Holdings Ltd (Londis), which has only recently extended its operations to Scotland, but has already announced that it has signed up 70 stores; and the Central Retail Trade Group (CRTG), the procurement agent for the Co-operative Wholesale Society Limited (CWS) and other Co-op stores, which now buys on behalf of 278 retail outlets in Scotland. Wiseman estimated that over half of all the fresh processed milk supplied to middle-ground retailers in Scotland went to these larger players (those described in (a), (b) and (c) of the next paragraph). All these groups and organizations are seeking to negotiate deals with processors so as to reduce the price differential between the middle ground and the supermarkets. The number of suppliers providing fresh processed milk to this category is greater than for either of the other two, with middle-ground retailers buying fresh processed milk from small and large dairies as well as direct from farmer/processors.

2.12. Middle-ground retailers fall into a number of sub-categories:

- (a) the smaller supermarket chains, such as Iceland Frozen Foods plc (Iceland), Lidl UK GmbH (Lidl), and the larger Co-op stores;
- (b) the convenience store chains, such as Alldays, Morning Noon & Night, the smaller Co-ops and some garage forecourts;
- (c) the symbol groups, such as Mace Stores Ltd (Mace) and Spar, which are substantially made up of separately owned stores that come together for the purposes of central buying and marketing; and

(d) individually owned stores and corner shops.

The Scottish processors

2.13. Around 565 million litres of fresh processed milk was supplied in Scotland in 1999/2000. Detailed descriptions of the major Scottish processors can be found in Chapter 3.

2.14. By far the largest supplier of fresh processed milk to all types of outlets in Scotland is Wiseman. It supplies 74 per cent of the milk taken by all categories of customers in Scotland and around 66 per cent of that taken by middle-ground retailers—the subject of this inquiry. Most of its output takes the form of own-brand milk for the major retail chains (including those in the middle ground) but it also produces a range of milks under its own name, a semi-skimmed milk, sold as Fresh’N’Lo, and a range of Ayrshires milks processed under licence for Ayrshires Milk Marketing Limited (a division of Cattle Services (Ayr) Ltd) (see paragraph 3.17).

2.15. Wiseman was founded in the late 1940s when Robert Wiseman senior began retailing milk from his farm in East Kilbride. The company is now run by two of his sons, Alan, the current Chairman, and Robert, the Managing Director. By the mid-1990s, Wiseman had increased in size, by acquisitions and organic growth, to supply about half the Scottish requirement for fresh processed milk. Since then it has achieved further substantial growth by three more acquisitions. The largest was the purchase of the fresh milk business of Scottish Pride from the receiver in 1997. This increased its share of the supply of fresh processed milk in Scotland to over 70 per cent. One of the undertakings that Wiseman gave to the Secretary of State in connection with this acquisition was to seek the prior written consent of the DGFT before purchasing any operators in Scotland processing more than 1 million litres a year. This was granted when it acquired an 80 per cent shareholding in Gilmour’s Dairy Limited (Gilmours) in April 1999. It subsequently bought the remainder of the issued shares in the company—one of the few independent Scottish processors of any size, which, Wiseman said, supplied about 3 per cent of the fresh milk sold in Scotland at that time. Consent was also granted when Wiseman bought AMCo in May 1999. At that time, Wiseman said that the Aberdeen-based dairy farmers’ co-operative supplied about 8 per cent of the raw milk processed in Scotland. It also had some processing capacity—although not for liquid milk. (See paragraphs 3.10, 3.11, 4.28, 5.2 and 5.3.)

2.16. At the same time as it has been increasing its sales in Scotland, Wiseman has been establishing itself in England and Wales with an expanding network of dairies and depots. It now supplies almost as much milk south of the border as it does in Scotland. In 1999/2000, the split was 334 against 418 million litres. In the late 1980s/early 1990s, it began supplying milk to retailers in northern England, and since then has been gradually extending its activities southward. Wiseman’s operations have benefited from the fact that packaged milk now stays fresh for longer, and can be transported profitably over greater distances, than in the past. This allowed it initially to service its northern England customers from its processing plants in Scotland and then, once established there—with a very large new dairy in Manchester—to begin supplying customers further south. Earlier this year, Wiseman began the next stage of this process by starting to construct another large new dairy, outside Droitwich, and to identify sites for a new range of depots to serve its existing customers in the Midlands, and to open new markets, north of the M4 (see paragraphs 3.18 to 3.21). During the course of this inquiry Wiseman also made a conditional cash offer for the milk and cheese business of Unigate PLC (Unigate) which had a substantial presence in the South of England and in Wales. It was eventually outbid by Dairy Crest Group plc (Dairy Crest) (see paragraph 3.20).

2.17. The next largest supplier of fresh processed milk in Scotland is Express/Claymore—the former NSMCSL operation based in Nairn where Express has a controlling stake. It meets 6 per cent of demand in Scotland (around 7 per cent among middle-ground retailers). Express is

the leading fresh milk processor in Great Britain with around 27 per cent market share (compared with Wiseman's 14 per cent). Express was established in its current form in March 1998, following its demerger from Northern Foods plc (see paragraph 3.47).

2.18. At that time, the only Express operation in Scotland was a UHT plant in Kirkcudbright that had been bought from Scottish Pride's receivers in May 1997. In December 1998, when Express acquired its controlling interest, Claymore had a modern plant in Nairn, which supplied the great bulk of customers in the Highlands and Islands, with an output, according to Express, equating to about 5 per cent of Scottish demand. Express told us that it regarded the purchase of its interest in Claymore as the first leg of a strategic entry into Scotland. Its thinking was that the acquisition of Scottish Pride's fresh processed milk business by Wiseman, had made room for a major new competitor north of the border (see paragraph 3.52). Express told us that it had looked at the possibility of supplying Scottish customers from its dairies in northern England, but had discarded the idea, in part because it believed that there was a very strong preference among Scottish consumers for milk produced in Scotland. Express said that it had been reluctant to invest in a new plant in Scotland before it had established itself north of the border. So it had decided to proceed by taking an interest in two existing Scottish dairies—one in the North, and one in the Central Belt—from which it could mount a Scotland-wide operation. The main attractions had seen were the chance to supply the Scottish outlets of the supermarket chains with which it already had contracts in England, and the possibility of establishing itself with middle-ground retailers which, it believed, were paying more for their milk than their counterparts further south (see Figure 4.4). Express's rivalry with Wiseman might have been another factor in its decision to come north of the border. Wiseman told us that the two companies had been major competitors for a number of years, supplying fresh processed milk to (mainly supermarket) customers in northern England and the Midlands. This competition was due to become even more extensive in 2001 with the opening of Wiseman's large new dairy in Droitwich. [

Details omitted. See note on page iv.

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2.19. The other leg of Express's strategy was to acquire Gilmours, located near Kilmarnock, which had a capacity of 18 to 20 million litres a year. James Gilmour, the Managing Director, told us that Express first approached him in August 1997, but its terms proved unattractive to Gilmours' owners (more detail is provided in paragraphs 2.93 to 2.95). They subsequently sold to Wiseman, which acquired an 80 per cent stake in April 1999, purchasing the remainder later in the year. This left Express without a processing facility in the most densely populated area of Scotland. Having already dismissed the option of supplying Scottish customers from its dairies in northern England, Express was now faced with three choices: (a) to pull out and dispose of its interest in Express/Claymore; (b) to confine itself to the traditional Claymore business in the Highlands and Islands—now about to be reduced by Wiseman having won a number of all-Scotland contracts from the larger middle-ground retailers; or (c) to continue with its plan of becoming a major supplier of fresh processed milk to customers in all parts of Scotland. It chose (c). That decision seemed to us to present Express with four further choices: (d) to take a share in another processor with a business in the Central Belt; (e) to convert part, or all, of its plant at Kirkcudbright to fresh milk processing; (f) to enter into a contractual relationship with a dairy in the Central Belt to process and package milk on its behalf; or (g) to transport processed milk from Nairn down to the Central Belt. Express initially opted for (g). Having already leased a large factory in Coatbridge, it fitted it out with refrigeration equipment and brought it on-stream as a milk depot (primarily supplied from Nairn) in April 1999. It subsequently supplemented this with (c), the most notable example being its agreement with Scottish Milk Dairies Limited (SMD) in April 2000.

2.20. Express/Claymore told us that, despite losing a sizeable volume of business in the Highlands and Islands in the first half of 1999, by March 2000, it had increased its share of

supply in Scotland from the 5 per cent held by Claymore at the end of 1998 to 8 per cent. It raised the output of the dairy at Nairn from the equivalent of [§] million litres a year to [§] million litres, over the same period. A large part of the increase in sales came from a new contract with Sainsbury in November 1999, when Arla Foods Plc (Arla), then known as MD Foods, withdrew from supplying Scotland, but there was growth in sales to middle-ground retailers too, largely in Scotland's Central Belt. In a survey of mainly independent middle-ground retailers carried out for the Commission (see paragraphs 4.270 and 4.272 for more details), 8 per cent of the sample said that they had switched away from Wiseman as their fresh milk supplier in the last year. Of these, 80 per cent had switched to Express/Claymore.

2.21. In addition to the own-brand milks which it supplies to supermarkets, Express/Claymore sells milk in northern Scotland under Claymore's Highland Fresh brand, and in the Central Belt under the Scottish Pride name, the rights to which Express had previously bought from the receiver. It uses the Express name in Scotland only for the milk which it supplies to [§] under a nationwide contract. (See paragraphs 3.37 and 4.135.)

2.22. Express told us that, since this inquiry began, it has rationalized its operations in the Central Belt. The depot at Coatbridge has been closed, because Express's logistic arm has recently acquired Blakes Chilled Distribution Limited, with a refrigerated storage facility in Airdrie that can be used to supply customers in the region. Express also entered into agency agreements with three dairies to process milk on its behalf. [

Details omitted. See note on page iv.

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2.23. Apart from Wiseman and Express/Claymore, SMD, which is based in Hamilton, and Graham's located at Bridge of Allan, near Stirling, are the only fresh liquid milk processors of any size operating in Scotland. In 1999/2000 SMD processed 11 million litres of fresh milk under its own name and under the Low & Lite brand, a low-fat blend of skimmed milk and buttermilk. Some 90 per cent of this output was sold to middle-ground retailers in the Glasgow area. SMD also supplies customers as far north as Stirling and as far south as Ayr. In total, SMD accounted for 2 per cent of all sales of fresh processed milk in Scotland in that year (around 4 per cent of sales to the middle-ground retailers). Express/Claymore told us in June that under its arrangement with SMD—which came into effect in April 2000—it was taking over [§] litres of fresh processed milk a week, equivalent to over [§] million litres a year. SMD also produces UHT milk and butter. Scottish Milk acquired a 36 per cent stake in the dairy (previously known as Drakemire Dairy Foods Limited (Drakemire)) in 1998 and increased its holding to 80 per cent in December 1999. It is due to buy the remaining 20 per cent later this year.

2.24. In 1999/2000 Graham's produced [§] million litres of fresh processed milk. Around 22 million litres were sold for consumption in Scotland, accounting for 4 per cent of total supply and for 7 per cent of that taken by middle-ground retailers. Most of its output is sold in shops or delivered to doorsteps in Dundee, Perth, Stirling, Fife and most parts of the Central Belt. Its largest contract is for the supply of [*Details omitted. See note on page iv.*

]—which is reported to require an increase in its total output this year to over [§] million litres. Graham's also produces cream, cheese, yoghurt and butter. It has grown more than tenfold in the last decade—through acquiring smaller dairies and by picking up business from those that have ceased trading—and it is continuing to expand. Within Scotland, it regularly delivers at distances up to 70 miles.

The market

2.25. The market for the supply of fresh processed milk in Scotland is discussed at length in Chapter 4, and the methodology we have used to define it is explained in paragraphs 4.43 to 4.46. The rest of this section sets out the various conclusions that the members of the Group have drawn.

The product market

2.26. All the members of the Group consider that the market for the supply of fresh processed milk is distinct from that for other dairy products. The obvious taste difference between fresh milk and other liquid milk products—sterilized and UHT—is reflected in consumer preferences: fresh milk accounts for around 90 per cent of household sales of liquid milk in the UK. On the supply side, producing UHT and sterilized milk requires different techniques and plant from those needed for processing as fresh. And, once produced, UHT milk has a long shelf life, does not need to be chilled and is traded internationally. By contrast, the fresh processed milk sold in the UK is almost entirely domestically produced. As a result, we would not expect either consumers or producers to switch between fresh milk and UHT or sterilized in response to a small, but significant, price change.

The geographic market

2.27. The last time that the Commission considered whether there was a separate geographic market for the supply of fresh processed milk in Scotland was in December 1996—in its report on the proposed merger between Wiseman and Scottish Pride.¹ It said then that ‘there is clear evidence that the market in Scotland for fresh processed milk has become less distinct from that in England and Wales since our 1992 report’.² Nonetheless, it found that there was ‘still relatively little trade between Scotland and the rest of Great Britain’ and that there was ‘some evidence indicating that there is scope for [non-supermarket] retailers to be able to charge somewhat higher prices than their counterparts in England and Wales’. This gave ‘scope for [Scottish] processors to charge somewhat higher wholesale prices in the knowledge that transport costs restrict their customers’ ability to obtain supplies from English-based dairies. In short, the market still has some regional characteristics’.

