Neutral citation [2005] CAT 30

IN THE COMPETITION APPEAL TRIBUNAL

Case: 1008/2/1/02

Victoria House
Bloomsbury Place
London WC1A 2EB

2 September 2005

Before:

Sir Christopher Bellamy (President)
Mr. Peter Clayton
Mr. Peter Grant-Hutchison

Sitting as a Tribunal in Scotland

BETWEEN:

(1) CLAYMORE DAIRIES LIMITED
(2) ARLA FOODS UK PLC
(formerly Express Dairies plc)

Appellants

-v-

OFFICE OF FAIR TRADING

Respondent

-supported by-

(1) ROBERT WISEMAN DAIRIES PLC
(2) ROBERT WISEMAN AND SONS LTD

Interveners

Mr. Nicholas Green QC (instructed by Ashurst) appeared for the appellants.

Mr. Jon Turner and Mr. George Peretz (instructed by the Treasury Solicitor) appeared for the respondent.

Lord Grabiner QC, Mr. James Flynn QC and Mr. James Goldsmith (instructed by Herbert Smith) appeared for the interveners.

Heard at the Sheriff Court, Chambers St, Edinburgh on 12, 13 and 14 January 2005.

JUDGMENT (Non-confidential version)

Note: Excisions in this judgment marked "[…][**C**]" relate to commercially confidential information: Schedule 4, paragraph 1 to the Enterprise Act 2002.

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I BACKGROUND

1. This is the judgment of the Tribunal on an appeal brought by the appellants ("Claymore"[1]) against the decision of the respondent ("the OFT") contained in a letter of 9 August 2002 ("the decision of 9 August 2002") to the effect that certain conduct on the part of the interveners ("Wiseman") did not on the evidence available infringe the Chapter II prohibition of the Competition Act 1998 ("the 1998 Act"). That letter, together with a further letter of 6 September 2002 rejecting Claymore's request for the matter to be reconsidered under section 47(1) of the 1998 Act, was supplemented by a witness statement dated 16 May 2003 ("the OFT Witness Statement") following the Tribunal's judgment on the question of the admissibility of Claymore's appeal: see *Claymore (Admissibility)* [2003] CAT 3.

The Scottish milk market

2. At the material time the volume of the market for fresh processed milk in Scotland was around 565 million litres per annum. Most consumers live in the Central Belt, where the bulk of Scotland's population resides. Retailers of milk may be divided into three categories: supermarkets, who at the time accounted for around 48 per cent of household sales; "middle-ground" retailers, i.e. the smaller supermarkets or multiples, convenience store chains, symbol groups (e.g. Spar) and individually owned stores and corner shops, who accounted for about 42 per cent of household sales; and "doorstep delivery" sales, which accounted for the balance of 10 per cent of household sales. In addition, there are non-retail customers, such as hospitals, schools and the armed forces.

The parties

3. Claymore's main activity, at the material time, was the processing of raw milk into liquid milk at its dairy in Nairn, and the sale of that processed milk, principally in the North of Scotland. Claymore supplied many geographically-isolated and sparsely-populated areas.

[1] References to "Claymore" are to be read, where appropriate, to Claymore and Express Dairies Limited ("Express"), the second appellant, now Arla Foods UK plc.

4. Claymore's dairy at Nairn was opened in 1991 by the then North of Scotland Milk Marketing Board ("the NSMMB"). In 1994, the dairy at Nairn was transferred to a voluntary co-operative of dairy farmers, the North of Scotland Milk Co-operative Society Limited ("NSMCSL").

5. In December 1998, Express Dairies plc ("Express") acquired a 51 per cent interest in Claymore, this being subsequently increased to 75 per cent. The remaining 25 per cent of Claymore is owned by the North Milk Co-operative, which is the successor to NSMCSL. Most of the dairy farms in the surrounding area belong to the North Milk Co-operative, and supply their raw milk to Claymore's dairy in Nairn.

