5 Views of Wiseman

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Introduction

5.1. This chapter summarizes the views of Wiseman as presented at hearings and in various submissions and responses to questions.

Background

5.2. Wiseman said that its business consisted principally of the processing of raw milk and the supply of fresh pasteurized liquid milk and cream. It currently served customers in Scotland, Wales, northern England, Birmingham and as far south as Gravesend. Wiseman's business had grown rapidly in the last ten years and it now had turnover of £286.7 million for the year ended March 2000, compared with just £32 million in the year to March 1991. This growth was partly the result of significant investment in new facilities, and partly from acquisitions. The company also said that its growth reflected the rapid increase in market share of the larger supermarkets (see the glossary for the precise definition) in the sale of milk at the expense of doorstep deliveries.

5.3. Wiseman said that it had foreseen the growth in the sale of milk through the larger supermarkets and had taken advantage of decisions by a number of long-established family dairy businesses in Scotland to leave the industry. In the early to mid-1990s it had acquired the liquid milk business of the Kennerty, Hamilton and Mackies dairies. By the mid-1990s it was supplying about half the Scottish requirement for fresh processed milk. It had also acquired the Scottish liquid milk business of CWS; its largest purchase in volume terms had been of Scottish Pride, from the receiver, in 1997. This had increased its share of the supply of fresh processed milk in Scotland to close to three-quarters (Wiseman's estimate was 70 per cent). The resulting business was of such a size that Wiseman had been able to invest in efficient modern processing units, thereby enabling it to satisfy the demands of the larger supermarkets. For example, Wiseman had invested £24 million in its Bellshill dairy since its construction on a greenfield site and had also invested approximately £10 million in upgrading the dairy at Tullos (Aberdeen) which it had acquired when it purchased Kennerty.

5.4. Following its acquisition of Scottish Pride, which was the subject of an earlier Commission report,[1] Wiseman was required to give undertakings, including that it would seek the prior consent of the DGFT before purchasing any further dairies capable of processing more than 1 million litres a year. This consent had been given before it acquired an 80 per cent shareholding in April 1999 in Gilmours, one of the few remaining independent processors of any size which, Wiseman said, supplied about 3 per cent of the fresh milk sold in Scotland at the time. Gilmours operated mainly in the Ayrshire part of the Central Belt. Wiseman had subsequently bought the remaining shares in the company. The DGFT had also agreed to the company's purchase in May 1999 of AMCo, based in Aberdeen. AMCo was a raw milk producers' co-operative which, Wiseman said, supplied about 7 per cent of raw milk in Scotland. It had also had some processing capacity, although not for liquid milk.

5.5. The company's growth had also been the result of other significant greenfield investment. In 1991, Wiseman had opened a depot in Manchester at the request of two relatively small supermarkets, Farmfoods and Capital Foods Retail Limited (Capital). Wiseman had floated on the London Stock Exchange in 1994 and with the resulting funds was able to open a purpose-built state-of-the-art dairy in Manchester in 1995 which, it believed, was the most efficient dairy processing unit in the UK. The company had subsequently established distribution depots in Leeds and Wolverhampton which were now supplied from its Manchester dairy. Wiseman had so far invested more than £55 million in its English facilities.

5.6. Wiseman said that it would also shortly open a new dairy and depot in Droitwich (scheduled to be operational in March 2001), at a cost of £32 million. Further depots would be opened in southern England to support distribution from this site. Wiseman anticipated that it would eventually need to open another dairy in the South of England to be able to provide a service throughout Great Britain.

5.7. As a processor Wiseman was concerned only with fresh processed milk and cream production. The company's sales, 82 per cent of which were to the main supermarkets in Scotland and England, amounted to 800 million litres a year (annualizing the figures for February 2000) of which 421 million were in Scotland and 379 million in England. In Scotland, Wiseman's ability to deliver milk to consumers now covered the whole country, although it used contractors to deliver to the Western Isles. It had four dairies in Scotland. The functions and production processes in each were the same. The differences between them lay in what was packed at each plant:

[1]See footnote 1 to paragraph 2.27.

— Bellshill in Glasgow (277 million litres a year) was a high-volume producer, especially for supermarkets.

— East Kilbride (37 million litres a year) was a specialist dairy producing products such as school milk, flavoured milk and cartons of cream. Starting in the late summer of 2000 it was also being utilized to process and pack organic milk.

— Rutherglen (12 million) only packed milk into glass bottles. It supplied Wiseman's depots in the Central Belt and in Carlisle with bottled milk.

— Aberdeen (129 million) was similar to Bellshill but also had some of the characteristics of East Kilbride and Rutherglen.

Once the milk was packed it was despatched to one of the seven depots Wiseman had in Scotland—from Keith in the North to Kilmarnock in the South of the country and to Carlisle in England.

5.8. Wiseman classified its customers as follows:

(a) supermarkets: broadly, the larger supermarkets (see glossary);

(b) other supermarkets;

(c) other shops: independent retailers and customers;

(d) sub-purchasers: those that bought milk for onward sale to the ultimate consumer;

(e) doorstep: franchisees or Wiseman employees, responsible for deliveries to homes;

(f) catering/hotels: restaurants, hotels and assorted small manufacturers; and

(g) public sector bodies.

Recent developments in the industry in Scotland

5.9. There were a number of specific events and developments that had affected Scotland since 1996. These had included, principally: the extension of the shelf life of milk (from 10 to 12 days) allowing milk to be transported further and/or depots to hold more stocks for customers; the benefit to the cost of transporting milk which the growth in supermarket sales had provided; the acquisition of a controlling interest in Claymore by Express in December 1998 and Express/Claymore's subsequent decision to increase processing capacity by at least 20 million litres a year along with Express's investment in a depot in the Central Belt, at Coatbridge. In addition there had, of course, been Wiseman's own acquisitions of the Scottish Pride liquid milk business in March 1997, of Gilmours in April 1999 and AMCo in May 1999. Alongside this had been Scottish Milk's acquisition of Drakemire (now SMD) which had begun in February 1998.

5.10. According to Wiseman, the mergers which had most affected the dairy industry in Scotland were Wiseman's acquisition of Scottish Pride's liquid milk business assets and Express's purchase of a majority shareholding in Claymore. The company considered that there had been no adverse impact on consumers as a result of its Scottish Pride acquisition. Indeed competition for middle-ground customers had increased—evidenced by Wiseman's post-acquisition volume being more than 50 million litres below the expected combined volume at the time of the Commission's report into the merger.

5.11. The Express/Claymore venture and the opening by Express of its Coatbridge depot, however, had been followed by intense competitive activity in which Express/Claymore had systematically targeted Wiseman customers with what, Wiseman believed, were below-cost price offers; although it was uncertain whether the price reductions were being passed on to consumers. Wiseman believed that Express's entry into the market in Scotland was motivated by a desire to destabilize Wiseman as a result of its successes in England.