2.28. In addressing the question of the geographical market on this occasion we have, once again considered evidence on:

- (a) the extent to which there have been price differences;
- (b) the additional transport costs required to supply Scotland from England; and
- (c) the market shares of the major processors in England and Scotland, and the extent of trade between the two locations.

In addition, we have also looked at:

- (d) the means of local distribution to supply middle-ground customers in Scotland;
- (e) consumer preferences; and

¹*Robert Wiseman Dairies plc and Scottish Pride Holdings plc: a report on the proposed merger*, HMSO, Cm 3504, December 1996.

²*Scottish Milk Marketing Board and Co-operative Wholesale Society Limited: a report on the proposed acquisition by the Scottish Milk Marketing Board of the Scottish milk business of Co-operative Wholesale Society Limited*, HMSO, Cm 2120, December 1992.

(f) the implications of corporate strategies.

2.29. The ‘hypothetical monopolist’ test, which is conventionally used in defining markets, asks whether a supplier in a narrowly defined location could charge higher prices, say, an extra 5 to 10 per cent above the competitive level, for a non-transitory period, usually taken to be a year or more, if there were no competitors in that locality; or whether products from other suppliers could come in to prevent it from doing so. So, we have begun this analysis, by looking at whether such a price differential could be sustainable between Scotland and England (a). It is often argued in relation to retail or distribution markets that there is a ‘chain of substitution’ which links local areas together into a single geographic market. Thus, while a commodity such as milk might not be supplied directly from Penzance to Perth or from Dundee to Dover, the fact that all the local areas overlap with one another, so that price pressures are transmitted from one locality to the next, creates a single geographic market. Stated in those terms, the question is whether there is a break in this chain between northern England and Scotland.

2.30. In its 1996 report, the Commission concluded that the differential between prices charged to (and by) supermarkets north and south of the border had largely disappeared. Price data relating specifically to middle-ground retailers are more difficult to come by. The source to which we have had access is a survey by Taylor Nelson Sofres plc (TNS) (see paragraphs 4.140 and 4.142 for details). This collects information about the prices charged by all retailers for all types of milk. It covers the three types of fresh processed milk—whole, semi-skimmed and skimmed—and a wide range of container sizes. It is not ideal for the purposes of this inquiry as it records retail prices charged to consumers, rather than wholesale prices charged to stores, and some of the information is too fragmentary to rely on—for example, very few corner stores stock 4-pint containers of skimmed milk. But it does provide a useful general comparison of the relative movement in prices between Scotland and the regions of England and Wales over the period that it covers: May 1996 to May 2000. For the larger supermarkets, the figures show a close similarity between the prices in Scotland and in the regions of England and Wales throughout the period—showing a continuation of the trend that the Commission discerned in its last report.

2.31. For middle-ground retailers, the figures show a somewhat different picture. For the period up to the end of 1997 (during much of which milk supply had been adjusting to the collapse of Scottish Pride, a company which, until shortly before its demise, had been the principal Scottish processor), prices in Scotland were distinctly higher than those in England and Wales, widening from a differential of 6 per cent to a peak of 10 per cent. This differential then began falling from the beginning of 1998, and by mid-1999 had all but disappeared. Retail prices on both sides of the border have been moving closely in line with each other ever since. As for the differential between Scotland and just northern England, this increased from around 8 per cent in mid-1996 to a peak of 12 per cent at the beginning of 1998. It then fell to a range between 5 and 8 per cent towards the end of 1998 and the beginning of 1999, and to less than 2 per cent by the second quarter of 2000. The Group considered whether these differentials were likely to reflect differentials in wholesale prices or could be attributed to other causes. The three main factors that might account for changes in retail prices are likely to be: the cost of raw milk; wholesale fresh processed milk prices; and competitive conditions among retailers. The similarity in raw milk prices between Scotland, and England and Wales (which the Commission has, in the past, considered to be a single market) does not suggest that this is a reason for the differential. Nor have we seen any evidence that there were changes in practices or in the nature of competition at the retail level in 1998 to 2000 that were noticeably different from those in the two previous years. So we would expect the changes in retail price differentials to reflect—to a substantial degree and after a time lag of a few months—changes in the level of wholesale prices. It would appear that there has been a significant decline, since the beginning of 1998, in Scottish wholesale prices relative to those in England and Wales—from a differential of 10 per cent down to parity.

2.32. The same pattern can be discerned in the difference between the wholesale prices that Wiseman charged to the larger supermarkets and to middle-ground retailers. On the general assumption that the larger supermarkets possess sufficient market power to buy their milk at competitive prices, the change in the differential between what they pay, and what middle-ground retailers pay, can be taken as an index of competitive conditions in the sale of milk to middle-ground retailers. Figure 4.15 shows the trend in this differential for middle-ground customers as a whole; middle-ground retailers experienced a similar trend. In 1995/96 the differential between middle-ground retailers and the larger supermarkets was 17 per cent. This increased to over 21 per cent in 1997/98 and 1998/99 before falling sharply to 11 per cent in 1999/2000. This trajectory of wholesale prices is consistent with the evidence of retail prices.

2.33. However, despite being agreed about the direction in which prices have been moving in Scotland in recent years, the members of the Group gave differing weights to the causes. Two members, Mrs Kingsmill and Professor Cave, attached particular importance to the arrival of Express in Scotland at the end of 1998, as the factor which had precipitated a major change in competitive conditions and had eliminated the significant pre-existing differential between Scotland and northern England in retail prices in the middle ground. They noted that the higher differential in wholesale prices between the larger supermarkets and the middle ground (see Figure 4.15) was maintained over the three years to 1998/99, falling only in the subsequent year; and that all the major milk processors in Scotland told us that a fall in wholesale prices was attributable to the heightened competition following Express's entry. The other two members, Mr Clothier and Mr Mackay, pointed to the fact that Scottish prices for fresh processed milk had started to fall almost a year before Express took its interest in Claymore, and saw the ending of the former differential as the latest phase in a process of long-term convergence between prices in Scotland and those in other parts of Great Britain. They also considered that, from 1997 onward, the larger middle-ground retailers made increasing efforts to negotiate supply contracts with the same wide geographic coverage and low prices as the larger supermarkets enjoyed.

2.34. Their view is supported by the specific information on wholesale prices that we received from CWS—the largest middle-ground retailer of milk in Scotland, and one of the few that operates throughout Great Britain (see Table 4.9). This shows the price it paid for fresh processed milk to its two Scottish suppliers, Wiseman and Claymore, against the prices it paid to four of its English suppliers, Arla, Unigate, and two co-operative dairies, Associated Co-operative Creameries (ACC) and Southern Co-operative Dairies (SCD), in September 1997, July 1998, May/June 1999 and June 2000. The information is most complete for Wiseman and for the two English co-operative dairies, all of which were supplying CWS with milk throughout the period. If we take the cheaper English co-operative and compare its prices with those of the two Scottish dairies, then we find that in 1997 both were charging more than the English comparator: Claymore by 3.96 pence per litre (ppl) (18 pence per gallon (ppg)) and Wiseman by 1.76 ppl (8 ppg). In 1998 Claymore was charging only 0.66 ppl (3 ppg) more, and Wiseman 0.66 ppl (3 ppg) less. In 1999 Wiseman was still charging 0.66 ppl (3 ppg) less and Claymore—which failed to follow a general fall in prices as it was at the very end of its supply contract—2.86 ppl (13 ppg) more. In 2000, Wiseman was charging 0.88 ppl (4 ppg) less than the comparator, and its price fell exactly between those charged by the two independent dairies supplying CWS in England and Wales at that time. With the exception of Express/Claymore's price for 1999, when it was in the course of terminating its contract, these actual wholesale prices broadly reflect the changes we have inferred from TNS's retail series.

2.35. So, taking these pieces of evidence together, the Group infers that a significant but varying difference in wholesale prices between Scotland and the rest of Great Britain—and between Scotland and northern England—persisted until 1998, but that this has since reduced and has now all but disappeared. Members differ, however, in the relative importance that they attribute to the elements that have contributed to this reduction, and to precisely when it began.

2.36. As for the additional transport cost of servicing Scottish customers from a dairy in northern England, (*b*), the three northernmost plants of the major English dairies are located in

Newcastle (Arla), Blaydon (ACC) and Middlesbrough (Express). The shortest journey between these sites and a major Scottish population centre is just over 100 miles (Newcastle or Blaydon to Edinburgh). The longest is just under 200 miles (from Middlesbrough to Glasgow). Based on the estimates that we have been given by Wiseman, Express, Graham's, Arla and ACC, the cost of transporting milk from the northernmost dairies in England to a depot located in Scotland's Central Belt ranges from 0.9 ppl (to Edinburgh using the lowest estimation) to 2.2 ppl (to Glasgow using the highest) representing a haulage element—depending on a range of factors—that is likely to be in the area of 3 to 6 per cent of the wholesale value of the milk (see paragraphs 4.104 to 4.112). The estimates that we have been given may, however, overstate to some extent the differential in costs faced by English and Scottish suppliers, because both Wiseman and Express/Claymore, with processing plants in Scotland, also transport milk from their dairies to depots. Even in the case of Wiseman, with processing plants in the Central Belt, this involves a journey of, on average, 20 miles—with a cost equal to about 1 or 2 per cent of the value of the milk transported. So the real cost differential between Scottish and English dairies in supplying a Scottish depot is likely to be rather less than the figures we have been given for transporting milk from northern England to the Central Belt.

2.37. Wiseman has pointed out that, over the last decade, developments in the industry have substantially reduced the significance of distance when defining markets, by making it possible to deliver economically to depots that are many miles away from the processing dairy. Larger lorries, better roads and modern packaging techniques mean that milk can now be transported much further and faster than in the past. Improvements in processing techniques, and the much greater availability of refrigeration on farms, in dairies, on lorries, in depots, and in shops have significantly extended the life of fresh milk. This, and the fact that milk is increasingly being bought from supermarkets and other large stores, means that the bigger, more efficient dairies are able to compete for customers over much greater distances than hitherto (see paragraphs 5.16 to 5.18). We noted too that one major English processor told us that it routinely supplied supermarkets in Cornwall with fresh processed milk, which involved transporting 4 million litres a year in a round trip of some 560 miles from plant to store.

2.38. In considering the additional costs that processors based in England would incur in order to sell into Scotland, the Group also looked at the implications of possible under utilization of processors' capacity. From the information available to us, it appears that capacity utilization is less than optimal among some of the processors represented in northern England. In this situation an assessment of additional costs arising from increased supply would have to take into account any production efficiencies that the extra volume could bring. When a dairy wins new orders which enable it to maximize the utilization of its capacity, then not only does that mean the new business can be priced competitively but the cost of meeting existing orders should fall too. So the transport costs that arise in meeting more distant orders can be offset not only against that new business but also against the increased profitability of existing business. (See paragraphs 4.74 to 4.79.)

2.39. Turning to market shares and trade, (c), it would be likely that, if an area were a single market rather than two separate ones, the large companies would be operating throughout the area. In the case of fresh processed milk, there are three major English-based companies—Dairy Crest (which is in the course of absorbing Unigate's milk business), Express and Arla. There are also a number of co-operative dairies, most part of ACC, but some not. The only major processor based in Scotland is Wiseman. Dairy Crest and (before it sold its milk business) Unigate both had a tradition of operating in southern England and in Wales. The major northern England dairies are Express, Arla and ACC. All three have experience of selling fresh processed milk to customers in Scotland. Express is currently the second largest supplier north of the border through its controlling interest in Express/Claymore (it supplies around 6 per cent of Scottish demand). And in the 1990s Arla had both a middle-ground business in the Central Belt and a contract for supplying all Sainsbury's Scottish stores (meeting about 2 per cent of Scottish demand). ACC had a processing plant in the Central Belt which it sold to Wiseman in 1995, but continues to supply Co-op stores and some other customers in the South and East of

Scotland from its dairy in Blaydon ([3] per cent of Scottish demand). But, that said, the vast majority of the sales of the three main northern-England-based dairies are to customers in England. Wiseman's business is now almost equally divided between Scotland and England—with a Great Britain market share of 14 per cent. It is the fourth largest supplier in England and Wales, meeting around 7 per cent of demand south of the border.

2.40. As for cross-border flows, ACC supplies its Scottish customers from England—although, in total, cross-border flows represent only 2 per cent of milk consumption north of the border. As Scotland produces more milk than it consumes, most of the traffic is in the other direction—with around 4.6 per cent of the milk processed in Scotland in 1999/2000 consumed in England. Wiseman supplies its depot in Carlisle from Bellshill and, before building its dairy in Manchester, supplied most of its English customers from there. Until its demise in 1996, Scottish Pride routinely supplied milk to its depot in Gateshead from its dairy in Govan. Among the medium-sized Scottish dairies, Graham's contract with [3] covers northern England as well as Scotland. That said, the amount of Scottish processed milk consumed in England is lower now than it was in the mid-1990s.