6. Express was at the time the largest processor of fresh milk in England and Wales. Arla Foods UK Holding Limited ("Arla"), another major processor of fresh milk, merged with Express in October 2003 to form Arla Foods UK plc ("Arla Foods"). In terms of total turnover Express was, at the material time, larger than Wiseman.

7. Wiseman is, and was at the material time, the largest processor of fresh milk in Scotland, and had made significant advances in England. It owns three processing dairies in Scotland, at Glasgow, East Kilbride and Aberdeen, and two more recently constructed dairies in England, at Manchester and Droitwich Spa. Wiseman supplies processed liquid milk to a wide range of retail and non-retail customers, and has made substantial investments in new facilities over the past 10 years. We are told that more than half of Wiseman's turnover is now in England and Wales, with the remainder in Scotland.

8. It appears that Wiseman had at the material time at least 74 per cent of the market for fresh processed milk in Scotland. Claymore accounted for around 6 per cent of sales of fresh processed milk in Scotland. Wiseman supplied about 66 per cent of the supply of fresh processed milk to middle-ground retailers in Scotland, while Claymore supplied 7 per cent of that market: see the Competition Commission's *Scottish Milk* Report at paragraphs 2.14, 2.17, 2.68 and Table 4.10.

Wiseman's alleged reaction to the acquisition by Express of a stake in Claymore

9. According to Mr. Larg's witness statement of 6 November 2002, filed on behalf of Claymore, until 1998 there was a so-called "rationalisation agreement" between Wiseman and Claymore under which Wiseman and Claymore agreed prices to common customers and respected certain territories in the North of Scotland.

10. Claymore contends that Wiseman reacted to Express's acquisition of a stake in Claymore in December 1998 by a sustained campaign of anti-competitive practices, targeted against Claymore's middle-ground customers in Northern Scotland.

11. The anti-competitive practices alleged by Claymore are principally:

    (a) the targeting by Wiseman of Claymore's existing middle-ground customers with various deals designed to ensure that those customers would in future deal exclusively with Wiseman;

    (b) the offer by Wiseman of "below-cost" prices to Claymore's existing middle-ground customers; and, in particular

    (c) the offer by Wiseman of "All of Scotland" deals at low prices to Claymore's principal middle-ground customers such as the Co-operative Wholesale Society Limited ("CWS") and Aberness.

12. According to Claymore, these tactics began early in 1999, immediately following the acquisition by Express of its stake in Claymore. Wiseman on the other hand considers that its conduct was a reasonable response to what it saw as an aggressive move by Express into the Scottish market, in response to Wiseman's competitive activities in England.

13. According to Claymore, by mid-1999 many of Claymore's middle-ground customers – representing some 40 per cent of Claymore's business – had switched to Wiseman, allegedly as a result of Wiseman's anti-competitive practices.

14. The most important of these customers were the Highlands stores of CWS, which represented some 30 per cent of Claymore's business. Up to February 1999, Wiseman supplied about 75 per cent of CWS' requirements in Scotland, mainly in the Central Belt, while Claymore supplied the remainder. Wiseman acquired the whole of CWS'

business in February 1999 under an "All of Scotland" contract which involved supplying all CWS' Scottish stores at the same price.

15. By mid-1999 Claymore, which had previously been profitable, became, and has apparently remained, loss-making. An attempt by Claymore to supply customers in the Central Belt from its dairy in Nairn ended, as we understand it, in 2001. Claymore's losses have been sustained by Express during the OFT investigation and these proceedings.

16. During 1999 Claymore complained to the then Director General of Fair Trading ("the Director") about Wiseman's conduct in Scotland. At that time the Chapter II prohibition under the Competition Act 1998 was not yet in force.