Strategy

5.12. The company said that its strategy was to continue to provide a high standard of service and quality and it had invested heavily to achieve this. It also planned to continue its strong growth in England. It had been particularly successful as far as sales to the larger supermarkets—the main growth sector in milk sales—were concerned. But Wiseman was also concerned to retain and obtain middle-ground customers, where these provided a positive financial contribution to the business. It would hold to this aim even though it had experienced margin pressure and lost custom as a result of Express/ Claymore's aggressive pricing tactics in the middle-ground segment of the market following Express's acquisition in December 1998 of a 51 per cent stake in Claymore.

Jurisdiction

5.13. The company accepted that, for the purposes of the Act, it possessed a scale monopoly in respect of the supply of fresh processed milk to middle-ground customers in Scotland. However, it maintained that its share of supply in Scotland did not confer market power given that, in its view, the market was Great Britain-wide and that in any event, the middle ground in Scotland was highly 'contestable'. In any case, the finding of a scale monopoly in Scotland did not indicate that the scale monopoly itself was contrary to the public interest. It was not uncommon in the UK dairy industry to find dairies with large shares of supply in particular regions. For example, Unigate/Dairy Crest would account for over 70 per cent of fresh milk supplies in the South-West. Equally, Express accounted for approximately 70 per cent of milk supplies in Merseyside.

5.14. Wiseman estimated that its current share of supply to the Scottish middle ground, as defined for the purposes of this inquiry, was 70 per cent. Wiseman currently estimated its share of supply of fresh processed milk in Scotland, other than to the Scottish stores of the larger supermarkets, to be 57 per cent.

Market definition

Geographic market

5.15. Wiseman said that the relevant market was that for the supply of all types of fresh milk to all types of retailers in Great Britain. However, it also believed that it was not necessary for the Commission to reach a definitive conclusion on market definition to resolve its inquiry since, whatever market definition was adopted, Wiseman's position in Scotland was fully contestable and its actions were defensible and not contrary to the public interest.

5.16. The reasons for Wiseman's view that the relevant geographic market was national (ie Great Britain-wide) were of different kinds, but compelling. First, distances over which milk could be transported had continued to increase in recent years because of several factors: the increased use of depots was one. For example, in 1991 Wiseman had established a depot in Manchester on the basis of a promise to supply the Farmfoods chain and had transported milk for a period of four years from its Bellshill dairy in Glasgow, a distance of approximately 200 miles. Once milk had been transported in bulk to a depot many miles away, it could then be transported even further to individual customers, almost as if the depot were itself a local dairy. Another was the increased proportion of milk sold by supermarkets. The higher volumes purchased by supermarkets meant that processed milk could be profitably transported over longer distances. Lastly, the shelf life of milk had continued to increase from an average of eight days in 1992, to ten days in 1996 and an average of 12 days today. This provided further latitude to transport milk from dairies to depots and on to retailers who could be a considerable distance from the dairy. Shelf life had been extended as a result of a number of developments: improvements in raw milk quality due to refrigeration and farm controls at the producer end; improvements to temperature control during storage, processing and filling; improvements in plant and machinery cleaning; and investment in plant and machinery to prevent contamination and to secure maximum hygiene at the milk packing stage.

5.17. The second reason for Wiseman's view that the geographic market was Great Britain-wide was that each region of the country was linked by an unbroken chain of substitution. Throughout Great Britain, there were large overlaps between the areas supplied by rival companies, meaning that many customers could be supplied by more than one dairy. If a dairy attempted to increase prices in its

immediate locality, a sufficient number of customers could switch to a supplier in a neighbouring region to render such a price rise unprofitable. This continuous chain of substitution constrained prices both locally and nationally. There were various examples of dairies expanding into new areas by opening depots, including Express, which had established a depot in Coatbridge that could be supplied by Express/Claymore's Nairn dairy or by the Express dairy in Durham. Arla (formerly MD Foods) had had a distribution facility at Sainsbury's in central Scotland from 1997 to 1999 that was supplied by its Newcastle dairy. There was also a possibility that Arla might return to the market in Scotland, as might ACC.

5.18. The third reason was that road links between and within neighbouring regions were now more efficient, and those between northern England and the Central Belt were just as efficient as, say, the road links between Wales and the West of England. This, combined with larger lorries, more up-to-date packaging techniques, and the greater availability of refrigeration on farms, vehicles, dairies and depots, meant that milk could be transported much further and faster than in the past. There was no compelling geographical reason for assuming that the connection between Scotland and England was any weaker in market definition terms than the link between two English regions or that between England and Wales.

5.19. The fourth reason was the close link between the prices charged to consumers in the larger supermarkets and those in other retailers. The price of milk in a major supermarket's store in Surrey would generally be the same as in its Aberdeen store. This generally resulted in the larger supermarkets paying uniform prices for their supplies throughout the country. Most important, however, the larger supermarkets' national pricing policy also effectively set a national price level for the other categories of retailers, each category adopting well-established differentials from the larger supermarkets' prices. Retail pricing and in particular middle-ground prices were therefore determined nationally by the prices set by the larger supermarkets. It was clear from the Commission's report into Wiseman's acquisition of Scottish Pride that the larger supermarkets could resist any pressure by Wiseman to increase prices for wholesale milk. In turn this had a knock-on effect for other groups of customers including the middle ground. If Wiseman tried to raise prices to the middle ground, those customers would go elsewhere in order to safeguard their margin while at the same time maintaining the differential from the larger supermarkets' prices. Such middle-ground customers had numerous alternative sources of supply. The larger supermarkets' prices therefore acted as a 'collar' preventing a widening of the differential from middle-ground pricing. It was a regular feature of Wiseman's business that middle-ground customers would seek a price reduction if prices charged by supermarkets were reduced.

5.20. The above factors meant that there was no scope for prices in Scotland to move out of line with those on offer in other parts of Great Britain. Empirical evidence supported this assertion. A correlation analysis, which had been undertaken on the basis of data supplied by TNS, showed that prices in different regions within Great Britain followed each other closely. There was no evidence that price patterns in Scotland were in any way unusual.