2.41. The next factor to be taken into account is the means of local distribution by which an English dairy would supply its customers from its Scottish depot, (*d*). It seems clear that processors would need such a system, as middle-ground customers require relatively small drops—and many customers with multiple sites are not prepared to accept a single delivery to a central depot. It is possible, however, that some retail chains and symbol groups may move in the direction of handling their own distribution. Indeed, some already do so, and a number of those that we spoke to told us that, if there were a risk of Scottish prices rising out of line with the rest of Great Britain, they would themselves consider buying milk from England and distributing it to their stores (see paragraphs 6.92 and 6.102) as Boots, for example, already does. There are also a number of other possibilities. One would be for any new supplier to create its own network from a Scottish depot to middle-ground stores. Another option would be to find a Scottish partner with an existing network and use that. This is what Express is doing with Express/Claymore and what Arla did, in a rather different context, in its joint venture with McLeod's Dairies (McLeod's), a bottle milk buyer (BMB). Another possibility is to distribute milk along with other chilled foods, as with ACC and the Lothian and Borders Co-operative Society. We have also been told about a catering company that supplies milk from England to Scotland along with other types of food (see paragraph 6.53). Another option—which Express/Claymore has used in transporting some of its milk from Nairn—is to contract out distribution to haulage companies who can themselves ensure that their trucks are fully loaded by taking business from a number of disparate customers.

2.42. So, although the difficulties of new suppliers establishing distribution arrangements in Scotland are not to be underestimated—and it may take time to negotiate and set some of them up—there is no shortage of practical examples of ways in which processors have sought to address this problem. Local distribution from a Scottish depot—unlike hauling milk to that depot from a dairy in northern England—would not represent an additional cost for the English processor over what its Scottish competitor would have to pay. Scottish dairies need to distribute milk to their middle-ground customers too.

2.43. As for consumer preferences, (*e*), it has been put to us that the Scots prefer their milk to be Scottish. This argument was used by Express as one reason why it felt that it needed to acquire processing capacity north of the border, rather than supply Scottish customers from its northern England dairies. It cited as evidence the fact that when M&S stores in Scotland moved their business to an English supplier (from the SMMB's processing arm) in 1991 they were criticized in the tabloid press and consequently saw a 2 per cent reduction in sales. It also cited Sainsbury's recent contract with Arla which, although met from Newcastle, required the dairy to process raw milk brought down from Scotland (see paragraph 6.20(*b*)). In addition, Express showed us two market surveys that it had commissioned on this issue, which pointed to varying

degrees of preference for Scottish-produced milk on the part of Scottish consumers (see paragraphs 4.121 and 4.122 for details).

2.44. While there are a number of brands in Scotland—as elsewhere in the UK—which trade on local connections, such as Highland Fresh and Ayrshires Milk, Wiseman and the other Scottish processors that we have spoken to, SMD and Graham’s, did not feel that there was any strong Scottish preference among consumers. They told us that although all the larger supermarket groups label their own-brand milk as ‘Scottish’, this was not usual among middle-ground retailers, where customers appeared to put price and quality before place of origin. For example, for a number of years in the 1990s, when its sales of fresh processed milk were growing rapidly, Graham’s sourced some of its raw milk from northern England—suggesting that it suffered no adverse effects from doing so. It is also worth recalling that, even if a Scottish retailer did insist on buying only milk that was processed from raw milk produced in Scotland, it should not be too difficult for dairies based south of the border to obtain supplies. In its previous report on the proposed merger between Wiseman and Scottish Pride,¹ the Commission found that there was sufficient scope for raw milk to be traded between southern Scotland and northern England to ensure that the market in Scotland was part of a continuous chain of substitution linking it with the market in England. In addition, Scotland produces more than it consumes, so Scottish Milk has to export if Scottish farmers are to find outlets for all their produce. Also, raw milk sold for processing as fresh normally attracts a small premium over that sold for other purposes. Scottish Milk and the smaller milk group, Sorn Milk Ltd (Sorn), routinely sell milk in England. Arla, for example, regularly buys raw milk from Scotland, even though it does not supply customers there at the moment (see paragraph 4.30). And ACC buys raw milk from Scottish Milk at the same price it pays for milk from English farms. So dairies in northern England that want to process Scottish milk should not find it too difficult to do so—although, in some cases, they may face additional haulage charges. The representatives of the middle-ground retail chains and symbol groups that we have spoken to played down the importance to Scottish consumers of where milk is produced or processed. They even speculated about whether many consumers would know where their milk came from, given that the packaging is as likely to feature the name of the retailer as the processor. For example, the containers in which Spar currently sells the milk which Wiseman processes for it in Scotland mention only the location of its head office: Middlesex. Similarly, the milk sold in Scottish Co-ops mentions only the movement’s head office in Manchester on the container—although both Spar and CWS told us that, in future, they might well label as Scottish the milk they sold in Scotland. As stated in paragraph 2.41, some retailers have told us that they would buy milk from England if that gave them a better price.

2.45. In order to improve our understanding of this issue we commissioned two surveys, one of the smaller middle-ground retailers which we could not meet individually, and the other of Scottish consumers (see paragraphs 4.124 to 4.126 for more details). We also wrote to the larger supermarkets.

2.46. Of the smaller middle-ground retailers, just over half (53 per cent) felt that their customers preferred Scottish milk.

2.47. The consumers’ response was more mixed. 40 per cent thought that where milk came from was more important to them than what it cost—although only 18 per cent made a point of using shops that sold only Scottish milk. 54 per cent said that they would choose a Scottish brand over a cheaper one in the same store—although only 14 per cent had actually paid more for milk just because it was produced in Scotland. And only 33 per cent said that they would not buy milk from Northumberland if their local store stocked it.

¹See footnote 1 to paragraph 2.27.

2.48. The larger supermarkets (excluded from our inquiry) do label their milk as Scottish, although a number of them told us that they had not discerned any marketing advantage from doing so.

2.49. So, while there does appear to be some preference among Scottish consumers for Scottish milk—other things being equal—two members, Mr Clothier and Mr Mackay, considered that it was easy to exaggerate the extent to which it is reflected in the actual behaviour of those who buy from middle-ground retailers. It was their view that, while some Scottish customers may be willing to pay a small premium for Scottish milk, it is unlikely to be significant; and they noted that the middle-ground retail chains operating throughout Scotland had found no evidence of this. In any event, because substantial parts of the Scottish milk field were close to the border (in some cases no further from Newcastle and Blaydon than from Glasgow) because there was a surplus of raw milk in Scotland that had to be exported, and because there was a small premium for milk sold for processing as fresh (which accounted for only about half the raw milk produced in Scotland), should a northern England dairy wish to buy Scottish milk for processing and resale back into Scotland, it would be able to do so without difficulty and with no (or very little) southward haulage charge.

2.50. The other two members, Mrs Kingsmill and Professor Cave, regarded the survey evidence that over half of the Scottish consumers preferred Scottish-sourced milk; that more than half of the smaller middle-ground retailers believed that this preference existed; as well as the fact that the larger supermarkets label their milk as Scottish and some of the middle-ground chains told us that they might well do so in future, as an impediment to English-based processors selling milk into Scotland.

2.51. The final factor that the Group considered in addressing the market definition issue, (f), was company strategies. Express is clearly very interested in operating in Scotland, and has invested in a Scottish processing facility. From having previously supplied very few customers north of the border, it has now become the second largest supplier there (the third largest to middle-ground retailers) through its controlling interest in Express/Claymore, and the relationships it has built with other Scottish dairies such as SMD. It has told its customers north of the border that it is in Scotland for the long term (see paragraph 6.18). Wiseman is committed to developing its operations in England—as is clearly evidenced by the new dairy being built in Droitwich. Arla told us that it was considering supplying Scottish customers once again and, were it to do so, might well deliver milk directly from England, or that it could set up a new processing facility in Scotland. The restriction on ACC supplying milk to the outlets for which the CRTG is the buying agent—which was a condition of the sale of its previous plant to Wiseman—came to an end in June of this year, so it too is now considering whether it wishes to canvass these customers or to resume processing north of the border (paragraph 4.131).

2.52. The Group was divided on what conclusion should be drawn from this analysis of the geographic market. While all agreed that the differential between Scottish and English middle-ground retail prices for fresh processed milk that the Commission identified in its 1996 report has disappeared, the view of two of the members, Mrs Kingsmill and Professor Cave, was that this was largely the result of the competition occasioned by Express's arrival in Scotland, and that the differential could be restored if Express were to leave. Their view was based on what the Group had been told by middle-ground retail chains and symbol groups about the price cuts that had been offered to them after Express's arrival. In the three years, 1996, 1997 and 1998, the price differential between Scotland and northern England first rose and then fell, which may have been the result of a softening of competition following the collapse of Scottish Pride. At the time of Express's entry it stood at between 7 and 8 per cent and fell thereafter. All the major milk processors in Scotland told us that Express's purchase of an interest in Claymore precipitated significant increase in competition and reductions in prices. For the other two members, Mr Clothier and Mr Mackay, the fact that prices in Scotland had begun to come into line with those in England and Wales at the beginning of 1998, and that the differential had halved before Express's arrival, indicated that the trend was a continuation of the process of

convergence to which the Commission had drawn attention in 1996. They saw the increase in the differential in 1997 as a reaction to the demise of Scottish Pride which, until shortly before its liquidation, had been the main milk supplier in Scotland. They also drew attention to the stated determination of the larger middle-ground retail chains and symbol groups to use the growing buyer power that their increasing volumes have given them to resist vigorously any attempt by suppliers to restore the old differentials, and also to the willingness of some of them to buy milk from England if that were the best way to maintain competitive prices.

2.53. While all the members of the Group accepted that the cost of transporting fresh processed milk to a depot in the Scottish Central Belt from a dairy in northern England is—depending on a range of factors—likely to be in the area of 3 to 6 per cent of the wholesale price, two, Mr Clothier and Mr Mackay, considered that costs of this order would not prevent an efficient English supplier—which could be expected to operate at the cheaper end of the range—from delivering milk to Scottish customers below the price premium of 5 to 10 per cent cited in the hypothetical monopolist test. The other two, Mrs Kingsmill and Professor Cave, attached importance to the fact that the two companies with the northernmost dairies had estimated that the cost of transporting milk to the Central Belt would exceed 5 per cent of its wholesale price, and expected that this extra cost would be a significant factor in their decision about whether to supply Scottish customers. They also note that the hypothetical monopolist test relates to prices, and that no conclusion can be drawn from it in relation to cost factors alone.

2.54. All the members of the Group accepted that, of the major Scottish and northern English dairies, Wiseman, Express and ACC were currently active on both sides of the border and that, while Arla was not, it had told us that it was considering becoming so. The Group also accepted that fresh processed milk was not traded cross-border in substantial quantities. They were also satisfied that recent experience had shown that there were a number of ways in which an English dairy could arrange for milk from a Scottish depot to be distributed to local customers—although two members, Mrs Kingsmill and Professor Cave, placed importance on the fact that it might take an English processor some time to put arrangements in place. Although there is some perceived preference for Scottish milk among Scottish consumers, two members, Mr Clothier and Mr Mackay, considered that it was easy to exaggerate its importance in practice in the middle ground; that English processors who wanted to process Scottish raw milk would not have difficulty in obtaining supplies; and that it was not clear that it would be possible for processors consistently to charge a significant premium for Scottish-produced milk over English. The other two, Mrs Kingsmill and Professor Cave, judged that the preferences of Scottish consumers represented an impediment to English processors selling milk into Scotland.

2.55. Finally, the Group had no doubt that Wiseman's corporate strategy involved a clear commitment to continued operations in England and that, for the major north English processors, Scotland was a current focus for the activities of two (Express and ACC) and a potential focus for the activities of the other (Arla) although this had yet to be realized.

2.56. So two members of the Group, Mr Clothier and Mr Mackay, saw the evidence on the geographic market as pointing to a continuation of the trend which the Commission had discerned in 1996: that the market in Scotland for the supply of fresh processed milk was becoming less distinct from that in England and Wales. They concluded that the point had now been reached where there was a single Great Britain market in the supply of fresh processed milk to both the larger and smaller supermarkets and to other large middle-ground retail chains and symbol groups, which Wiseman estimated accounted for almost four-fifths of the fresh milk sold through retail stores in Scotland. Although, in their view, supply to the diminishing number of smaller independent stores, which lacked the buying power of the larger groupings—and which Wiseman estimated accounted for just under half the milk sold by middle-ground retailers and one-fifth of that sold through retail stores—continued to constitute a separate Scottish market.

2.57. In the view of the other two members, Mrs Kingsmill and Professor Cave, the retail price data show that a significant difference in middle-ground retail prices between Scotland and northern England had persisted, although at fluctuating levels, in the three years before Express's entry. They judge that its fall thereafter is largely due to changes in competitive conditions in the Scottish market and consider that the data on wholesale prices in paragraph 2.32 support their analysis. In their view, the existence of a separate market is also supported by evidence that cost and demand conditions create a wedge between Scotland and northern England and by evidence that trade in fresh processed milk between Scotland and England is negligible and declining. For these reasons, they conclude that the supply of fresh processed milk to all categories of middle-ground retailers in Scotland constitutes a separate market.

2.58. Mrs Kingsmill and Professor Cave also note that, on the basis of the market as defined in their conclusion, Wiseman enjoys a 66 per cent share, the next largest supplier, Graham's, 7 per cent and the other two Scottish processors of any size, Express/Claymore and SMD, 7 and 4 per cent respectively. They note that market structures of this kind often, although not necessarily always, create conditions in which the largest firm is able to exercise substantial market power, independently of other firms in the industry.