The reference to the Competition Commission

17. On 3 February 2000 the Director, in exercise of his powers under the then sections 49(1) and 50(1) of the Fair Trading Act 1973 ("the 1973 Act"), referred to the Competition Commission ("the Commission" or "the CC") "the matter of the existence or possible existence of a monopoly situation in relation to the supply of fresh processed milk to middle-ground retailers". "Middle-ground retailers" were defined in the reference as retailers who are neither Asda, Marks & Spencer, Safeway, Sainsbury's, Somerfield, or Tesco, nor small retailers delivering direct to households. The Commission was required to confine its investigation to Scotland and to report within nine months.

18. The Chapter II prohibition came into force on 1 March 2000.

19. Claymore made lengthy written submissions to the Commission during the course of its investigation, and also attended three oral hearings, including one on 27 April 2000 at which both they and Wiseman were present.

20. The Commission completed its report on 23 October 2000 ("the CC Report"). The report runs to 261 pages. The Secretary of State for Trade and Industry published the report on 22 December 2000: see *Scottish Milk* (Cm 5002).

The Scottish Milk Report

21. In its Report the Commission found that a "monopoly situation", within the meaning of section 6(1)(b) of the 1973 Act, existed in favour of Wiseman because it supplied about two-thirds of fresh processed milk to middle-ground retailers in Scotland (paragraph 2.68). However, the group conducting the inquiry (Mrs Kingsmill, the chairman, Mr. Clothier, Mr. Mackay and Professor Cave) were evenly divided in their assessment of Wiseman's actions, and as to whether any of the facts found operated, or were likely to operate, against the public interest.

22. So far as now material, the CC's conclusions included, among others, the following findings:

    (1) In relation to CWS, all the members of the group conducting the inquiry reached the conclusion that in the year March 1999 to February 2000, and in the year May 1999 to May 2000 (the first full year of the new CWS contract), the total cost incurred by Wiseman in serving the whole of the CWS account (i.e. all the CWS stores in Scotland, including those in the Highlands won from Claymore) was more than the revenues gained by Wiseman from that account, according to Wiseman's figures: see paragraphs 2.120, 2.129, 3.111 to 3.114, 4.340 to 4.342, and 4.348. The CC thus found that Wiseman was pricing below average total costs (ATC) in these periods.

    (2) According to paragraph 3.111 of the CC Report, Wiseman's price to CWS was 0.53 ppl below ATC in the period March 1999 to February 2000. According to paragraph 4.342 of the CC Report, Wiseman's price to CWS was […][**C**] ppl below ATC in the period May 1999 to May 2000. However, Wiseman contended that its business with CWS covered ATC in the month of May 2000 as a result of the fall in the raw milk price (paragraph 4.341).

    (3) Mrs Kingsmill and Professor Cave considered that Wiseman's pricing below ATC, resulting in the gain of Claymore's largest customer, was an anti-competitive step taken for the purpose of exploiting or maintaining its monopoly position. Mr Clothier and Mr Mackay disagreed with this conclusion, seeing Wiseman's activities as a "defensive and matching response" to an aggressive sales campaign by Express (paragraph 2.127-2.137).

(4) As regards average variable costs (AVC), according to paragraphs 3.111 to 3.114 of the CC Report Wiseman's prices to CWS as a whole covered AVC in the period March 1999 to February 2000. However, Mrs. Kingsmill and Professor Cave considered that, depending on what assumptions were made as to the price which Wiseman would have charged in 1999 under the contract for the CWS stores that it already supplied, the price offered by Wiseman to CWS in 1999 did not cover the AVC of supplying the *incremental* business represented by CWS' stores in the Highlands in the year to May 2000: see paragraphs 2.121, 2.124, 4.342 to 4.349, and 4.355. On the other hand, Messrs. Clothier and Mackay considered that the CWS contract should be viewed as a whole, in which case Wiseman's price was above AVC: see paragraphs 2.127 to 2.131.