Contestability

5.21. Amplifying its claim that Wiseman's position in Scotland was fully contestable, the company said that smaller middle-ground retailers (such as independent shops) had a wide range of viable alternative suppliers of fresh liquid milk. These included:

— Express/Claymore in Nairn, Graham's, SMD, Mitchells and various processors in north England such as Arla and Taylor's of Preston;

— other processors in England;

— Scottish processors which could deliver on a regional basis, such as Stevensons Dairy Farms and SMD in Ayrshire/Dumfries and Galloway; George L Ballantyne's Ltd in Lanarkshire; Grahams in Perthshire, Tayside and Argyll and Fife; Bonally, Cockburn, Fayrefield and Quothquan Farms Ltd in Edinburgh and the Lothians; Quothquan and ACC in the Borders; Angus Dairies Ltd in Angus and south of Aberdeen; Mitchells throughout Grampian and Allarburn throughout Banff and Buchan. According to one Scottish processor, Graham's, there were 60-plus dairies in Scotland which could supply middle-ground retailers;

— retailers' ability to use the Independent Dairy Consortium, an organization grouping small dairies to tender for larger contracts;

— the possibility of middle-ground retailers being serviced by cash-and-carry stores;

— the fact that certain symbol groups such as Spar, Mace and Nisa had their own direct regular refrigerated deliveries to members across the country meant they could decide to assume responsibility to distribute milk from their own central distribution networks (so could garage forecourt shops, such as those in the Shell chain); and

— small convenience stores could also form buying groups, increasing their attractiveness to a wide range of dairies.

Scottish consumers' preferences

5.22. Wiseman was aware of the argument put forward for the existence of a Scottish market, separate from the rest of Great Britain, on account of the alleged preference of consumers in Scotland for milk produced from Scottish farms. In the company's view, milk was a commodity product which was easily and cheaply transported and there was no compelling evidence that a significant proportion of Scottish consumers would be prepared to pay a premium for Scottish milk. Wiseman did not believe that the origin of milk was a significant factor in competing for the middle-ground customer base in Scotland.

5.23. While a number of the major supermarkets had indeed required that milk supplied for their stores in Scotland should be sourced from Scottish farms, in Wiseman's opinion this did not reflect any local preference for Scottish milk: it was more credibly and more likely to be a marketing issue and might reap some commercial advantages for such companies. Wiseman said that none of its own middle-ground customers had made Scottish origin a requirement of the milk they bought from the company—they were chiefly concerned about price and level of service.

5.24. Wiseman was aware that there was survey evidence purporting to show that consumers in Scotland preferred Scottish milk. This was hardly surprising: if people were asked—as seemed to have been the case with most such surveys—if they would prefer something produced 'on their own doorstep' to something produced further away, they would generally, and quite predictably, plump for the former. In this, consumers in Scotland were no different from their counterparts in England and Wales. Retailers there were responding by marketing, for example, 'Welsh' milk, 'West Country' milk, etc. At the end of the day, however, what really counted with consumers was price and quality of service, not origin.

Raw milk supply from England

5.25. In Wiseman's view, there were no costs or difficulties specific to supplying customers in Scotland with raw milk from England (or vice versa) which did not relate to the distribution of raw milk throughout England and Wales. It needed to be borne in mind, however, that Scotland produced more raw milk than its processors and consumers needed.

Product market

5.26. Wiseman considered the relevant product market to be the supply of all types of fresh processed milk products to all types of retailers in Great Britain. The middle ground was not a separate market. No dairy specialized in the production of particular types of fresh processed milk (whole, semi-skimmed or skimmed milk). If the profitability of producing a particular type of milk increased, then processors would immediately and at no extra cost be able to increase their production of that type of milk. The ease of supply-side substitutability meant that there was a single market for all fresh liquid milk. Similarly, if a processor attempted to exploit a high share of supply to a certain retail category, other dairies would be able to enter that sector and offer competitive prices. Wiseman did not believe that any distinction should be drawn in economic terms between the supply of milk to middle-ground retailers and non-retailers such as caterers and schools. Both types of customer were part of the same product market. Any dairy currently supplying middle-ground retailers alone would have in place a distribution network which could easily be used to supply caterers. Prices to customers in the middle ground were determined by the cost of supply and the volume of milk required rather than by the category of the customer in question.

5.27. Equally, Wiseman did not believe that supplies of fresh processed milk to the middle ground and to the larger supermarkets formed separate product markets. The larger supermarkets set benchmark prices from which there were established differentials in the middle ground.

Operational issues

Contracts with retailers

5.28. Wiseman explained that in the milk processing business it was rare to find formal contracts between processors and their retailer customers. Arrangements tended to be short term. The main reason for this was that retailers did not want to be held to any arrangement that might constrain them if the processor concerned failed to deliver on any particular day or if the quality of the milk delivered—especially in hygiene terms—was unacceptable.

5.29. For similar reasons Wiseman did not, except in one case, have any deals with retailers which specified that Wiseman would act as their exclusive supplier. Retailers were able to walk away from a deal if Wiseman failed to deliver the requisite quality and service. The exception to this was the arrangement between Wiseman and Aberness. A letter to Aberness of 7 July 1999 had included the following element of the proposed agreement between Wiseman and Aberness: ‘A “one-off” loyalty payment of £[✂] will be made at the end of this month. This ensures that provided we do everything to the reasonable standards of service and product quality you rightly expect, we will remain your single supplier of fresh milk and cream for at least the next three years.’ Even so, there was no guarantee that the arrangement would necessarily last that long, especially if Wiseman’s price levels changed or if quality and service were called into question. Besides, Aberness had not formally replied to the letter in question; and in any event the arrangement could not be described as a contract.

5.30. Middle-ground customers of Wiseman were not generally subject to any restriction in switching supplier. A customer could call one day to cancel its order the next. For example, Wiseman had lost a customer to Express/Claymore in Kilmarnock. The customer had sent a fax informing Wiseman of its decision that supplies were to cease with immediate effect. It was, however, common practice for deliveries to cease at the end of the week. In addition, supermarkets would usually provide adequate notice for packaging to be utilized or would compensate processors for reasonable costs.

5.31. Marketing allowances or special price deals were not tied to the length of the deals. There was no recourse to recover these amounts in the event of the relationship with a customer terminating. In other words, these provided no guarantees that the processor would not lose the business at short notice. Payments for such allowances were generally made at the customer’s request. Wiseman would view any such payments in the context of the overall profitability of the customer relationship. These allowances were not restricted to Wiseman. They were generally only demanded by large middle-ground customers and were part of normal practice in the industry in Scotland.

5.32. As to the supply of free refrigerators to retailers in Scotland, Wiseman said that this was common practice in the country. It believed that Express/Claymore also offered this arrangement. Other processors also did so. It should be noted that Wiseman placed no restrictions on the use of its refrigerators. Retailers were free to stock any product in them with no restriction on the source of supply.

Contracts with producers

5.33. In contrast to the situation between Wiseman and retailers, the relationship between the company and Scottish Milk and between the company and the farmers that acted as its direct raw milk suppliers was characterized by formal contracts. These direct suppliers benefited from an arrangement made by Wiseman, which was common to all its direct suppliers throughout Scotland, under which Wiseman was obliged to give them 12 months’ notice of termination of contract while the farmers were only obliged to give Wiseman three months’ notice.

Proximity of dairies to sources of supply

5.34. Operationally, it was much more cost effective if the raw milk source was close to the processing dairy; subject to the cost of milk in the milk field in question, moving and handling costs made the delivered price higher the further the dairy was from its source of supply. For example, the Grampian milk field production was not enough to satisfy demand in the Aberdeen and Grampian area, so that raw milk had to be brought up to Wiseman's Aberdeen dairy from the Central Belt and this involved additional cost.