Market segmentation

2.59. The next issue to address is whether the supply of fresh processed milk to the different categories of retailer—the larger supermarkets, middle-ground stores, and those who deliver to the doorstep—constitutes three separate market segments. This, too, was an issue that the Commission considered in its 1996 report. It decided then that supplying the larger supermarkets was different from supplying the middle ground for a number of reasons. These reasons all remain relevant today, despite growing attempts by the tier of retailers immediately below the larger supermarkets in size to emulate their success in obtaining lower prices from processors. The larger supermarket business is characterized by national players which:

- (a) have considerable power to negotiate prices based on their sales across Great Britain; and
- (b) set higher standards of quality and hygiene for dairies to meet, and demand more exacting levels of service, than other retailers.

2.60. The larger supermarkets have also since 1996 become more national in their approach, reducing the range of processors whose milk they buy, requiring a single price for all—or at least a sizeable group of—stores and demanding that their suppliers deliver over larger areas (see paragraph 4.225).

2.61. In the period since 1996, the larger supermarkets have continued to increase their share of the total retail market for fresh processed milk. We have been told that their prices act as a control on other stores, because those who get too far out of line with them lose customers—although the TNS survey suggests that national supermarkets' prices can diverge substantially from those of middle-ground retailers (see Figures 4.6 and 4.9), perhaps indicating the varying premiums that middle-ground retailers can charge for 'convenience'.

2.62. Doorstep delivery is also a different segment of the retail market from the middle ground: first, because it generally involves the use of glass bottles, rather than plastic or paper containers; and second, because it tends to be very local and many of its costs are associated with providing regular domestic delivery. Both elements are absent from the business of supplying other retail customers.

2.63. The Group concluded that the supply of fresh processed milk to the larger supermarkets, middle-ground retailers and doorstep deliverers constitutes three separate market

segments—although the purchasing patterns of many of the larger middle-ground retailers are becoming more like those of the larger supermarkets.

2.64. The final market issue to address is whether the supply of fresh processed milk to middle-ground retailers should be regarded as a distinct market from supplying other types of middle-ground customers. From what we have been told, for example by Graham's (see paragraph 6.50), perhaps the most meaningful segmentation of middle-ground customers would be between national chains and local operations rather than between the types of business they are in. It seems that national chains—whether they are the smaller supermarkets, convenience stores, hotels or coffee shops—are increasingly looking for national, or at least much more than local, supply. This means that smaller dairies can compete only for local customers, whether those are caterers, retailers, public sector bodies or doorstep deliverers, because they lack the distribution networks—in terms of fleets, depots and dairies—that national chains require and/or the higher-quality processing facilities and sheer volume that this business demands. The only exception we have come across is where a chain handles its own distribution, so that a smaller dairy with the requisite quality and capacity can win national business by delivering large quantities of milk to the chain's depots. The Group's conclusion is that it is more appropriate to define the economic market as 'middle-ground customer' rather than 'middle-ground retailer'.

The questions that we have to address

2.65. Our terms of reference ask us to investigate and report on whether a monopoly exists in the supply of fresh processed milk to middle-ground retailers in Scotland and, if we find that it does, to answer these questions:

- (a) By virtue of which of the provisions of sections 6 to 8 of the Fair Trading Act 1973 the monopoly is to be taken to exist.
- (b) In favour of what person or persons that monopoly situation exists.
- (c) Whether any steps (by way of uncompetitive practices or otherwise) are being taken by that person or persons for the purpose of exploiting or maintaining the monopoly situation and, if so, by what uncompetitive practices and in what other way.
- (d) Whether any action or omission on the part of that person or persons is attributable to the existence of that monopoly situation and, if so, what action or omission, and in what way it is so attributable.
- (e) Whether any facts found by the Commission, in investigating these matters, operate or may be expected to operate against the public interest.

2.66. Our response to question (a) is that section 6 of the Act deals with monopolies in the supply of goods, section 7 with the supply of services, and section 8 with exports: so it is section 6 that is relevant to this inquiry.

2.67. Subsection (1)(b) of that section says that a monopoly shall be taken to exist if 'at least one-quarter of all the goods of that description which are supplied in the United Kingdom are supplied by members of one and the same group of interconnected bodies corporate'. Section 9 of the Act qualifies section 6 by allowing 'the person ... making the reference ... to ... determine that consideration shall be limited to a part of the United Kingdom'. Our terms of reference limit the inquiry to Scotland.

2.68. Because members of the group of companies under the ownership (or control) of Wiseman supply about two-thirds of the fresh processed milk sold to middle-ground retailers in Scotland, we conclude that a monopoly situation exists by virtue of subsection (1)(b) of section 6 of the Act.

2.69. Our response to question (b) is that the monopoly situation exists in favour of Wiseman.

2.70. To answer questions (c) and (d), we have carried out a review of Wiseman's competitive behaviour, both currently and in the recent past. We have also considered the likelihood of current trends and competitive conditions continuing into the future. We have focused our examination on Scotland. We have looked carefully at the material provided to the DGFT in the months leading up to his making this reference, and we have also gathered further information from those who might have an interest in the questions raised in our terms of reference. We have visited a number of Scottish milk processing plants, held hearings in London and in Scotland, commissioned survey reports on middle-ground retailers, customers' attitudes and retail prices, and advertised widely to encourage anyone with information or views on these issues to share them with us. The level of response—from the industry and the public—has been low, with very little interest being shown by consumers or their representatives. The Scottish Consumer Council declined to submit any evidence to our inquiry.

2.71. There are, of course, many ways in which the information that we have collected could be reviewed in assessing its relevance to the questions we have been asked to address. The approach we have adopted is to examine Wiseman's behaviour under a series of headings, concluding, at the end of each section, whether or not any of the evidence we have considered could constitute a step, action or omission, in terms of questions (c) and (d). In the penultimate section of this chapter we then turn our attention to the public interest question, (e).

Wiseman's behaviour

Non-price-related market management

2.72. The first area that we looked at was whether there is any evidence that Wiseman has, in the recent past, sought to manage the supply of milk to middle-ground retailers by means other than competitive pricing and service quality, and is continuing to do so.

Alleged market-sharing arrangement with Claymore Dairies

2.73. On 31 March 1999 Express/Claymore provided the OFT with a memorandum claiming that a market-sharing agreement had been in place since December 1994 between Claymore and Wiseman. Under it, the two dairies were alleged to have divided the supply of milk to middle-ground retailers in northern Scotland along a line running through Elgin, and to have entered into an unwritten arrangement that they would not compete with each other on either side of this line. Claymore supplied customers to the North and West, Wiseman those to the South and East. Existing customers that fell on the 'wrong' side of the line were transferred to the other company. As part of this arrangement Express said that Wiseman also sold to Claymore two depots and their associated business in Fort William and Kingussie, which it had acquired when it bought Kennerty Farm Dairies Limited (Kennerty) in May 1994. Although the arrangement had led to an extra 4,500 or so litres a day being processed at Nairn, Express/Claymore contended that, overall, it operated against Claymore's interests. The quality of the customers it had gained was inferior to those it had lost; and the territory over which it was left to operate was sparsely populated with high transport costs. Nonetheless, Express/Claymore claimed that Claymore had felt that it had to agree to the arrangement, because it feared the

commercial pressure that Wiseman could have applied had it not accepted the proposal (see Appendix 3.2).

2.74. We asked Wiseman about Express/Claymore's claim. Its version of events was rather different. It told us that when it acquired the loss-making Kennerty in Aberdeen in 1994 it found a large number of complex agency agreements in place with Claymore designed to rationalize distribution for the two dairies. They involved Claymore supplying the shops of many of Kennerty's customers located nearer to Nairn than Aberdeen, and Kennerty supplying several Claymore customers in the Aberdeen area. In addition, Kennerty supplied some of its and Claymore's customers from depots in Kingussie and Fort William with milk that was processed by Claymore. These arrangements were backed up by administrative staff in both dairies who tracked the invoices relating to these agented deliveries and tried to ensure that payments were allocated to the appropriate supplier.

2.75. Wiseman thought this a complicated and labour-intensive way of doing business. It suggested to Claymore that it would be simpler and more efficient for Wiseman to take over and supply all the Claymore and former Kennerty customers located in the Aberdeen area, and for Claymore to do the same for those located in northern Scotland. A schedule was drawn up which showed that such a rationalization would result in extra volume shifting from Wiseman to Claymore. An agreement was subsequently reached along these lines with the transfer to Claymore of the depots, and a payment to Wiseman—reflecting both the value of the depots and the extra volume—of £75,000. Wiseman denied that there was any agreement not to compete with Claymore, beyond the normal commercial one relating to the sale of the depots, which was included in the purchase agreement and which prohibited Wiseman from competing—for a limited period—for the business that it had sold along with the sites. It cited as evidence its subsequent contracts to supply milk in northern Scotland—when Tesco acquired the William Low chain in 1994, and when it won Somerfield's northern business in 1997 following the demise of Scottish Pride—although some of these deliveries were made by Claymore on its behalf. Wiseman also denied that the arrangement was not favourable to Claymore. It pointed out that in the mid-1990s Claymore had no significant competitors (apart from Wiseman) in northern Scotland, whereas Wiseman—a much smaller company then than it is today—faced competition from Scottish Pride and E Mitchell & Sons Ltd (Mitchells) (as well as Claymore) in the Grampian area.

2.76. We asked a leading market participant who was close to the arrangement, [*Details omitted. See note on page iv.*], for his version of events. He told us that Wiseman had approached Claymore with a proposal for both companies to cut their costs by improving their distribution arrangements through concentrating their activities on areas closer to their respective dairies. He said that Claymore had been concerned about its future relations with Wiseman if it did not accept, although the dairy was put under no pressure by Wiseman to do so. He was clear that he did not see the proposal as a market-sharing agreement. He did not think that such an agreement would have been feasible as there were other dairy companies competing for business. He cited Mackies of Scotland Ltd (Mackies), Mitchells and Scottish Pride as being present in the Aberdeen area and Allarburn Farm Dairy Ltd (Allarburn), Farmers Dairy and Stratton Depot Ltd (Stratton) in the Highlands. With these companies actively seeking business, no sharing of trade or areas between Wiseman and Claymore would have been possible. He also made the point that the sum Claymore had paid Wiseman for the extra volume (which had also included the price for the two depots) was not excessive and, if anything, below the going rate in the industry at that time. (See paragraphs 6.74 to 6.78 and Appendix 3.2.)

2.77. The Group is divided about how the relationship between Wiseman and Claymore should be viewed. Two members, Mr Clothier and Mr Mackay, consider that, although there clearly were arrangements of various sorts in place between the two dairies in the period from 1994 to 1998, they did not constitute a market-sharing agreement. Nor do they find it significant that there was little competition between Wiseman and Claymore during this period.

Claymore emerged as an independent entity only at the end of 1994 with the abolition of the NSMMB, and for most of the subsequent period Wiseman was expanding its operations elsewhere. In 1994 it was floated on the Stock Exchange in London, and acquired the Mackies and Kennerty businesses in Grampian. In 1995 it acquired CWS's fresh milk business in Scotland and Hamilton's Dairies Limited (Hamilton); it also brought its large new dairy in Manchester on-stream. In 1996 it was expanding its activities in the Central Belt and elsewhere in Scotland as Scottish Pride's business began its final decline: Wiseman bought the bulk of what remained of Scottish Pride's operations from the receiver in 1997. In 1997 and 1998 Wiseman was consolidating its position in northern England and beginning to extend its operations further south, into the Midlands, by winning (mainly supermarket) business from the major English dairies already established there. So, given: the existence of these other priorities for Wiseman, in parts of the country much more populous than those served by Claymore; what they regard as a lack of convincing evidence about market sharing; the conflicting interpretations of events; and the fact that no one is claiming that any agreement is in place today, these members do not conclude, by reference to these events, that any steps are being taken to exploit or maintain Wiseman's monopoly position, nor are any of its actions or omission in this area attributable to it.

2.78. By contrast, the other two members, Mrs Kingsmill and Professor Cave, note that the conflicting evidence from Wiseman and Express/Claymore make it impossible to determine the precise nature of the agreement and the period over which it operated. However, they see the existence of a rationalization agreement between Wiseman and Claymore as an indicator of deliberately muted competition. They also point to the very few customers that Wiseman supplied in the area north and west of Elgin before the end of 1998 (see Map 3 at the end of this report) and contrast that with the picture in March 2000 (Map 4) when Express's entry had triggered a much higher level of competition between Wiseman and the Nairn dairy. So they conclude that Wiseman's failure to compete with Claymore in the period before December 1998 constitutes an omission attributable to its monopoly position.

Arrangements or agreements with processors other than Claymore Dairies

2.79. We next looked for any evidence of Wiseman having been involved in market-sharing arrangements or agreements with processors other than Claymore which were having a continuing effect on the pattern of supply of fresh processed milk in Scotland.