(5) As regards Aberness, all the members of the group appear to have accepted that the Aberness/Mace business was won by Wiseman from Claymore at a price below ATC, as calculated by Wiseman, for the periods March 1999 to February 2000 and July 1999 to July 2000. According to the CC Report, Wiseman's price to Aberness (Mace) was 0.22 ppl below ATC in the period March 1999 to February 2000 (Table 3.26, found at paragraph 3.111). Wiseman's price to Aberness (Mace) was similarly below ATC in the year July 1999 to July 2000: see paragraphs 2.122, and 3.111 to 3.114 and 4.354 to 4.355. Mrs Kingsmill and Professor Cave saw this as part of Wiseman's anti-competitive practices, while Mr. Clothier and Mr. Mackay did not.

(6) In addition, it appears that in July 1999 Wiseman made a one-off so-called "loyalty payment" to Aberness to remain as Aberness' single supplier of fresh milk and cream from July 1999 for a period of three years. Before the CC, there was a dispute as to whether and to what extent this arrangement amounted to an exclusive agreement. Mrs. Kingsmill and Professor Cave considered that Wiseman's arrangements with, and payment to, Aberness was an anti-competitive step taken by Wiseman for the purpose of maintaining its monopoly position: see paragraphs 2.103 to 2.105, 2.107, 4.267, and 5.29. Mr. Clothier and Mr. Mackay dissented from that conclusion.

23. Mrs. Kingsmill and Professor Cave considered that the above facts operated, or may be expected to operate, against the public interest but Mr. Clothier and Mr. Mackay dissented from that conclusion: see paragraphs 2.139 to 2.160. Since Mrs. Kingsmill cast her chairman's casting vote in favour of the conclusion that the facts found by the CC operated, and may be expected to operate, against the public interest that was, formally speaking, the Commission's conclusion in its report (paragraph 2.161). However, under the relevant provisions of the 1973 Act no action could be taken on the CC Report, because the conclusion was not that of at least two-thirds of the members of the group conducting the inquiry.

24. However, at paragraph 2.163 of the CC Report, the group noted:

> "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."

25. The press release issued on behalf of the Secretary of State on 22 December 2000, the day of the publication of the report, states that:

> "The Secretary of State has asked the [Director] to keep the market under close review with regard to potential infringements of the prohibitions in the [1998 Act]."

The opening of the Chapter II investigation

26. Section 18 of the 1998 Act provides:

> 18. - (1) … any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
>
> (2) Conduct may, in particular, constitute such an abuse if it consists in-
>
> > (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
> >
> > (b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts…"

27. In a letter of 5 April 2000 – i.e. while the CC investigation was in progress – Claymore requested the Director to adopt interim measures, under section 35 of the 1998 Act, to protect Claymore from irreparable damage, pending an investigation by the Director of an infringement by Wiseman of the Chapter II prohibition. As far as we know, the Director did not take any action on that request, nor did Claymore press the matter.

28. On 26 October 2000 – that is to say, almost immediately on receiving a copy of the CC report and before its publication – the Director opened an investigation into whether the activities of Wiseman infringed the Chapter II prohibition. Under section 25 of the 1998 Act, the Director may conduct such an investigation if there are reasonable grounds for suspecting that the Chapter II prohibition has been infringed.

The opening of the Chapter I investigation

29. Meanwhile, in June 2000 the Director had also opened an investigation, following a complaint, into whether price fixing and market sharing had taken place between Wiseman and other dairies situated in the Central Belt of Scotland, contrary to the Chapter I prohibition imposed by section 2 of the 1998 Act. It appears that Claymore and Express furnished the Director with considerable information relevant to the Chapter I investigation.

Later developments

30. Little of note appears to have occurred until 30 March 2001, when Claymore made a further application to the Director to adopt an interim measures direction under section 35 of the 1998 Act, pending the completion of the Chapter II investigation. The grounds of Claymore's application for interim measures were that Wiseman had a dominant position in the supply of fresh processed milk to Scottish middle-ground

customers; that Wiseman was abusing that dominant position, by making exclusive arrangements, selling below cost, and entering into "All of Scotland" deals; that Claymore was suffering serious, irreparable damage; and that, in any event, the public interest required the adoption of interim measures.