Closure of depots

5.35. Asked why it had closed three of its depots—Peterhead, Perth and Stirling—Wiseman said that it had acquired all three when it had bought the Hamilton and Kennerty dairies. These depots did not fit well with the distribution network Wiseman had established in their respective areas and, in addition, were not up to the standards required. The main reasons for the disposal, however, were operational ones: Peterhead, for example, was badly situated (on the coastline) for the deliveries in the North and East of the region. Keith could do this more efficiently.

The larger supermarkets and the middle ground

5.36. Questioned on the differences in requirements between the larger supermarkets and the middle ground, Wiseman replied that supermarkets generally, and not just the larger ones, were more likely to set quality and other conditions, such as on animal welfare and traceability, than were the other middle-ground retailers. Although these middle-ground retailers did not set standards or audit Wiseman's facilities, they nonetheless benefited from them, as all Wiseman's milk was processed to the standard required by the most exacting supermarket customer.

5.37. In effect, the only difference between supermarkets' requirements and those of other types of middle-ground retailers was in packaging. Supermarkets would generally market milk in imperial measures and higher volumes—for example, up to 3.4 litres (6 pints); whereas the largest size offered by the average 'corner' shop would be 2 litres.

Doorstep business

5.38. Although the company was orientated towards supplying supermarkets, it was important to bear in mind that Wiseman was also the major doorstep delivery company in Scotland. This explained, in particular, why in its business deal with Graham's, which ran from June 1996 for two years, it had taken on additional doorstep business from Graham's in exchange for providing Graham's with middle-ground business—both these areas of business were in the Stirling/Falkirk/Grangemouth area of the Central Belt. The doorstep business was, however, a declining one. In Wiseman's view it now amounted to no more than 9 per cent of the market.

Profitability

5.39. Wiseman said that, in the middle-ground sector, margins had been seriously eroded in the last two years. Its margins had been reduced by between £4 million and £5 million. It believed that current prices were below competitive levels and also that the differential between different customer category prices had been eroded beyond what the company would consider appropriate for the long term. Certain prices could not, therefore, be sustained indefinitely. At some point it would be necessary for the market to allow some greater profitability from servicing the middle ground.

5.40. The present situation had arisen because Express, on entry into the market in Scotland, had targeted only the middle ground in offering lower prices, and this for very good reason: Express also supplied the larger supermarkets in Great Britain whose prices were standard throughout the country, and Express would obviously not want to reduce the prices charged to these.

5.41. The company confirmed, however, that each of its depots was making money—even after allowing for the activities of Express and for recent new cost factors such as, principally, higher packaging costs and oil prices.

Competition issues

5.42. Wiseman said that in considering the many sources of supply available to the middle ground it was important to take account of the wide range of customers making up the so-called middle ground. This sector covered small corner shops through to medium-sized supermarket chains. The amount ordered could range from very low volumes to approximately 500,000 litres per week. Different customers had different service or product requirements, but all customers in the middle ground already had viable alternative sources of supply (see paragraph 5.21), and, it was very easy to enter this sector of the market.

5.43. It also needed to be borne in mind that Express, the major shareholder in Express/Claymore, had three times the turnover, profits and assets of Wiseman. Express had also increased the capacity of Claymore's dairy at Nairn and had also established a depot at Coatbridge (in the Central Belt) and had recently acquired the Blakes distribution business, which had a national network of depots, including one in Airdrie, serving Scotland.

5.44. Whatever market definition was adopted, Wiseman's position in Scotland was highly contestable. This in turn constrained its prices. In summary, the main constraints were: the link between middle-ground prices, the prices of the larger supermarkets, the wealth of choice of local processors available to middle-ground customers and ease of establishing depots (see paragraph 5.19).

Allegations of anti-competitive behaviour

5.45. Wiseman's views on various allegations of anti-competitive behaviour are set out in Appendices 3.2 and 3.3 and in Chapter 4, for example, in paragraphs 4.263 and 4.264, 4.267, 4.276, 4.282, 4.296, 4.298 and 4.300.

Competition with smaller processors

5.46. According to reports, there were some 60 smaller processors in Scotland, a sign that healthy competition characterized the milk processing business. Asked whether, given its relatively immense scale and much greater efficiency, the survival of these smaller processors depended on Wiseman purposely avoiding vigorous competition with them, the company said that it did not do so and that the reason such processors were flourishing was that they were generally excellent at providing bespoke services—to, for example, the hotel, catering and corner shop trade—within a 40-mile radius of their base. They were very good at this and would no doubt continue to do well in this area of the market. Some of these had grown very strongly in recent years—the outstanding example being Graham's.

Competition practices in the Highlands and Islands, 1994 to 1998

5.47. Prior to Express's acquisition of a majority share in Claymore, Wiseman said that it had tended to concentrate on the Grampian market rather than on Inverness (and further west and north) which was Claymore's main operating area. Wiseman had had agency arrangements with Claymore, such as for the delivery in the Highlands and Islands of Wiseman's Fresh'N'Lo milk. One of the key reasons for this situation was that at the time Claymore was not perceived as a threat to Wiseman as it was not in a position to supply supermarkets and retail chains on a national, all-Scotland, basis whereas Wiseman was. Clearly, this had changed with Express's arrival. It was simply not credible to suggest that Wiseman could force Express/Claymore out of Scotland or that this would be a sensible strategy in circumstances where Express had three times the turnover, profits and processing capacity of Wiseman. In any case, there would always need to be a processing facility in northern Scotland given regional demand in the Highlands. However, Express was a head-to-head competitor with Wiseman for supermarket business, with dairies/depots throughout England. The Express/Claymore dairy at Nairn in conjunction with

Express's English dairies were clearly in a position to service supermarkets throughout Scotland. Moreover, Wiseman was convinced (see paragraphs 5.54 and 5.55) that Express was intent on targeting its business and was therefore a significant competitive threat. In these circumstances, it was only natural for Wiseman to terminate all subcontracting arrangements which would have enabled Express/Claymore to deal directly with Wiseman's customers. The circumstances would have been completely different if another organization had bought Claymore. If that had happened, Wiseman's reaction would have been to wait and see what kind of lengths it was prepared to go to to win business from Wiseman, and then to match that effort. That would have been a more natural marketplace, which was not the case with the one involving Express

5.48. In any event, by the time Express acquired its majority stake in Claymore, Wiseman had already been in discussion with CWS about an all-Scotland deal. CWS's attitude to Claymore had, in any case, been influenced by a breakdown in the quality of milk processed by Claymore at Nairn. This had occurred towards the end of 1996. Wiseman had agreed to step in to secure supplies to Claymore's customers. The terms of the Wiseman offer to supply CWS's stores on an all-Scotland basis were influenced by the fact that the price charged to CWS on the previous contract had not changed for 17 months despite the fact that there had been two raw milk price reductions in the period. Further, CWS had become aware of the price charged to [✂], which was Wiseman's national customer with the lowest price deal. CWS was also using its procurement division, the CRTG, to benchmark prices across suppliers throughout Great Britain.