2.80. After Express/Claymore, the next largest processor in Scotland is Graham's. Three points were made to us about its operations that are relevant under this heading. First, we were told by a milk purchaser that he could not interest Wiseman in supplying him because he was already a customer of Graham's. Second, we received claims from other participants in the market that Wiseman and Graham's had arrangements in place to agree wholesale prices to middle-ground retailers and, in one case, to compensate Graham's—by means of uncontested access to new customers—when it lost contracts to Wiseman in Glasgow. And third, the survey of smaller middle-ground retailers that we carried out (see Appendix 3.3) indicated that shopkeepers had a stronger perception of agreed areas of operation among milk suppliers in Stirling—the centre of Graham's operations—than anywhere else in Scotland.

2.81. We put all three instances to Graham's and Wiseman. Both said that they were not aware of any such arrangements. Graham's explained that there had been a time limited non-compete agreement with Wiseman (which was later registered with the OFT) relating to an exchange of doorstep business—which went to Wiseman—and middle-ground customers—which went to Graham's. Both parties told us that the agreement was now at an end and that they were once more competing in the area that it had covered. Graham's said that allegations about market sharing were rife in the milk trade throughout the UK but it had never entered into any such agreement, formal or informal, with Wiseman. It also pointed to its continuing expansion, which had seen the company grow tenfold over the last decade, as a counter-

indicator to any suggestion of market sharing (see paragraphs 5.37, 6.50 and 6.52 and Appendix 3.3).

2.82. We also raised the issue of market sharing with Mr Jim Gilmour, the former Managing Director of Gilmours which, until it was bought by Wiseman in 1999, had also been a middle-sized Scottish processor. Mr Gilmour denied being a party to any such agreements and made the point that, throughout the 1990s, Gilmours, Graham's and Wiseman had all been expanding very rapidly, taking business from each other and from other processors as they did so. He felt that, while market sharing might be consistent with a static and mature marketplace, such allegations were much more difficult to sustain when change was as fast and wide-ranging as it had been in the Scottish milk business during the last decade. (See paragraph 6.48.)

2.83. We were also told by another participant in the market that Wiseman had entered into an arrangement with Gilmours and Hamilton (before it acquired them) and with Drakemire (now known as SMD) designed to fix the prices at which fresh processed milk was supplied to retailers in the Central Belt. We asked Mr Gilmour about this too. He said that he had no knowledge of any such arrangement and pointed, once again, to the marked increase in his company's sales volumes, and the business that it had won from Wiseman as the result of keen pricing, as evidence of its highly competitive relations with the larger dairy.

2.84. Scottish Milk said that it was not aware of any market-sharing or price-fixing agreements in the period since February 1998, when it had first acquired an interest in Drakemire (now SMD).

2.85. We also raised the issue with a number of middle-ground retail chains and symbol groups. None of them was aware of any such arrangements.

2.86. Next we looked for evidence of active competition—the reverse of market sharing—during the recent past. Apart from the tenfold growth achieved by Graham's and Gilmours through taking business from other processors, SMD provided us with evidence about accounts it gained from, or lost to, other dairies since February 1998. Wiseman too showed us records which illustrated that it gained and lost significant volumes in milk sales from other processors between April 1997 and March 2000.

2.87. In considering the various reports brought to our attention about arrangements and agreements with processors other than Claymore, our inquiry has been hindered by the fact that those who provided the information said that they did not wish their identity to be known or their allegations used openly to confront Wiseman or the other processors directly at a hearing; nor have they provided us with detailed and specific written evidence. Wiseman and the companies with which it has been linked all deny any knowledge of such events. We have not found any evidence of market-sharing agreements or price fixing in the supply of fresh processed milk in Scotland. The Group does not conclude, by reference to these events, that any steps are being taken to exploit or maintain Wiseman's monopoly position, nor are any actions or omissions attributable to it.

The relationship with Scottish Milk Limited

2.88. Next, we examined the relationship between Wiseman and Scottish Milk, to see whether it could be characterized as a dependent one that had grown out of Wiseman's monopoly position and/or a desire on its part to manage milk supply in Scotland. Express told us that it thought Scottish Milk was afraid that Wiseman would lure away its member farmers if it did not do what Wiseman wanted. It suggested that Scottish Milk might have acquired Drakemire simply to deny it to Wiseman's competitors. (See paragraph 6.25.)

2.89. Scottish Milk refuted these suggestions vigorously. It told us that although Wiseman was its largest customer, their relationship was an arm's length, commercial one. It provided us with recent documents indicating robust negotiations over raw milk prices to illustrate the point. It explained that its involvement with Wiseman—and with Scottish processors generally—was becoming less central to its business as it continued to expand its operations southwards by signing up English farmers, and winning more contracts from English dairies. It had members in Cumbria, Cheshire, Lancashire, Warwickshire and Shropshire, and delivered raw milk as far south as Oxfordshire. It was significant, for example, that it did not supply Wiseman's Manchester dairy, nor were there any plans for it to supply the new Droitwich plant next year (see paragraph 6.161).

2.90. Scottish Milk also made it clear that SMD (in which it has an 80 per cent holding) was in day-to-day competition with Wiseman in the Central Belt. It cited the fact that it had supplied Express/Claymore with raw milk to support the expanded production at Nairn, and that SMD was processing and packaging milk for Express/Claymore, as further evidence that it was pursuing its own business agenda, not Wiseman's. It told us that Wiseman derived considerable benefits by obtaining raw milk from Scottish Milk, as it allowed Wiseman to balance out seasonal variations in milk production and demand. (See paragraph 6.157.) Also its supply was matched with that of a large cheese producer. This arrangement allowed Wiseman to balance out seasonal variations in milk production and demand with the flow that it received from the farms it had under contract. This meant that Scottish Milk was providing a valuable service to Wiseman (which was reflected in the higher price it paid for raw milk than some other, much smaller, customers). This service would not be available were Wiseman to seek to turn the co-operative's members into its own direct suppliers. We have not been able to find any evidence of a dependent relationship between Wiseman and Scottish Milk and, Express apart, those that we have spoken to support Scottish Milk's version. We have no reason to doubt its veracity.

2.91. The Group's conclusion on this range of issues is that, on arrangements and agreements with processors other than Claymore, and in its relations with Scottish Milk, Wiseman is not seeking to control the supply of fresh processed milk to middle-ground retailers in Scotland by means other than competitive pricing and service quality and that, in relation to these issues, it is not taking steps to exploit or maintain its monopoly position, nor are any of its actions or omissions in this area attributable to it. On the alleged market-sharing agreement with Claymore, the Group is divided. Two members, Mr Clothier and Mr Mackay, come to the same conclusion on this as they do on the other items under this heading, but the other two, Mrs Kingsmill and Professor Cave, conclude that Wiseman's failure to compete with Claymore in northern Scotland in the period before December 1998 constitutes an omission attributable to its monopoly position.

Exclusion of competitors through acquisition and/or the closure of capacity

2.92. The next area that we examined was Wiseman's acquisition of other operators in the Scottish milk business and its closure of their processing capacity. Given the strength of Wiseman's position in Scotland, any acquisition it made—other than the most trivial—would almost be bound to have the effect of maintaining its monopoly position. And, in assessing the purpose of Wiseman's actions, it is difficult to demonstrate that such a motive formed no part of its intentions, whatever other considerations it might have had in mind. So, in addressing this issue, we have also looked at whether there was a coherent commercial rationale for Wiseman's activities, whether or not they could also be seen as steps taken for the purpose of maintaining or exploiting its monopoly position in Scotland, or as actions attributable to it.

The acquisition of Gilmour's

2.93. Wiseman concluded two major acquisitions in 1999. The first was Gilmours. Wiseman told us that the suggestion that it buy Gilmours came from James Gilmour, its Managing Director. It said that Mr Gilmour and the other owners of the dairy were keen to sell, but were divided about how best to go about it. They had welcomed the approach that they had received from Express in August 1997, but negotiations subsequently stalled. Over a year after the initial Express approach, Mr Gilmour had contacted Wiseman, which eventually offered a more attractively structured deal and a sum marginally higher than Express was proposing to pay (see paragraph 5.68). Wiseman's plan was to take over Gilmours' customers—mainly in Ayrshire, where it was under-represented—and supply them from its own dairies, closing down Gilmours' ageing plant but continuing to use its modern depot.

2.94. Wiseman told us that once the DGFT had given his approval to the purchase—something that was required in the aftermath of its acquisition of Scottish Pride—it was happy to go ahead. The figures that Wiseman showed us demonstrate that Gilmours was operating successfully at the time of the acquisition and that the profitability of its operations was further enhanced by closing down the dairy and supplying the former customers from Bellshill. Wiseman estimated that the purchase contributed about £1 million a year to its profits, and we are satisfied that this more than justified the price that it paid. (See paragraphs 3.10 and 5.68.)

2.95. Mr Gilmour confirmed to us that it was he who approached Wiseman about the acquisition. He also told us that he did not tell Wiseman the identity of the other bidder. From the point of view of Gilmours' owners, the price which Express was offering was less of an issue than how the purchase was to be structured. Express had wanted to buy only a controlling interest in the dairy (51 per cent) with the existing directors continuing to be involved in the business for a number of years. It had told them that the plan was then to use Gilmours to compete with Wiseman in the Central Belt. The directors had not been attracted by this proposition, fearing that the strategy would lead to their interest in the remaining 49 per cent of the business losing value if the competition with Wiseman were not a success. They had also been concerned about the way in which Express had conducted the negotiations. They feared that its lack of urgency might indicate an underlying lack of interest. Mr Gilmour said that the reason why he and his fellow shareholders had been considering selling up was that their business had grown tenfold over the previous decade, but could not expand further as the plant was now working to the limits of its capacity and needed to be modernized. To stay in the industry would have required a substantial degree of capital investment, which they were not sure they could justify—hence their desire to get out at the top of the market. (See paragraph 6.45.)

The acquisition of AMCo

2.96. The other acquisition that Wiseman made in 1999 was its purchase of AMCo in May. Express/Claymore told us that this damaged its own competitive position by:

- (a) raising the raw milk price received by the former members of AMCo, and so forcing Express/Claymore to pay more to the farmers who supplied it; and
- (b) foreclosing AMCo supplies and so requiring the dairy at Nairn to source milk from Scottish Milk's depots, located further afield (see paragraphs 3.12, 6.17 and 6.35).

2.97. Wiseman's response was that the prices paid to the AMCo farmers for raw milk were lower than they should have been because the co-operative had high administrative overheads and owned a loss-making processing plant in Aberdeen, which was used to make butter and milk powder. Because raw milk was in short supply locally, the plant was either underutilized or used to process raw milk from elsewhere at greater cost. As a result, part of the price which Wiseman, and the other customers, paid AMCo for raw milk was used to subsidize the plant's operations, thus depleting the sum paid on to farmers. This was causing some of them to move

out of dairy into other, more lucrative, forms of agriculture—reducing further an already inadequate local milk supply.

2.98. When it acquired AMCo—again with the agreement of the DGFT—Wiseman closed the plant and sold off the site, and the former AMCo farmers received the benefit of the full price paid for their raw milk.

2.99. As for foreclosing milk supplies, Wiseman pointed out that the Grampian area was a net importer, from the rest of Scotland, of raw milk for processing as fresh. This means that, although it had been taking 90 per cent or more of AMCo's output since acquiring Kennerty in May 1994, Wiseman had, over the last four years, also been buying in further supplies from Scottish Milk to meet the demands on its Aberdeen plant. Wiseman also said that any former AMCo farmers who now supplied it directly would be able to terminate their contract by giving three months' notice if they wanted to sell their milk to someone else. Their previous supply contracts with AMCo had involved a 12-month notice period. Wiseman told us that in the years before its acquisition, when AMCo was an independent milk producer, Claymore never bought any milk from it (see paragraphs 5.69 to 5.71).

2.100. Wiseman's stated reasons for buying AMCo make sound commercial sense in their own terms. Wiseman told us that it had been seeking to buy the co-operative for some time before it finally completed the purchase, as this seemed to be the only way to make its operations more efficient and prevent more local farmers from leaving the dairy sector. As a result of the purchase, Express had been faced with the choice of seeking to recruit some of the former AMCo farmers as its direct suppliers or buying the extra milk it needed for its greatly expanded throughput from Scottish Milk and to pay the extra cost of hauling it to Nairn. But had AMCo remained independent, there is no certainty that Express/Claymore could have bought raw milk from it at the same price it paid its own farmers. With Wiseman's operations in Aberdeen already requiring more milk than AMCo could provide, and Express seeking to expand its activities in Nairn beyond the capacity of its own farmers, the outcome would have been one where local demand exceeded supply. In that case, one would expect prices to rise to the level of the nearest alternative supplier, ie to the prices that Express had paid to Scottish Milk. It seems significant to us that Express/Claymore has not recruited any former AMCo farmers since May 1999, even though some of them are located next to its existing farms and the notice period that they would have to give to Wiseman is only a quarter of that which AMCo required.

2.101. The view of the Group is that the acquisitions of both Gilmours and AMCo, and the subsequent closing down of their processing facilities, had the effect of enhancing Wiseman's profits. The acquisition of AMCo involved the additional benefit of securing future supply in an area of declining milk production and did not change adversely Express/Claymore's ability to recruit producers—in some ways it made AMCo's milk field more accessible to other purchasers than it was before. That said, both acquisitions did have the effect of maintaining Wiseman's monopoly position—as any purchase of a similar size would have done. Gilmours did so more directly as it was previously a competitor in Wiseman's core business: the supply of fresh processed milk. AMCo, as a raw milk producer, is in a different category, but improving the quality and security of its raw milk supply would also help Wiseman maintain its strong position in Scotland. So while it is impossible to be definitive about Wiseman's purpose, we conclude that the steps it took are likely to have been, at least in part, for the purpose of maintaining its monopoly position, and that its actions are likely to have been, to some extent, attributable to it. However, both acquisitions were approved by the DGFT.