31. On 10 May 2001 the OFT made an unannounced visit under a warrant granted by the Court of Session to Wiseman's premises at East Kilbride under section 28 of the 1998 Act.

32. On 25 June 2001 the OFT gave written notice to Wiseman, under section 35(3)(a) of the 1998 Act, that the Director proposed to give an interim measures direction under section 35(2) of the 1998 Act for the purposes of preventing serious, irreparable damage to Claymore, preventing serious, irreparable damage to Express and protecting the public interest. The proposed direction would have had the effect of limiting the extent to which Wiseman's maximum price in Scotland for fresh, processed milk to middle-ground customers, could exceed its minimum price in the Highlands. The interim measures notice relied substantially on the findings made in the CC Report and on certain documents obtained by the OFT during the visit to East Kilbride.

The Assurances

33. On 14 September 2001 the Director announced in a press release that:

> "The OFT has accepted informal interim assurances from Robert Wiseman & Sons Ltd and Robert Wiseman Dairies PLC relating to milk sales in the Highlands of Scotland.
>
> Wiseman has agreed to cover its cost of supply to each middle-ground customer it sells to in the Highlands of Scotland. (Middle-ground customers are those customers who are not supermarkets or supplied by doorstep deliveries.) This will ensure that competition for those customers is protected while the OFT carries out its current investigation under the Competition Act. In order that Wiseman's competitors can bid for each customer's Highlands outlets, the interim assurances mean that some national contracts may have to be split."

34. The text of the assurances is before the Tribunal. In paragraph 1, Wiseman gave, on a without prejudice basis, an assurance that, as from 30 September 2001 onwards, the Net Revenue which it derived from all of the Highland Outlets of each of its Middle-ground

Customers in any month should not be lower than the Aggregate Cost to Wiseman of supplying those Outlets of that Middle-ground customer for that month. The expressions "Net Revenue", "Highland Outlets", "Middle-ground Customers" and "Aggregate Cost", among others, are defined in the assurances (paragraph 13).

35. As we understand it, the intention behind paragraph 1 of the assurances was that Wiseman would not supply the Highland Outlets of each Middle-ground customer at a price below the cost of supplying that customer's Highland Outlets, the relevant cost being "the Aggregate Cost", as defined in the assurances. "Aggregated Cost" seems to have been intended to include all fixed and variable costs except finance, administration and central selling costs. In addition, Wiseman undertook that any change in the terms of supply to a Middle-ground customer who had both Highland Outlets and other outlets should not make the terms of supply to the other outlets dependent on supplies to the Highland Outlets of that Middle-ground customer (paragraph 4). The existing "All of Scotland" contracts were not subject to paragraph 4, but became subject to the assurance in paragraph 1 not to sell below "the Aggregate Cost", as defined. By paragraph 9, the assurances were to lapse on the completion of the Director's investigation. The assurances do not address the problem of how common costs should be allocated, which is one of the central issues in the case.

36. Claymore did not challenge the action taken by the Director in accepting the assurances given by Wiseman on 30 September 2001. We do not consider that the validity or effectiveness of the assurances form part of the scope of this appeal.

37. After the assurances were given, the Director's investigation proceeded. In October 2001, as explained in more detail below, the Director embarked on a detailed attempt to establish Wiseman's cost of supply to individual outlets of all kinds situated throughout Scotland. By April 2002 that investigation was, apparently, nearing completion.

38. At a meeting with Claymore on 22 April 2002, the Director's officials expressed doubts as to whether they would be able to establish a breach of the Chapter II prohibition by Wiseman.