Claymore's future

5.49. Asked which company might purchase Claymore, or Express's share in Claymore, if Express decided to leave the market in Scotland, Wiseman said that it thought Express had a commitment to a long-term future in Scotland. If this proved incorrect, however, and Express decided to leave Claymore, a possible contender for its place might be the successful Allarburn Dairies based in Elgin. Its owner, Mr Dean Anderson, had been a member of the NSMMB (which had become NSMCSL in late 1994, ie NMC, the part-owner of Claymore) and was a raw milk producer with a herd of some 300 cows. Other possible candidates were Scottish Milk, Graham's and even NMC itself. But there might well be others.

Prices

5.50. Prices of milk in Scotland had not been excessive prior to Express's arrival in late 1998. Since then Express's aggressive behaviour had reduced Wiseman's margins. There was no evidence of customer detriment in the Scottish middle ground before Express's acquisition of a controlling interest in Claymore. Indeed, in the period between Wiseman's acquisition of Scottish Pride's fresh liquid milk business and the entry of Express, Wiseman's prices to all middle-ground customers had decreased in line with price reductions to the larger supermarkets which were sophisticated and powerful purchasers. Further, while direct comparisons between retail prices in Scotland and the rest of the country were not straightforward, market research data showed that the absolute average prices in Scotland had been, and were still, among the lowest in the UK.

5.51. In any event, there were plenty of other processors to whom a retailer dissatisfied with Wiseman's prices could turn (see paragraph 5.21).

5.52. That said, Wiseman believed that middle-ground prices were currently below competitive levels—as a result of Express's attempts to make the company financially unstable—and questioned whether the present level was acceptable in the long term.

Difficulties in switching suppliers

5.53. Wiseman did not believe that retailer customers would have difficulty in switching suppliers, if the need arose. They could do so overnight as arrangements between processors and retailers—certainly as far as Wiseman was concerned—did not specify any notice periods.

Express's strategy and charges of aggressive behaviour

5.54. The company had been accused of anti-competitive behaviour. It was important to set this accusation in context. Wiseman was the innovator in the UK dairy industry. Others had closed significant facilities, but Wiseman was the only company which had made significant greenfield investment in the same period by opening a dairy in Manchester. Wiseman was continuing to expand further into the English heartland of the established dairy companies and would shortly open a new dairy and depot south of Birmingham. Express, by contrast, was the largest UK dairy, with over 30 per cent of the market, and had more than three times the turnover, profits and assets of Wiseman. This disparity in size and Express's 'deep pockets' suggested that a charge of predatory behaviour on Wiseman's part would lack credibility. Wiseman had good reason and evidence for believing that Express's acquisition of a controlling interest in Claymore was not a normal commercial entry into Scotland; rather, it formed part of Express's targeting of Wiseman's customer base in an attempt to make Wiseman financially unstable and thereby slow down its expansion into England, Express's traditional heartland.

5.55. For example, Wiseman had been informed by various sources that Express had for some time been seeking to organize a co-funding arrangement with other English dairies to attack Wiseman in Scotland and thereby seek to curtail its progress in England. At the joint hearing on 27 April 2000, the Chief Executive of Express denied that any such co-funding discussions had taken place. Wiseman maintained, however, that these discussions had taken place, as had been intimated to it on a number of occasions. Express was also targeting the customers of Wiseman, the far smaller competitor, quoting prices in central Scotland on which it must be making a loss. Wiseman had lost considerable business to Express as a result of Express's activity.

5.56. By contrast, Express did not appear to have targeted the business of the major supermarkets in Scotland. This provided further evidence that Express's acquisition of a controlling interest in Claymore was not a normal commercial entry. By only targeting middle-ground customers in the Central Belt of Scotland (where Wiseman had a large share of supply and Express had minimal custom), Express had been able to offer a low price without affecting the prices charged to its existing larger supermarket base, especially the supermarkets in England.

5.57. The fact that Express had a deliberate strategy to undermine Wiseman's expansion in England had been confirmed by many sources. Wiseman had been informed by Express's house analyst that Express was actively recording the lost margin which it estimated its activity was costing Wiseman. This had been corroborated by comments from various other industry sources.

5.58. There was a wealth of independent sources which showed what Express's real motivation in acquiring a controlling interest in Claymore was. Express had argued at the joint hearing on 27 April 2000 that its approaches to Wiseman's customers simply reflected Wiseman's large share of supply to the Scottish middle ground; all the evidence, however, pointed to Express having a predetermined policy of selectively targeting Wiseman's customers.

5.59. Wiseman had responded to Express's arrival at Nairn by cancelling the agency arrangement it had with Claymore for the latter to deliver Wiseman's milk locally to Somerfield, Farmfoods and Inverness prison. This was not an example of Wiseman using a dominant market position to target business which a new entrant (Express) had inherited from the previous situation. The fact was that Express was Great Britain's biggest dairy company and a major rival which had already let it be known what its strategy in Scotland was going to be. In those circumstances it would have been very difficult for Wiseman to share its customers with Express. It would have been quite different if the buyer of Claymore had been a more normal third party.

5.60. Express's strategy looked very odd from a commercial standpoint. A credible long-term strategy for entry into the market in Scotland would have been much more focused on the Central Belt. And there had been the opportunity for Express to have made its investment there at the time of the demise of Scottish Pride and, later, when Gilmours became available for sale. But the company had chosen not to and had opted instead for the Nairn location where the population base was very low. It was difficult to believe, therefore, that the Express investment had anything to do with making profits. The company seemed more concerned simply to target Wiseman's middle-ground customers.

Major accounts

5.61. By contrast, the major accounts which Wiseman had won from Claymore following Express's entry were certainly not the result of selective aggressive targeting:

(a) The Alldays account in the North-West of Scotland was won after Express/Claymore approached Alldays offering to service all its stores in Scotland. Alldays had then approached Wiseman (which already serviced most of the Alldays stores in Scotland) to see if it would match the Express/Claymore offer.

(b) Claymore had lost its main business with Spar stores after Spar had decided that it wanted to use its own central distribution network for delivery of milk. Spar sought a quote from Wiseman for delivery of milk to the Spar central distribution depot in Dundee. Claymore had also provided a quote for this business.

(c) Wiseman had been in discussion with CWS in relation to the stores delivered by Claymore prior to Express's acquisition of a controlling interest in Claymore.

The company added that it was only interested in serving customers which made a positive financial contribution to its business.