Trading terms

2.102. Next, we looked for evidence on the part of Wiseman of its seeking to employ trading terms—such as the promotion of exclusivity deals in the supply of milk or the use of inducements—that could be relevant to questions (c) and (d).

Exclusivity arrangements

2.103. We looked first for any arrangements by Wiseman, to supply milk to middle-ground retailers that contained a stipulation that the purchaser would not buy milk from another processor. Aberness Foods Ltd (Aberness)—the buyer for the Mace symbol group—showed us a letter from Wiseman (dated 7 July 1999) that proposed an agreement under the terms of which Wiseman would make a ‘one-off’ loyalty payment of £[] in return for becoming Aberness’s sole supplier of milk for three years. We asked Aberness whether it thought that the actual agreement with Wiseman was exclusive. It told us that it was clear that it was not. Although it had accepted the payment, it said that it regarded the agreement only as one under which Wiseman would remain a main supplier of fresh milk and cream to Aberness’s company stores for at least the next three years (see paragraph 5.29). It saw the continuation of the business depending on Wiseman maintaining exacting standards on service and price, and Aberness said that it could withdraw from the deal at any time if it felt that Wiseman’s performance was falling short. Aberness also told us that as it believed in maintaining an element of diversity and competition. Mace stores continued to stock milk from Express/Claymore and from Mitchells. In 1999/2000 Express/Claymore accounted for around 13 per cent (by volume) of the milk bought by the group and Mitchells for around 5 per cent. It saw the deal with Wiseman as very much a gentlemen’s agreement that was open-ended and easy to get out of. It was not backed by any formal contract documentation that was legally binding. It told us that the idea for formulating such an agreement with Wiseman came from negotiations that it had started earlier in the year with Express/Claymore. The Wiseman proposal was a consequence of that. (See paragraphs 6.81 to 6.88.)

2.104. Wiseman agreed that it would be an exaggeration to describe its arrangement with Aberness as a contract, as it could be terminated by either side at very short notice. It also told us that none of its arrangements with other customers was exclusive and that where it made advance payments, for whatever reason, it was its practice to amortize the cost over the life of the contract. It explained that agreements to supply fresh milk tended to be short term, because no retailer wanted to be bound to a dairy for an extended period, as it might then be unable to offer milk to its customers if there were a hygiene problem or any other interruption in supply. It also made the point that where, for example, it provided customers with refrigerators, it did not stipulate that only its milk could be kept in them (see paragraph 5.29).

2.105. In our survey of smaller middle-ground retailers we asked whether exclusivity was a condition that was attached to supply contracts in 1998, 1999 or 2000. Of the 526 retailers questioned, only one claimed to be aware of such a condition in each of the years. And only two in 1999 and one in 2000 said that keeping their refrigerator was dependent on not changing their supplier (see paragraph 4.266).

Inducements

2.106. Wiseman told us that the provision of refrigerators is a standard feature of selling milk to middle-ground retailers in Scotland and should not be seen as unusual or improper. The practice went back to the time of the MMBs when smaller retailers were provided with refrigerators on public health grounds. Express/Claymore, SMD and Graham’s also told us that this practice was common in the Scottish middle ground. The responses to our survey showed that two-thirds of smaller middle-ground retailers had received no benefits or inducements of any kind from their milk suppliers. 22 per cent received free refrigerators, 5 per cent (each) some free milk or orange juice, and 2 per cent a payment or rebate.

2.107. So, based on the results of the survey and the lack of exclusive supply arrangements, two members, Mr Clothier and Mr Mackay, conclude that Wiseman has taken no steps under this heading for the purpose of exploiting or maintaining a monopoly position nor are any actions or omissions attributable to it. However, the other two members, Mrs Kingsmill and

Professor Cave, note that Wiseman sought an arrangement with Abernethy under which it would become its sole supplier of milk for at least the next three years, and that it paid over £[] in this connection. Although the requirement for exclusivity has not been adhered to by Abernethy, and Wiseman has not sought to terminate the arrangement on this account, they regard Wiseman's seeking such an agreement and the payment of £[] made in connection with it, as a step taken for the purpose of maintaining its monopoly position.

Competition and pricing

2.108. Finally, we examined the key area of price competition, to see if there were any evidence in Wiseman's behaviour of steps or actions being taken to maintain its monopoly position, or otherwise attributable to it.

The position before December 1998

2.109. We begin our analysis under this heading by looking at the prices prevailing in Scotland before the arrival of Express in December 1998. Figure 4.10 illustrates the divergence in the retail price of milk sold by middle-ground suppliers in Scotland and northern England in the three years to the end of 1998. We then went on to consider whether competitive conditions during that period permitted the charging of excessive wholesale prices.

2.110. Much of the evidence available to the Group on this question relates to retail prices charged for milk supplied by all Scottish processors, as well as for the small quantity of milk imported from England (Figure 4.10). The figures show prices higher than those in northern England by between 5 and 12 per cent. For the reasons mentioned in paragraph 2.33, two members, Mrs Kingsmill and Professor Cave, regard this differential as evidence of uncompetitive conditions in milk processing in Scotland which led to higher wholesale, and hence higher retail, prices. The other two, Mr Clothier and Mr Mackay, see the differential as a reflection of a temporary increase in wholesale, and hence retail, prices in Scotland brought about by the disorganization of supply caused by the decline and ultimate demise of Scottish Pride, hitherto the largest player in Scotland.

2.111. Mrs Kingsmill and Professor Cave also drew attention to information on the prices charged by Wiseman to its larger supermarket customers and to the middle ground (Figure 4.15) which show a much greater differential in 1996/97 to 1998/99 than from 1998/99 to 1999/2000. In addition, they considered it pertinent to examine Wiseman's profitability over this period. Table 3.3 shows the return on operating assets to Wiseman in the financial years 1995/96 to 1999/2000. The figures cover all Wiseman's activities, both its sales to Scotland and its growing sales in England, its production of processed milk and other products, and its sales to all categories of buyer, including larger supermarkets, doorstep deliverers' and all types of middle-ground customers. The table shows that the return increased over this period but fell to a low in 1999/2000. Further analysis shows that Wiseman's rate of return in the year to March 1999 was relatively high compared with other food producers and processors (see Table 3.9). Because these rates of return data cover a range of activity apart from sales to the middle ground, little can be read into them. Their interpretation of the pricing data, however, provides grounds for these members to conclude that Wiseman's prices to the middle ground between 1996 and 1998 were excessive (ie above competitive levels) and that its conduct between 1996 and 1998 constituted steps taken for the purpose of maintaining its monopoly position.

2.112. The other two members, Mr Clothier and Mr Mackay, dissent from this conclusion. They were not persuaded that the high level of prices obtaining between 1996 and 1998 could be attributed to Wiseman's behaviour. As for Wiseman's profits, the two members did not, in any event, agree that they were excessive during this period—neither its return on turnover nor on average operating assets was much out of line with those achieved elsewhere in the industry

at the time (compare Express's figures in Table 3.6). In their view, Wiseman's returns were consistent with what might be expected for a firm with the degree of technical and marketing innovation that it was demonstrating at this time. They did not accept, therefore, that Wiseman's pricing between 1996 and 1998 constituted steps taken for the purpose of maintaining its monopoly position.

The position after December 1998

2.113. While low prices are normally welcomed as the fruit of competition, offering prices that are too low and whose aim is to undermine a competitor to the point where it withdraws or ceases to compete effectively can be seen as a step designed to maintain a monopoly situation. But, on the other hand, for a company such as Wiseman, a wide range of the activities that it undertakes to defend its customer base, or to win new business, could arguably be characterized as steps to maintain its monopoly position. It is a matter of judgement how such activities are to be defined. In this area too, the Group was not able to reach a common view in assessing Wiseman's behaviour.

Falling prices

2.114. What does not seem to be in question is that the prices charged for fresh processed milk in the Scottish middle ground have fallen noticeably since the Commission last looked at this question in 1996¹ (see Figure 4.9). Part of the fall simply reflects a reduction in the cost of raw milk and is replicated in cuts throughout Great Britain. But, at the retail level, the TNS figures (mentioned in paragraph 2.30) show that Scottish prices have fallen further than those elsewhere, leading to the removal of the former differential between Scotland and the rest of the country. There is less clear comparative evidence on wholesale prices but the series of figures we have from CWS shows—for Wiseman's prices at least—a falling trend from levels that were well above an English comparator in September 1997 to a little below in July 1998, where they have stayed ever since. The oral evidence we have received from other major retail chains and symbol groups with a presence north and south of the border points to a convergence there too.

2.115. Express came to Nairn at the end of 1998, by which time, the differential between prices in Scotland and both England and Wales in general, and northern England in particular, had fallen from their peak at the beginning of 1998, although there can be little doubt that the intense competition over wholesale prices to which its arrival gave rise contributed to its final phase. What we now need to address is whether Wiseman's behaviour during this competition gave rise to any steps, actions or omissions that are relevant to questions (c) and (d).

An analysis of costs

2.116. We began this part of our inquiry with a cost analysis to see, in particular, whether Wiseman sustained losses during this price competition. The existence of losses—depending on how they were defined—could constitute evidence of steps taken to maintain a monopoly situation. So, we explored this question very fully with Wiseman and looked carefully at its pricing information for the period since December 1998. We have also spoken to many of the major middle-ground retailers in Scotland who have benefited from lower prices during that period.

2.117. It was at this point in our investigation that further differences of view emerged within the Group. All members agreed that an analysis of the competition between Wiseman and Express/Claymore at the beginning of 1999, for the all-Scotland business of CWS and the

¹See footnote 1 to paragraph 2.27.

other large middle-ground chains and groups, was central to forming a view on Wiseman's behaviour during this period. There was also agreement that the position of CWS—the first all-Scotland contract for which the two dairies competed—was particularly important, because it was the largest retailer of milk in the middle ground and Claymore's biggest customer. Claymore also had 25 per cent of CWS's business (against Wiseman's 75 per cent) whereas for most of the other large middle-ground retailers only around 5 per cent or less of their requirements were not already being supplied by Wiseman. But there was less agreement within the Group about how the events of early 1999 should be viewed and what conclusions should be drawn from them.

2.118. Two members, Mrs Kingsmill and Professor Cave, thought it significant that the first all-Scotland account for which Express/Claymore and Wiseman competed was CWS—previously Claymore's largest customer—and that it was Wiseman which initiated the negotiations for this account. They began from the position that, although inconclusive discussions had taken place between Wiseman and CWS over an all-Scotland contract in 1997, it was only after Express's acquisition of its interest in Claymore, in December 1998, that Wiseman contacted CWS with a firm quote to service its stores in the Highlands and Islands. This initiative, launched by Wiseman, led to competitive bidding with Express/Claymore which, in turn, led to Wiseman winning CWS's all-Scotland contract by the end of February, and beginning to supply its stores from May 1999.

2.119. For these members, this exchange raises the question of whether Wiseman was attempting to weaken Express/Claymore by offering to supply CWS at an anti-competitive price. In their opinion, the starting point for investigating this question should be the status quo ante, in which Wiseman supplied stores in the Central Belt and Grampian and Express/Claymore northern Scotland. In their view the relevant question concerns the pricing of Wiseman's bid for the CWS stores previously supplied by Express/Claymore.

2.120. The next step that these members took was to apply two tests to seek to establish whether Wiseman was offering prices for the purpose of exploiting or maintaining its monopoly position, by attempting to eliminate or weaken a competitor. The first involved comparing the price offered with the average variable cost (AVC) of supply, ignoring fixed costs. The second, and less stringent, test involved comparing the price with average total costs (ATCs). The investigation in paragraphs 3.111 to 3.114 shows that the revenue derived by Wiseman in the year March 1999 to February 2000 fell just short of covering its ATCs. The further analysis in paragraphs 4.340 to 4.349 of Wiseman's revenues in the first year of the all-Scotland CWS contract (May 1999 to May 2000) reaches the same view.

2.121. To discover whether Wiseman priced northern Scotland CWS business at less than variable cost, these members sought to establish the implicit price offered for this incremental business. Paragraphs 4.340 to 4.349 endeavour to calculate this price on the basis of alternative assumptions about what Wiseman would otherwise have charged for the part of the CWS contract it already held. Depending upon which assumption is used about what might have happened to prices in the absence of any negotiation for the Highlands and Islands stores, the extra Express/Claymore business was won at a price which lies in a range from [§<] per cent below to [§<] per cent above Wiseman's estimate of AVC—this latter figure also being [§<] per cent below Wiseman's ATCs.

2.122. In the case of its contract with Mace/Aberness, Wiseman also failed to cover its ATCs—to the extent of [§<]p on every litre of processed milk which it sold in the year to July 2000—although it did more than recover its AVC (paragraph 4.354 analyses the figures for the year July 1999 to July 2000; paragraphs 3.111 to 3.114 for the year March 1999 to February 2000).