The submissions by Claymore of 19 June 2002

39. On 19 June 2002 Claymore and their advisers made a detailed presentation to the Director's officials. That presentation was accompanied by a 32-page submission entitled "An analysis of Wiseman's abusive conduct in the Scottish Milk Market", and supported by a memorandum by Messrs Ernst & Young dated 17 June 2002.

40. On 20 June 2002 the Chief Executive of Express, Mr N Davidson, wrote to the Director, appealing to him not to terminate the Chapter II investigation, and advancing a number of arguments. On 21 June 2002, the solicitors for Claymore wrote to the OFT to express their concern that the Office "was presently minded to adopt a non-infringement decision" and advancing a number of legal arguments.

41. By letter of 25 June 2002 the solicitors acting for Claymore forwarded a memorandum on behalf of Claymore prepared by Law & Business Economics Limited setting out economic arguments as to why Wiseman's "All of Scotland" contracts constituted an abuse of a dominant position.

42. Further material was submitted to the Director by Claymore on 25 June 2002, 15 July 2002 and 5 August 2002. The letter of 5 August 2002 referred to new arrangements Wiseman had apparently reached with Aberness.

The Decision of 9 August 2002

43. On 9 August 2002 Mrs. Bloom, the Director of Competition Policy at the OFT, wrote to Claymore in the following terms:

> "I am writing to let you know the position on the Office of Fair Trading investigation into Robert Wiseman and Sons Ltd and Robert Wiseman Dairies PLC ("Wiseman") in respect of the Competition Act 1998 Chapter II case. We are taking the administrative decision to close our files on the Chapter II case on the basis that it is not sufficiently promising in terms of a likely decision of infringement to warrant the commitment of further resources. This decision is taken in the light of the considerable effort the OFT has already devoted to this investigation, which has not yielded evidence sufficient to support a conclusive finding. We have therefore decided not to proceed to the rule 14 stage of giving notice of a proposed infringement decision."

44. As regards the substance of the case, the letter of 9 August 2002 stated:

"Investigation on suspected Chapter II infringement

Substantial efforts and resources have been devoted to the investigation. It focused on the following alleged behaviours:

1) predatory behaviour;
2) price discrimination (involving exclusionary or excessive pricing);
3) exclusive dealing.

We asked Wiseman to provide a substantial amount of information under several section 26 requests. We analysed data on the monthly prices charged, since November 1998, for a selection of 10 products, to 800 customers across Scotland. We also looked at costs and other information for the same products and customers covering over 1000 individual outlets for three different months (May 2000, November 2000, and May 2001).

The sample for this data was carefully selected from a complete set of Wiseman's customers (including postcodes of individual outlets and details of products and volumes delivered). This was to ensure we had sufficient information to obtain statistically valid results, and as far as possible to minimise the burden on Wiseman.

Evidence was also collected during a section 28 on site investigation on the premises of Wiseman and section 26 notices were sent to farmers in the Highlands.

As well as the extensive information collected from Wiseman, we also used other independent sources of information, when available, to compare the results of the analysis of the data.

The analysis of the information collected for the investigation required us to allocate an additional Principal Case Officer to the case from January. Specialised software was also bought to carry out the quantitative analysis. Consultations inside and outside the OFT with expert practitioners have been held at different stages of the investigation to assess the quality of the information and of its analysis.

We investigated several dimensions of price patterns:
-- price evolution over the period November 1998 – September 2001, factoring for raw milk input price, by customer and by product type;
-- geographical pattern of prices in Scotland, by customer outlet for May and November 2000 and May 2001;
-- price differentials between customers and according to volume;
-- comparison of price policy with other milk suppliers;
We also investigated total and variable costs for each outlet served:
-- comparison of costs to selected measures of cost for other producers;
-- the schedule of price-cost margins in relation to volumes, by product type and on aggregate;
-- the price-cost margin differentials by customer/outlet;

-- the geographical pattern of outlets' price-cost margins in Scotland and in selected areas (by product type and on aggregate);
-- regression analysis of price-cost margins on volume, customer types, product type, and other factors.