Accusation of predatory behaviour

5.62. Wiseman was aware that it had been alleged that the prices charged under some of its deals since Express's intervention in late 1998 were below Wiseman's AVCs. (The arguments are discussed in paragraphs 3.111 to 3.113 and 4.340 to 4.349). It would be commercial folly for Wiseman to engage in a strategy of predation. Such a strategy would drive prices down to below cost in circumstances where there would be no realistic prospect of recouping the lost margin at a later date. Moreover, Wiseman was subject to undertakings to report price changes to the OFT, and any subsequent attempt to raise prices would be immediately identified by the OFT. The company only sought new business or retained existing business provided it made a positive financial contribution. In each of the cases which had been put to the company, the customer's business covered variable costs and at the least made a contribution to fixed costs. Wiseman had lost a considerable number of customers to Claymore in recent months. Wiseman's responses to a competitor's actions were often insufficient to retain the customer. If the price demanded by the customer were not profitable for Wiseman, the business would not be pursued.

5.63. The company's view was that, if a company supplied customers at a level below the cost of production, that would be uncompetitive behaviour. Wiseman did not do this. It believed that all its deals with retail customers ensured that variable costs were covered and that a contribution to fixed costs was made. But an 'aggressive' price could be defended as long as it was not loss making. The company was not at all certain that Express could defend itself convincingly against such a criterion as far as its targeting of Wiseman's middle-ground accounts was concerned. It had certainly been very disappointing to have had to issue a profits warning in December 1999, the primary reason for which had been the very aggressive behaviour of Express.

5.64. The company was now gaining new business in the Highlands and Islands. On the termination of the subcontracting arrangements with Claymore, Wiseman was obliged to ensure that its distribution network in the Highlands and Islands was sufficient to service directly the all-important supermarket business. Once this distribution network was in place, Wiseman had naturally sought to win new business in order to reduce its average distribution costs. Inevitably, in seeking to win business in the Highlands and Islands to reduce the cost of its new distribution network, Wiseman sought to win accounts from Claymore. This was not a question of selective targeting of Claymore accounts but rather a reflection of the fact that, prior to December 1998, Claymore served in excess of 70 per cent of customers in the Highlands and Islands.

5.65. An alleged example of Wiseman's selective targeting of Express/Claymore accounts was the all-Scotland deal Wiseman had secured with CWS in May 1999. In practice, however, this was the culmination of a process of discussion and negotiation with CWS that had begun in 1997, well before Express's arrival in Scotland in December 1998, and came on top of all-Scotland deals which Wiseman had made with other middle-ground retail chains—Farmfoods, Iceland and Costcutter, not to mention

three of the larger supermarkets and two major hotel chains—also before December 1998. The fact was that CWS had first raised the possibility of an all-Scotland agreement after the experience of a breakdown of quality at the Claymore dairy. The publication of a rumour in early 1998 that Northern (Express's owner at the time) was interested in Claymore had made no difference to this process. Wiseman had not taken this rumour seriously. It had prepared costings in the summer and autumn of 1998 and had subsequently approached CWS with a firm proposal in January 1999.

5.66. Nor was it credible to suggest that Wiseman's response to Express's entry into the market in Scotland had been designed to force Express to leave the country. This would not have been a sensible strategy given that Express had three times the turnover, profits and assets of Wiseman. And Express had already increased the capacity of the Claymore dairy by transferring equipment from the Glanbia business it had recently acquired. Express had also recently acquired the Blakes distribution business, which had a national network of depots serving Scotland. Whether or not Express retained its controlling interest in Claymore, Wiseman believed that there would always be a processing dairy in Nairn given the milk supply relative to regional demand in the Highlands. The dairy at Nairn was relatively modern and was a reasonable base for servicing the middle ground and certain larger supermarkets, such as Safeway. That said, competition for the middle ground in Scotland was in no sense dependent on Express remaining in Scotland. The middle-ground sector had a wealth of choice of dairy suppliers.

5.67. The likelihood was, only too clearly, that Express/Claymore was selling milk below cost. The evidence for this was that the latest financial results of Claymore indicated that a loss of £2.5 million was incurred in the year to 31 March 2000. Wiseman estimated that this equated to 5p for every litre sold. It was salutary to bear in mind that, prior to being acquired by Express, Claymore had been a profitable company.

Exclusionary activities

5.68. The company said that the acquisition of Gilmours and AMCo was not designed to prevent new entry or to foreclose supplies to Express/Claymore. Each had a legitimate commercial rationale. Gilmours had approached Wiseman in August 1998. The acquisition of 80 per cent of the ordinary share capital was concluded on 3 April 1999 with the remainder acquired in November 1999. The total amount paid was £3.5 million. The business had been selling approximately 18 million litres a year. It was considered that, once the business had been integrated into the Wiseman group, the business could generate operating profits of £1,000,000 a year. Given that the acquisition was expected to enhance the earnings per share of the Wiseman group, the valuation of £3.5 million was considered appropriate. The business was attractive to Wiseman because it had a good reputation among customers; it had important customers such as Aldi; and its business was predominantly in Ayrshire where Wiseman did not have a significant presence in the middle ground. The dairy at Newmilns was closed by Wiseman partly because it represented a potential health risk and partly because Wiseman could obtain greater efficiencies by increasing production at its Bellshill dairy. Wiseman had, however, retained Gilmours' depot at Kilmarnock. This allowed the company to deliver further into the Stranraer area direct from Kilmarnock rather than from Glasgow. Wiseman had obtained consent from the DGFT for the acquisition, although this was somewhat to its surprise. The fact that Wiseman had had to obtain consent pursuant to the undertakings had presented Express with the opportunity of quickly acquiring Gilmour unconditionally. In this period of two and a half months before the regulatory approval process had been completed, Express could have acquired the business and Wiseman could not have concluded an offer.

5.69. As to the AMCo purchase, made on 13 May 1999, Wiseman had consistently sought to persuade the board of AMCo to sell their business to Wiseman. Wiseman's interest in acquiring AMCo, therefore, did not result from Express's acquisition of a controlling interest in Claymore. Its primary concern had been to prevent the loss of quota from the Grampian milk field which arose because local farmers were leaving the dairy business because of the low price they received from AMCo for their milk. The land was of good arable quality, so the farmers had other options than just producing milk. Although Wiseman had been taking some 90 per cent of AMCo's milk since purchasing Kennerty in 1994, it had had to buy in further supplies from Scottish Milk to meet the demands of its Aberdeen processing plant. AMCo had had high administration costs and operated an inefficient processing facility for the production of milk powders, butter and cheese. Because raw milk was in short supply in the area, the plant was either underutilized or used to process milk from elsewhere bought at greater cost. AMCo's inefficiency had meant that an insufficient amount of the price paid by Wiseman for AMCo milk was passed through to the farmers. The acquisition had represented a 'win-win' situation for both AMCo and Wiseman. From Wiseman's perspective:

(a) It had recouped the £1 million cost of acquiring AMCo by the sale of assets.