2.123. To evaluate Wiseman's conduct, the two members not only investigated the relation between cost and price, but also considered whether it was feasible for Wiseman to put in place an anti-competitive pricing policy which would have the effect of eliminating or significantly weakening Express/Claymore. Express said that it had suffered significant losses on its investment in Claymore, and intended [*Details omitted. See note on page iv.*]. In their opinion, the factors outlined in paragraphs 6.24 to 6.35 indicate that the conditions in the Scottish market—which they believe to be separate from the rest of Great Britain for middle-ground retailers—are such that Wiseman can reasonably expect its conduct to have the effect of eliminating or significantly weakening Express/Claymore.

2.124. On the basis of the evidence relating to cost and prices, and in the light of Wiseman's acknowledgement that the nature of its response to Express's entry was different from the way it would have responded to a company with which it was not already a major competitor in England (see paragraphs 5.47, 5.54 and 5.55), they conclude that its conduct in this regard has been anti-competitive.

2.125. Next, these members turned to the question of whether Wiseman has targeted its response to Express's entry by focusing its price cuts in areas where it has been subject to increased competition. Paragraphs 4.320 to 4.329 show that the differential between the weighted average price charged to shops other than supermarkets and to the larger supermarkets for milk delivered from Wiseman's Keith depot—the one from which its customers in the Highlands and Islands are supplied—fell between 1997/98 and 1999/2000 by [3.8] percentage points, while other depots demonstrated a [2.8], even after accounting for the change in the composition of deliveries from Keith between these two dates. In any case, by 1999/2000, competition between Wiseman and Express had spread from northern Scotland, where Express told us that Wiseman had first sought Express/Claymore's smaller middle-ground business from March 1999, to the Central Belt, where Express/Claymore sought business after it had lost several of its major northern Scotland contracts to Wiseman.

2.126. Wiseman told us that its response to Express's entry was not the same as it would have been had another firm bought a controlling interest in Claymore. In particular, it did not think it acceptable to continue the subcontracting arrangements with Express/Claymore that it had previously had with Claymore. It said that in the case of other entrants it would have waited to see how they intended to compete before deciding how to respond. In the case of Express, a different strategy was deliberately adopted. Wiseman's response took the form, among other things, of a successful attempt to gain the business of Express/Claymore's largest customer at a price below ATCs. It also entered into contracts with other large middle-ground retailers, which Claymore had previously supplied, at prices that failed fully to recover their ATCs, in one case seeking an exclusive agreement. So these members conclude that these were uncompetitive steps taken by Wiseman for the purpose of exploiting and maintaining its monopoly position.

2.127. The other two members, Mr Clothier and Mr Mackay, come to a different conclusion about Wiseman's behaviour on pricing. Their starting point too was an examination of Wiseman's contest with Express/Claymore over the CWS contract at the start of 1999. But they attached more importance to what CWS told us about its discussions with Wiseman during 1997 and 1998 on an all-Scotland contract to replace the arrangement where Claymore supplied its stores in northern Scotland and Wiseman supplied the rest. CWS had experienced a quality problem in the milk it had received from Claymore in 1996, and had consistently faced higher prices from Claymore than from Wiseman—both factors that had encouraged it to approach Wiseman in the first place. But it was not until January 1999, just after Express's acquisition of Claymore, that Wiseman contacted CWS with a firm quote. CWS told us that it had then given Claymore the opportunity to bid for an all-Scotland contract too. But, as it was unable to match Wiseman's price of around [2.8] ppl ([2.8] ppg), Wiseman secured all CWS's business in Scotland.

2.128. Subsequent to the deal being concluded, Express approached CWS to ask if there were any way in which it could win the business. CWS told Express that it would be happy to look at a fresh bid at the end of 1999, if Express/Claymore wished to make one. CWS told us that it had heard nothing since (see paragraph 6.109).

2.129. These members accept that an analysis of Wiseman's own figures (see paragraph 4.348) suggests that the price at which the CWS stores that Claymore previously serviced were gained by Wiseman was below ATCs, and possibly below AVCs depending on how the contract is viewed. However, as the contract was not for these outlets alone but for all CWS's stores in Scotland, these members feel that that is the basis on which the contract should be considered. From that point of view, the price offered was above AVCs. Wiseman told us that once a price for supplying all of Scotland had been offered to CWS and competitive bidding was under way with Express/Claymore, there was no going back to the status quo ante. It was clear to Wiseman that the competition was as much about keeping its (much more substantial) contract to supply the CWS stores in the south of Scotland as it was about winning the smaller amount of new business further north. As CWS was already its sixth-largest customer in Scotland, Wiseman told us that retaining the existing volumes was central to the overall efficiency of its Scottish operations. CWS told us that the price that it was paying to Wiseman in Scotland was very similar to what it paid its other suppliers elsewhere in the UK and that, after a fall relative to English and Welsh prices between September 1997 and July 1998, Wiseman's prices had moved pretty much in line ever since. For example, in June 2000 the price that Wiseman was charging CWS fitted exactly between that charged by Unigate in Wales and south-west England and Arla in northern England. And the reduction in Wiseman's prices in 1999 and 2000—after Express took its stake in Claymore—was mirrored by similar falls in the prices charged by suppliers elsewhere in the country (see Table 4.9).

2.130. The way in which contracts with major middle-ground chains—CWS, Alldays, Aberness (including Mace), C J Lang & Son Ltd (C J Lang) (Spar), Morning Noon & Night—are seen is central to an understanding of how these members reached the view that they have. First, most take the form of a shift from a situation where Wiseman and Express/Claymore were both supplying the same retail chain (on a southern Scotland/northern Scotland split) to one where each company was bidding for the all-Scotland business of the retailer (or, in the case of Alldays, the all-Scotland and northern England business). As is clear from its strategy paper, Express recognized from the outset that winning all-Scotland contracts of this sort would be a key element in establishing itself north of the border. So it is not surprising that the initiative for all but one of these deals came from Express/Claymore approaching the retailer in question. The exception is CWS, where Wiseman was responding—albeit belatedly (see paragraph 2.127)—to a request from the chain itself for an all-Scotland proposal. In all cases both suppliers were negotiating for contracts that defended their existing business at the same time as offering the prospect of new business. Given that most of the Scottish population lives south of Aberdeen, the balance between the two dairies was that Wiseman was defending much more business than it was seeking to gain and Express/Claymore was seeking to gain more business than it was defending. That is why these members have chosen to view the resultant supply contracts as a whole in deciding whether or not Wiseman was making a loss on them, rather than focus just on the new business that it won. As Wiseman stressed to us, the commercial reality is that, once negotiations for all-Scotland deals were under way, there was no prospect of reverting to the status quo. The volumes that Wiseman was processing for these major middle-ground retailers—especially CWS—were so large that they played a key role in the overall efficiency of its processing plants in Scotland, which had been designed to minimize costs by maximizing the scale of their throughput.

2.131. These two members are satisfied that, while the level of profitability on Wiseman's Scottish middle-ground business has certainly been reduced—in some cases very substantially—by the current level of competition over pricing, it is not failing to cover at least its variable costs on any of the contracts presently in place (see paragraphs 3.111 to 3.114); and they do not

believe that the level of Wiseman's prices to middle-ground retailers in Scotland can, in itself, be seen as anti-competitive.

Effects on competitors

2.132. These members, Mr Clothier and Mr Mackay, then looked in more detail at the impact of this price competition on the profitability of Wiseman's main competitors in Scotland. Although none has been untouched by it, the effect on their financial position has varied considerably. Graham's has continued to operate profitably and has achieved improved figures compared with the previous year (paragraphs 3.64 and 3.65). SMD made a small loss, although this was attributable to intense international competition in the UHT market as much as to the fall in fresh milk prices in Scotland (paragraph 3.71). By far the largest losses suffered by Wiseman's competitors were those sustained by Express/Claymore (paragraphs 3.41 to 3.46). So they looked carefully at whether these losses could be attributed to Wiseman's behaviour.

2.133. Express's original intention, when it was planning its move north, was to supply customers throughout Scotland by acquiring a controlling interest in a dairy in the Central Belt, another in northern Scotland and, perhaps, by transporting milk from its own major dairies in Middlesbrough or Manchester. The decision to take a stake in two Scottish dairies, rather than take them over, seems to have been motivated, at least in part, by a desire to minimize costs at the outset of the operation. The subsequent decision to try to do everything from Nairn—following the failure to acquire Gilmours (see paragraph 2.19) and Express's perception that Scottish consumers would not buy English milk—seems to these members to have contributed to its current losses. The Claymore dairy, while relatively modern, is thought, by a number of those to whom we spoke, to be less efficient than Wiseman's larger plants. It lies in an area where the local milk field lacks the capacity to supply customers throughout Scotland, and is located at a greater distance from most of the Scottish population than rival Scottish dairies or even the northernmost English ones. So these members are not surprised that it is proving a costly base from which to support Express's operations in Scotland.

2.134. The Nairn plant had been meeting the needs of Highlands and Islands customers, and of the dairy farmers who owned it, with reasonable success. But it is clear from Express's board paper setting out its strategy for Scotland that it did not take its stake in Nairn simply to continue with the traditional business (paragraph 6.13). It had understood from the start that the larger supermarket and middle-ground retail chains north of the border required an all-Scotland supplier and that success depended on being able to meet orders in the Central Belt as well as further north. On the basis of figures which Express gave us, it appears to these members that the Scotland-wide operations which Express/Claymore sought to mount from Nairn (having failed in its attempt to acquire a dairy in the Central Belt) would have been barely profitable even at the prices achieved in 1998 (see paragraphs 3.41 to 3.46 and Appendix 3.8). Claymore would have been profitable had it continued to operate in its traditional area, supplying its traditional customers and using its own raw milk. The decision to supply customers further afield, which required Express/Claymore to buy in additional raw milk from elsewhere, added unprofitable new business. So, while the price-cutting competition with Wiseman has made Express/Claymore's losses worse, its profitability would have been under pressure even at the earlier price levels.

2.135. Express's latest plan, to supply some of the Central Belt through a milk packaging agreement with SMD and to make use of an existing food depot rather than one exclusively devoted to its milk (see paragraph 2.22), may be a recognition of this and appears to these members to hold out the prospect of improving its results.

Wiseman's intent

2.136. These members completed their consideration under this heading by examining the intent that lay behind Wiseman's behaviour on pricing. They have little doubt that Wiseman perceived Express's arrival in Scotland as a significant and deliberate challenge to its position in a part of the country where it had been developing an increasingly strong presence over a number of years. Wiseman explained that it was because of its experience of competing with Express in other parts of the country that its actions following Express's arrival in Nairn were both swift and vigorous. It told us, at a joint hearing with Express, that its response might well have been different had Claymore sold a controlling interest to a firm which was not already a major UK competitor. Within a short time, the two companies were engaged in intense competition over customers and prices. These members' view is that in gaining CWS's business in northern Scotland—formerly Claymore's most important customer—the price Wiseman offered was justified commercially, did not involve pricing the contract below AVCs, and was consistent with those charged by CWS's suppliers in other parts of Great Britain. But they question whether Wiseman would have gone for this business so vigorously and so quickly—or responded so forcefully to the bids made from Nairn for all-Scotland contracts with other retail chains in the early months of 1999—had Express not taken its stake in Claymore.

2.137. These members do not consider that Wiseman's pricing of these contracts was anti-competitive, and they regard its pricing policy, and its negotiations with customers, as no more than a defensive and matching response to an aggressive sales campaign by Express/Claymore offering prices that were likely to cause it to make losses. But these members do consider that Wiseman responded to the threat from Express in a rapid and wide-ranging manner, even though they do not regard that as having been an uncompetitive practice. They therefore conclude that Wiseman has not taken any steps to exploit or maintain its monopoly position engaged in any acts or omission attributable to it, except for the speed and wide-ranging manner in which it went about targeting Express/Claymore's major customers in northern Scotland in the period immediately after Express acquired its controlling stake, which these members regard as a step that could have had as part of its purpose the maintenance of Wiseman's monopoly position.

2.138. The Group's final answers to questions (c) and (d) are that they all concluded that the steps taken by Wiseman in acquiring Gilmours and AMCo—albeit with the consent of the DGFT—could have had, as part of their purpose, the maintenance of its monopoly position. Two members, Mrs Kingsmill and Professor Cave, also concluded that Wiseman's conduct between 1996 and 1998 in respect of charging excess prices was a step taken for the purpose of maintaining its monopoly position and Wiseman's failure to compete with Claymore from 1994 to 1998 constitutes an omission attributable to the existence of the monopoly. These same members also regard Wiseman's seeking an exclusive supply agreement with Aberness and the payment of £[] made in connection with it, as a step taken for the purpose of maintaining monopoly position. Last, they concluded that Wiseman's entering into contracts with former customers of Express/Claymore at prices which did not cover their total average costs—and on some assumptions AVCs—was for the purpose of undermining Express/Claymore's continued presence in Scotland and constituted uncompetitive steps taken by Wiseman for the purpose of exploiting and maintaining its monopoly position. The other two members, Mr Clothier and Mr Mackay, in part because they did not agree that the CWS contract should be viewed on an incremental basis, dissented from these conclusions, but themselves concluded that the speed and wide-ranging manner in which Wiseman went about targeting Express/Claymore's major customers in northern Scotland in the period immediately after Express acquired its controlling stake was a step that could have had as part of its purpose the maintenance of its monopoly position—although they do not regard it as being by way of an uncompetitive practice.