Market Definition

We did find persuasive evidence that the middle-ground market in Scotland is a distinct market. On the basis of the information provided in the Competition Commission's Scottish Milk Report, of interviews with competitors, and price patterns, we would have been likely to conclude that Wiseman had a dominant position on this market.

Alleged Abuse

Our investigation into Wiseman's alleged infringement of the Chapter II prohibition looked for sufficiently persuasive evidence of the alleged abusive behaviours.

We are not however reaching any final view on these points because the evidence gathered during the investigation is not sufficiently persuasive as to the existence or absence of an infringement.

Predation

We found instances of pricing below total cost, for example in the health care/hospital sector, which appeared to diverge from regular pricing behaviour, but we do not think these instances could support a conclusion that Wiseman had engaged in predatory behaviour. Furthermore, the investigation did not uncover sufficiently persuasive evidence either way of intent to exclude competitors.

Price discrimination (involving exclusionary or excessive pricing)

We also found evidence of price discrimination. However, there is insufficient evidence to come to the conclusion as to whether or not it departs significantly from normal competitive behaviour, it constitutes targeted pricing or has exploitative or exclusionary effects.

Exclusive supply contracts

As you know these were covered in detail by the Competition Commission and we studied its report and conclusions carefully. We also looked closely at the material you provided in your letter of 5 August in relation to Aberness.

We looked at whether the all Scotland deals entered into by Wiseman were in fact based on exclusive supply either explicitly or by offering additional incentives for exclusivity. However, the evidence available was not sufficiently persuasive to lead us to think that we would be able to make a finding as to whether or not the contracts in question amounted to abuse.

> I hope you find the above constructive and helpful. I shall be on leave for the next three weeks. If you have any queries please feel free to call Donald Mason or any of the case officers in my absence or get back to me on my return."

45. A similar letter was sent to Wiseman on 9 August 2002. On the same date the OFT issued a press notice announcing the closure of its investigation.

46. On 14 August 2002 the solicitors for Claymore wrote to Mrs Bloom expressing the fear that, following media comment on the OFT's press release of 9 August, Wiseman would further target Claymore's existing customers.

47. On 15 August 2002 Mr Lawrie, the Principal Case Officer on the investigation, replied to the applicants' letter of 14 August 2002 in the following terms:

> "I think that it must go without saying that the OFT will consider all complaints about and evidence of abuse under the Competition Act 1998 that is submitted to us. However, I think it only right to express my view that in this case, given its history over the last three to four years, we would need to have persuasive if not compelling evidence of abuse before we would be likely to devote significant administrative resources to further investigation of Wiseman's behaviour in the market."

The application under section 47(1)

48. On 21 August 2002 the applicants submitted a detailed application under section 47(1) of the 1998 Act (as then in force) to the Director requesting him to withdraw or vary his decision of 9 August 2002. On 6 September 2002 Mrs. Bloom wrote to the applicants rejecting the applicants' request.

The Chapter I proceedings

49. By letter of 9 October 2002 Claymore were informed that the Director had decided to close his file on the Chapter I investigation.

50. On 7 November 2002 Claymore asked the Director to withdraw or vary that decision, but the Director declined to do so by letter of 4 December 2002. On 3 February 2003 Claymore appealed the decisions of 9 October 2002 and 4 December 2002 to the

Tribunal (Case 1011/2/1/03) ("the Chapter I proceedings"). Since then, we were told that the OFT has reopened the Chapter I investigation upon receipt of further potentially relevant information. By order dated 2 September 2003, the Tribunal stayed the Chapter I proceedings pending the outcome of the reopened investigation, but we have no information about the progress of that case. We propose to make no further reference in this judgment to the Chapter I proceedings, not least because we are not in a position to make a finding, one way or another, as to whether any infringement of the Chapter I prohibition has occurred.