(b) It paid marginally less to farmers in Aberdeen than it had to AMCo, once transport costs were taken into account, and yet the farmers were receiving more money, thereby increasing the likelihood that they would remain in the dairy business.

(c) By developing a direct relationship with farmers, Wiseman was better able to 'trace' milk supplies and ensure quality standards.

5.70. From the perspective of the AMCo farmers:

(a) The capital which they had invested in AMCo had been released.

(b) The members would no longer be responsible for the losses of the AMCo processing facility.

(c) They received higher prices for their milk.

5.71. Wiseman's acquisition of AMCo, which had also been approved by the DGFT, had not altered the competitive position for the supply of raw milk. Wiseman had provided those other processors who previously acquired raw milk from AMCo (accounting for approximately 6 per cent of its output) with written assurances that they would pay no more for their milk supplies than the amount paid by Wiseman to the farmers and the cost of transport and administration. The farmers supplying AMCo had previously been bound by contracts which were terminable on 12 months' notice. From 1 April 2000 they had been subject to contracts that could be terminated on only three months' notice. Express/Claymore or any other processor could contract with these farmers subject to the notice period. However, to the best of Wiseman's knowledge, Claymore had never bought any milk from AMCo, certainly not in the 12 months prior to Wiseman's purchase of the company. Wiseman paid no more to farmers in Aberdeenshire than to farmers elsewhere in Scotland who had direct supply contracts with Wiseman. There was, therefore, no question of Wiseman giving premium prices to Aberdeenshire farmers to prejudice Express/Claymore. Wiseman had also kept under review the option of seeking to recruit farmers from the Claymore co-operative. However, it decided against this, given:

(a) the loyalty of Claymore farmers to the company in which they still had a shareholding; and

(b) the greater cost of extending the Wiseman milk field further into the North and West and transporting such milk to the Tullos dairy in Aberdeen against the cost of acquiring supplies from Scottish Milk.

Alleged market-sharing agreements

5.72. Wiseman's views on the market-sharing agreements it was said to have had in the past with Claymore in 1994 and Graham's in 1996 respectively are summarized in Appendices 3.2 and 3.3. The company said that it had not had any understandings with other dairy companies in relation to influencing which company could distribute fresh processed milk in different areas. It had in the normal course of business acquired and sold businesses in Scotland. As a result of these transactions there had been agreements not to compete for a limited period in respect of the business sold so as to ensure the transfer of goodwill. Such arrangements were in accordance with normal commercial practice.

Barriers to entry

5.73. The company did not believe that there were significant obstacles to entry into the milk processing industry. It did not believe that the costs would vary significantly between Scotland, on the one hand, and England and Wales, on the other. Wiseman estimated that the cost of setting up a dairy to process 50 million litres of milk would be about £1.5 million; and distribution depots capable of supplying, say, 20 million litres would cost about £500,000 each. (Wiseman cited five new producer processors which had either entered the market in Scotland in the previous two years or increased capacity and activity.) Nor were there major obstacles to companies, inside or outside Scotland, wishing

to establish themselves as milk groups in Scotland. It needed to be borne in mind, however, that the supply of milk processed in Scotland exceeded demand and that in net terms milk had to be 'exported' from Scotland.

5.74. Wiseman did not believe that the competition which had taken place between itself and Express/Claymore would deter future new entry. Future entrants into Scotland which had a strategy similar to that adopted by Wiseman in England of expanding its sales on a combined package of price, quality and service could successfully enter Scotland.

Remedies

5.75. Wiseman said that it was well aware that its share of supply in Scotland had resulted in the company being defined as a technical scale monopolist for the purposes of the Act. It had sought to conduct its affairs in a responsible manner and was unaware of any complaints being lodged with the OFT prior to the allegations made by Express, or of any allegations by retailers or the general public to the OFT either before or after the allegations made by Express. It believed that it had provided comprehensive rebuttals of any allegations made.

5.76. Structural remedies would be costly, disruptive to Wiseman and to retailers and would not necessarily create any further competition. It did not believe that it was appropriate for the Commission to dictate that certain retailers could not acquire their milk from their preferred supplier. As to behavioural remedies, those resulted in problems for all processors as well as Wiseman. Fixing prices for Wiseman would have the impact of fixing prices for the industry. If other processors tried to increase prices either to increase margins or to reflect higher costs, the Wiseman price would be the lower one. Such measures could result in retailers gravitating towards Wiseman.

5.77. The company did not consider any of the suggested remedies to be necessary and hoped that the Commission would conclude that it had not acted against the public interest and would not be expected to do so in future. It believed that it was one of the most efficient UK dairies, sharing efficiencies with customers and offering effective competition for the established and larger UK dairies such as Express and Dairy Crest/Unigate.

Structural remedies

5.78. It would not be practicable or desirable for any of Wiseman's plants to be divested to remedy any alleged public interest detriment in the middle ground: the Bellshill facility processed 277 million litres of milk a year, amounting to almost 150 per cent of the size of the entire Scottish middle ground sector; the Tullos facility in Aberdeen processed approximately 2.5 times the volume of the middle-ground market in the region currently served by this dairy.

5.79. The East Kilbride facility provided specialist products such as school milk cartons, flavoured and special milks and potted cream. Any conversion of the dairy to service the mainstream middle ground would not be able to utilize such equipment and new equipment would be required. If Wiseman were to divest East Kilbride, it could not continue to produce the range of products required by the larger supermarkets, which would severely prejudice its ability to compete with its larger English-based competitors. The facility at Rutherglen, by contrast, was a glass bottle facility. Glass bottles were used only for doorstep business, which was not part of the middle ground for the purpose of this inquiry.

5.80. So divestment of Tullos or Bellshill would go beyond the scope of the current inquiry while divestment of either of the other two dairies could not practicably or economically cure any alleged public interest detriment in the middle ground since they were specialist facilities which could not be converted to serving the middle ground at a sensible cost.

5.81. Divestment/sale of a proportion of its business would not benefit retailers or consumers, which would be forced to source their milk and cream supplies from someone other than their preferred supplier. The company's very efficient plants would be disrupted by any form of divestment, impacting on its ability to compete for the business of the larger supermarkets. There would be extensive disruption to Wiseman's business as well as significant costs. So it would ultimately seek to recover these costs from its remaining customers.

5.82. The conversion of either East Kilbride or Rutherglen to service middle-ground retailers would be problematic and costly. For example, more than £5.5 million in the last three years had been invested in developing East Kilbride. It would need to be replaced with a similar facility. Wiseman would need to establish a new site and acquire and install all the necessary equipment to produce specialist products at an estimated minimum cost of £10 million.

5.83. It should also be noted that the primary site for vehicle maintenance in the Central Belt of Scotland was the East Kilbride site. The office accommodation for the quality assurance, health and safety and milk procurement/farm services functions was also based at this site. To relocate these functions, in particular vehicle maintenance, would result in an expense in excess of £1 million.