The public interest

2.139. It now remains for the Group to answer the last of the DGFT's questions, (*e*), whether any of the facts that we have found operate, or may be expected to operate, against the public interest. Again, the response is a divided one.

The views of Mrs Kingsmill and Professor Cave

2.140. These members consider that their analysis of the facts that the inquiry has brought to light indicates that, in the period between 1996 and 1998, Wiseman enjoyed substantial market power in the supply of processed milk to the middle ground in Scotland (although the scope for the exercise of that power has been reduced by the growth of the share of the retail market accounted for by the larger supermarkets). In their view, the competition provided to Wiseman by other smaller processors in Scotland was limited until 1998. They have concluded that during this period retail prices in Scotland were excessive and that this was in large measure due to Wiseman, which was responsible for more than half the sales.

2.141. Their view is that, when Wiseman was confronted at the end of 1998 with the prospect of competition of a different kind, its policy—as the company itself has acknowledged—changed. Instead of accepting the change in ownership of Claymore—as might have been expected given the substantial market power Wiseman enjoyed in the supply of fresh processed milk to the middle ground in Scotland—it responded aggressively by seeking to take away Express/Claymore's major customers.

2.142. These members do not accept Wiseman's argument that its conduct in Scotland was justified because it was dealing with an entrant of larger size, with which it competed in the rest of Great Britain, because their conclusion is that the geographical market in this case is Scotland. Their view is that Wiseman is subject to constraints on its behaviour which are not conditional upon the identity of the (much smaller) competitor in its market. By the same token, they point out that Wiseman is subject to the same protection under competition law in any market where it might be dealing with a firm with significant market power.

2.143. Looking ahead, these members perceive serious risks to the long-term prospects of competition in Scotland if Wiseman is permitted to persist in its recent conduct. They consider that Express will have been discouraged by Wiseman's behaviour over the past year or so and, as a result, they judge it unlikely that Express will continue to sustain losses at the Express/Claymore dairy indefinitely and expect that it will leave Scotland. The increased competition which Express has brought to the Scottish market is, therefore, likely to be extinguished, in which case they expect competitive conditions in Scotland to revert to the situation pertaining before Express's entry. They do not share the view of the other two members that customers in Scotland, having enjoyed the fruits of competition, will be in a position to take steps to prevent prices rising. Unless there is a significant change in the structure of the market, they expect that competition will continue to be muted, with the remaining smaller processors offering little competition to Wiseman (as they judged was the case before Express's entry) and that prices will rise to above competitive levels. They expect that, as with many markets with one player with significant market power and a competitive fringe, competition will revert to its former muted form.

2.144. Although it has also been suggested that the growing practice of national retail chains contracting for supply at a single price for all, or for a large number, of their stores prevents the exploitation of market power in a particular market which makes up part of that contract, these members do not consider that it is necessarily so. Their view is that a national price can be constructed from separate prices charged in each market, each reflecting the supplier's degree of power in that market. Buyers such as the larger supermarkets may possess enough bargaining strength, reflecting the size of their purchases in England and Wales, to

resist the exercise of market power by the seller, but they are far from certain that middle-ground purchasers of processed milk in the Scottish market have similar strength.

2.145. These members conclude that the facts that the inquiry has found operate, and may be expected to operate, against the public interest.

The views of Mr Clothier and Mr Mackay

2.146. These members take a different view on the public interest, not least because they have reached a different conclusion about the geographic market and because they see the competition between Wiseman and Express/Claymore less as a Scottish contest between a monopolist and a medium-sized dairy, and more as an aspect of a wider rivalry between the UK's largest processor of fresh milk (Express) and a rapidly growing dairy (Wiseman) that has won a considerable amount of business in northern England and the Midlands during the last decade as a result of its investment in very large modern plant. It is significant to them that—as Express's latest accounts make clear—it is Express that is financing the losses being made in Nairn and that it is its 'deep pockets' that are involved rather than the much more modest resources of its 49 per cent partners in the enterprise.

2.147. Then they point out that, since the end of 1997, the prices that Scottish middle-ground retailers pay for fresh processed milk have declined even more rapidly than the reduction in raw milk costs would justify. And, for the last year or so, the differential that used to exist between prices north and south of the border has disappeared. Consumers have benefited too, so that Scottish retail prices in the middle ground are also now at levels similar to those in the rest of Great Britain.

2.148. Then they draw attention to the fact that the retailers that the Group spoke to appear very content with the quality of Wiseman's service, and most characterize its stance on prices in the period immediately after December 1998 as being a reaction to cuts proposed by Express/Claymore (for example, see paragraphs 6.81 and 6.141). One sizeable chain said that Wiseman had refused to match very low prices being offered by Express/Claymore, but that it had chosen to stay with Wiseman anyway because of the quality of its service (see paragraphs 6.82 and 6.83).

2.149. Their initial response to the facts found during this inquiry is that the immediate outcome of the changes that have taken place in Scotland over recent years has not been harmful to the public interest. Competition has been introduced into areas—particularly northern Scotland—that have not previously seen much of it. There has been an increase in the choice available to middle-ground retailers, and a fall in prices to levels that match those elsewhere in Great Britain.

2.150. Their view is that Wiseman's behaviour has not prevented Express from establishing itself in Scotland—although it has meant that it has had to work extremely hard to do so.

2.151. They went on to consider whether the lower prices, to which Express's arrival in Scotland (and the competitive response to it) has been a contributory factor, could be sustained in the longer term. In their view, it is clear from the papers it has shown to the Group that Express assumed that Wiseman's reaction would be to try to see it off, and that this would initially damage margins for both companies (see paragraph 6.14). This is indeed what has happened—although to a rather greater extent than Express had expected.

2.152. These members believe that Wiseman's reaction to Express's entry should be seen as a legitimate response to the arrival of a major and deep-pocketed competitor. It was competing head-to-head with Express in England and, given their national rivalry for

supermarket and for much of the larger middle-ground business, it was both understandable and justifiable for Wiseman to react as it did to the arrival in Scotland of its largest competitor.

2.153. The position that Express itself is likely to take in future must be an open question. Although it has told its customers that it is in Scotland for the longer term, and it strongly disputes Wiseman's contention that its move north of the border was, in part, a spoiling tactic designed to discourage Wiseman from extending its operations in England, these members accept that Express's experience so far in Scotland has been expensive. Clearly one element in its attitude will be to watch what happens to prices. Express told the Group that when, in 1998, it was developing its strategy for extending its operations to Scotland, it calculated that the difference between middle-ground retail prices in Scotland and England and Wales—which it characterized as Wiseman's monopoly profits—equated to over 8 per cent (see paragraph 6.12). Our figures show, however, that the differential had begun to fall at the beginning of 1998 and, by the time of Express's arrival at the end of that year, was close to half the figure it had calculated. It has since disappeared altogether (see Figure 4.9). These members do not consider that the geography of Scotland justifies higher prices than in the rest of Great Britain—at least for the great majority of the population. Although parts of Scotland, particularly the Highlands and Islands, are remote and present distribution problems, 80 per cent of the Scottish population lives in and around the Central Belt where population densities are not very different from those in other urbanized parts of the UK. Even the Grampian region, dominated by Aberdeen, is not dissimilar from parts of England and Wales. So it is only in the northernmost parts of Scotland that population sparsity reaches levels not seen elsewhere in the country. That being so, they do not consider that any significant differential in middle-ground prices is justifiable on cost grounds throughout most of Scotland—although a small margin, in some remoter parts may be.

2.154. It will be for Express to decide whether it wishes to stay in Scotland but even if it does not, the Group has been told during the course of this inquiry that at least one, and perhaps two, major English processors are currently considering entering (or re-entering) Scotland, by supplying milk directly from England, by setting up a processing plant north of the border, or by establishing a joint operation with a Scottish dairy (see paragraphs 4.131 and 6.3). This indicates that Wiseman's recent behaviour is not seen as a barrier to entry by processors south of the border. And, although its other Scottish rivals, Graham's and SMD, find it challenging to do business at these levels, they are continuing to be very active, not least because they are successful in serving customers located reasonably close to their dairies and in areas of relative high population. Graham's has also won an important contract that straddles the border. So, these members consider that there are good prospects for continuing competition in the supply of fresh processed milk in Scotland. They also expect that, even if Express does decide to leave Scotland, someone else will take over its stake in Claymore, which they see as an attractive business with a fairly isolated customer base and its own milk field. Their view is that if it does not try to haul milk in and out of Nairn over long distances, then it should be profitable.

2.155. In the view of these members, the other vital element in whether current levels of competition can be sustained is the attitude of the larger middle-ground retailers—which are becoming an increasingly important part of the sector as more and more sole traders are taken over, go out of business, or elect to join buying groups. The representatives of retail chains and symbol groups that the Group spoke to had differing perspectives about whether the prices they paid for milk in the past were out of line with those elsewhere in the country. But as Scottish prices had now clearly fallen to levels similar to those in England and Wales, they were very definite that they were not going to accept a differential in future. They were confident that they could prevent this happening by negotiation, by making maximum use of the competition potential among existing Scottish suppliers, and—if necessary—by buying milk from English ones. Although this might require them to do more distribution themselves, they did not see this as an insuperable hurdle as they already had arrangements in place to handle chilled foods. And they were not concerned about consumer reaction to milk not being produced in Scotland, as it would simply be labelled with their name (for example, see paragraphs 6.92, 6.96 and 6.108).

These members see this new attitude reflecting a growing confidence among volume buyers—whether the CRTG, retail chains, or symbol groups—which is creating middle-ground customers with a buyer power and geographic range that is seeking to rival the larger supermarkets.

2.156. Another development to which these members attach importance is the increasing preference of these groups for a single national contract—or at least one that is more than simply local—to supply a large number of outlets (see, for example, paragraph 6.110). This reinforces their view that much of the middle ground is now part of a Great Britain market. [§] recent contract with Graham’s is a current example. Another is Wiseman’s contract with Alldays, which involves a single price for supplying milk to stores throughout Scotland and England down as far as Birmingham. Alldays’ requirements for the rest of the country are met by a second contract with another major processor, which covers everywhere else. These members expect that the Scottish middle-ground retailers which are supplied through such national, or at least cross-border, deals will provide a further constraint on any attempt to return to differential pricing.

2.157. They see all these developments as positive, and judge that they should help to foster competition within Scotland and act as a further encouragement to those currently outside who have expressed an interest in doing business there. They also recall that we were told that, despite Wiseman’s strength in Scotland as a whole, in almost every locality the smaller middle-ground retailers had at least one other milk processor to choose from: either one of the main Scottish suppliers—Express/Claymore, SMD or Graham’s—or one of the much larger group of small dairies or farmer/processors who collectively account for some 17 per cent of supply to middle-ground retailers as a whole, and for a much higher proportion of the smaller independent retailers (see Table 4.14).

2.158. These members acknowledge that Wiseman is a very effective operator in the processing and supply of fresh milk. Its plants, in Scotland and England, are technically advanced, and two in particular are very large, maximizing the potential for economies of scale in processing. Its transport fleet and network of depots north and south of the border are modern and efficient, and enable it to move substantial quantities of milk—largely from Bellshill, Aberdeen and Manchester—over long distances to supply its (mainly supermarket) customers throughout Scotland and well down into England. But, that said, they do not consider that Wiseman’s behaviour has prevented other suppliers from entering Scotland, nor from actively planning to do so.

2.159. Although these members have identified some steps that Wiseman has taken over the last year or so that could have had the purpose of maintaining its monopoly position in Scotland, they do not regard them as arising from any uncompetitive practices; nor do they regard them as having serious significance for competition in the supply of fresh processed milk north of the border which, in their view, continues to be effective. Neither do they consider that ease of entry into Scotland has been affected.

2.160. The conclusion of these members is that none of the facts that have been found in the inquiry operates, or may be expected to operate, against the public interest.

Conclusion

2.161. As will be clear from a number of passages in this report, the Group was evenly divided over how a number of the facts found in this inquiry should be interpreted. In these circumstances, the Act allows the Chairman a casting vote. Mrs Kingsmill has cast this in favour of the conclusion that the facts that have been found in the inquiry operate, and may be

expected to operate, against the public interest. So that is to be regarded as the Commission's view in this inquiry.

2.162. However, as there was not support for this conclusion among at least two-thirds in number of the Group of members of the Commission who carried out the inquiry, it does not form a basis upon which the Secretary of State would be in a position to impose remedies to deal with the detriment to the public interest that two members have identified.

2.163. In other circumstances, the Group would have gone on to consider what remedies might be appropriate to deal with the detriment to the public interest that these members have found. But as, in the case of this inquiry, the requirement for a two-thirds majority has not been met, the Group has not considered remedies further, noting, however, that the Competition Act 1998 has been in force since March 2000; that it prohibits anti-competitive agreements and abuses of a dominant position; and that in the event of a breach of either prohibition measures may be taken, including the imposition of a fine. The Group has no locus to consider, and has consequently reached no view on, whether either prohibition has been breached by any of the companies mentioned in this report.