5.84. Rutherglen only filled glass bottles. There could be issues with environmental health officers and middle-ground customers concerning filling plastic bottles and cartons in the same area as a glass bottle line with the possibility of contamination from debris or dirt contained in glass bottles and glass fragments. (This was not an issue in Aberdeen as glass bottles were filled there in a completely separate building adjacent to the filling hall for non-returnable containers.) If glass bottle filling were to be continued, major structural modifications would be required at Rutherglen.

5.85. The costs of divesting East Kilbride or Rutherglen would compromise Wiseman's costs in ensuring adequate replacement facilities, and costs to the new operator. Wiseman would also expect to recover the net book value of the assets at each site. It presumed that all these costs would be met by whoever operated the facility. The total costs would amount to over £21 million. There would also be a number of redundancies. Finally, operating costs for the remaining business would increase due to the lower volumes being processed.

5.86. It had been suggested as an alternative that market share with middle-ground retailers could be reduced to 50 per cent. To reduce it to 50 per cent would require the sale of 39.5 million litres. The goodwill associated with this volume amounted to £7.7 million (based on previous acquisitions). The company would obviously anticipate receiving a payment for the goodwill associated with any business divested. The divestment of this volume would also significantly affect processing and distribution efficiencies. To effect a reduction in market share to 50 per cent would mean forcing customers not to source milk from their preferred suppliers and to buy their requirements from arguably inferior facilities. It was impossible to see how forcing customers to transfer to suppliers they had previously rejected could be said to be in the public interest. A cap at 50 per cent would also reduce the level of competition for other retailers and, in turn, prejudice the position of the Scottish consumer.

Behavioural remedies

5.87. Price controls, the alternative to a structural remedy, were not necessary. There was no evidence that prices in Scotland had been higher for middle-ground retailers compared with England prior to Express acquiring Claymore. It should be noted that prices to middle-ground retailers had consistently been reduced since Wiseman's acquisition of Scottish Pride in March 1997. Prices were currently below competitive levels (as a result of Express's attempts to make Wiseman financially unstable). Wiseman would have great difficulty in seeking to raise prices but any attempt by the Commission to restrict prices to current levels in the long term would be contrary to the public interest. Such measures could deter new entry and force out of the market smaller, but nevertheless efficient, dairies.

5.88. Even if Express were to exit the market there would be no immediate increase in prices to retailers. Once prices had been reduced, it was extremely difficult to introduce price increases. Any attempt to increase prices to previous levels by Wiseman would be resisted by retailers and be met with alternative quotations from other suppliers.

5.89. But it would be wholly inappropriate to fix Wiseman's prices at a low level. Any attempts to increase prices by other processors would be doomed as Wiseman would continue to have a historically low price and would provide a check on prices for the whole middle-ground market. The effect of this could be an increased market share for Wiseman.

5.90. There were also a number of practical problems with any behavioural remedy related to prices. Such remedies would require considerable monitoring by the competition authorities. In addition, the

remedies suggested did not take account of changing conditions and changes in underlying costs, thereby resulting in pricing not being cost reflective. In principle the removal of the workings of a competitive market was flawed and would discourage new entrants. The proposed controls would not to be simple to operate and would impose a considerable cost upon Wiseman.

5.91. The company questioned the effectiveness of the suggested price-fixing mechanism based upon average prices, even prices linked to the RPI and the raw milk price. The average price charged to middle-ground customers heavily depended upon the mix of customers serviced; so, if the mix of middle-ground customers changed, then the average price would also change. Since Wiseman had over 4,500 middle-ground customers in Scotland it would be extremely difficult and costly to allow for changes in the mix of customers in any price setting mechanism.

5.92. Furthermore, such a measure would place Wiseman at a competitive disadvantage to dairy companies in England. These companies would retain their ability to increase prices to improve margins or to take account of increases in specific costs above the RPI. Wiseman would not be able to generate similar margins resulting in lower relative profitability. Investors would favour those companies with higher margins.

5.93. An alternative to price fixing, suggested as a remedy, was to maintain price reductions or to have a price freeze for three years. This remedy would not be appropriate. It would disadvantage Wiseman as it would be unable to compensate for increased costs. The imposition of a price freeze would perpetuate the low returns currently being generated by Wiseman and presumably by other processors. It would distort the competitive nature of the market and discourage future entry by new participants. Also three years was not a reasonable period of time for these remedies to apply to Wiseman's operations. The company would be particularly concerned by the imposition of such a time frame when it was unaware of what other factors might affect its business and the cost of servicing customers during such a period.

5.94. Another suggested behavioural remedy on prices was not to discriminate between middle-ground retailers. Wiseman's pricing reflected the costs of servicing different customers. To ignore these factors and establish a common price would unfairly advantage some retailers, such as those that presented credit risk, against those which paid promptly, and those which sold low volumes against those that sold high volumes. If a common price were established based upon the cost of serving all middle-ground customers, low-cost customers would be subsidizing the more expensive customers. This would result in other processors targeting those disadvantaged customers. The loss of these customers would increase the price charged to the remaining customers as fixed costs would be allocated over a lower sales volume.

5.95. Finally, on behavioural remedies, it had been suggested that price differentials between the various categories of retailer should be maintained. Wiseman had argued that supermarket prices provided a benchmark against which other retailers gauged their prices. It had also said that the current differential between different customer category prices had eroded beyond what it would consider appropriate in the long term. It did not consider it appropriate for current prices to be sustained indefinitely. To tie middle-ground prices to present differentials would be inequitable given the current pricing levels and the fact that prices to middle-ground retailers could fluctuate—if the prices of the larger supermarkets rose or fell—for reasons unconnected with their activities.

5.96. If the Commission concluded that Wiseman had been operating against the public interest, it would presumably also have concluded that the relevant geographic market was Scotland. Such a finding by no means prejudged the public interest question, however, since Wiseman had not in any event been engaging in any anti-competitive behaviour. If the relevant geographic market were Scotland, Wiseman would be very likely to be viewed as having a dominant position for the purposes of the Chapter II prohibition of the Competition Act 1998 (the 1998 Act). Companies which were dominant for the purposes of the 1998 Act were required not to engage in behaviour which had the effect of hindering the maintenance of competition. As such, if Wiseman sought to engage in any anti-competitive behaviour in the future, it would immediately expose itself to the risk of a fine of up to 10 per cent of its UK turnover, which would amount to approximately £28 million. For example, any attempt to engage in predatory pricing, charge excessive prices, or retaliate against any smaller dairy would immediately expose Wiseman to the risk of such a fine. The OFT had made clear in its guidelines on fining policy that it would not hesitate to impose substantial penalties for serious breaches of the 1998 Act. Retailers, consumers and competitors could rely on swift and effective action from the OFT.