II PROCEEDINGS BEFORE THE TRIBUNAL

51. The appeal in this case against the OFT's original decision letters of 9 August 2002 and 6 September 2002 was introduced on 6 November 2002. Admissibility was then contested, that issue being resolved by the Tribunal's judgment in *Claymore (Admissibility)* [2003] CAT 3 of 18 March 2003. The OFT Witness Statement, which in substance seeks to explain the course of the investigation, was filed on 16 May 2003.

52. That Statement, however, contained many material elements that were redacted on the ground of confidentiality. The confidentiality issues then had to be resolved by a further judgment of the Tribunal on 9 June 2003: see *Claymore (Confidentiality)* [2003] CAT 12. Following further directions given by the Tribunal on 2 September 2003, Claymore then made a request for further and better particulars on 14 October 2003 to which the OFT replied on 26 November 2003. Claymore then served a revised notice of application on 16 February 2004 supported by the expert evidence of Mr. Philip Haberman of Ernst & Young. The OFT's defence was filed on 29 March 2004. Wiseman's statement of intervention was filed on 7 May 2004, supported by the expert evidence of Mr. Mark Bezant of Deloitte & Touche and a witness statement by Mr. Gerard Sweeney, Wiseman's Finance Director, dated 7 May 2004. We refer to the expert reports as "Haberman" and "Bezant" respectively. A further application by Claymore for recovery and inspection was refused by the Tribunal on 24 September 2004: see *Claymore (Recovery and Inspection)* [2004] CAT 16. The final hearing took place between 12 and 14 January 2005.

53. Shortly before the final hearing the OFT disclosed copies of an internal memorandum dated 7 August 2002 setting out the basis upon which the case team had proposed the closure of the file.

III THE OFT WITNESS STATEMENT

54. The OFT Witness Statement sets out the reasons for the OFT's view that there was insufficient evidence to establish an infringement of the Chapter II prohibition. As to the allegations of predation, the OFT Witness Statement says:

> "42. We took two measures of variable costs. We took as the low measure of variable costs the sum of ingredients, drivers' wages, fuel costs and tyres as we believed that those costs are directly related to the supply of the product and can reasonably be avoided in the short term. For the sake of robustness, a high measure of variable costs was also computed, adding packaging and processing costs to the previous measure. This high measure includes some elements of fixed costs, but likewise, most of these costs can be avoided in the short term. Neither measure includes the variable costs of depots, but we can assume these to be mostly unavoidable, with a significant proportion of fixed costs. Besides, depot costs are relatively low and do not vary significantly. Taking the May 2001 cost data, we obtained for each measure 2646 measures of price cost margins (1150 outlets, each taking several products, with some gaps in the data). These were analysed on a number of different bases and I attach as Annexes A to V to RBL1 pages 116-118 a number of maps, graphs and tables that were produced for the analysis and which we found particularly illuminating, along with an explanation of each.
>
> 43. The *low* measure of variable costs led to a finding that no negative price cost margins were found at the *outlet* level. The *high* measure of variable costs led to a finding of negative price cost margins in 33 instances. This was a negligible proportion of the total of the 2646 observations, and the majority belonged to small customers so that the volume affected was lower than that proportion would suggest (0.8 per cent). We did not feel able to build any robust conclusion on that result.
>
> 44. However, we took the matter further by looking to see whether there was any *customer* for whom supplies were made at prices below variable costs on the high measure. The lowest margins were for customers in the health sector as illustrated by Annexes H and I to RBL1 pages

116-118. All these customers were located outside the area of Express/Claymore's principal concern in the Highlands, most of them being close to Wiseman dairies and to population centres. See Annex K to RBL1 pages 116-118 which shows the location of Wiseman's health sector customers in the sample.

45. Overall, therefore, the examination of variable costs uncovered hardly any evidence of below cost pricing. Instances of very low, possibly below cost level, were recorded at outlet level but we found it impossible to regard these as significant in the overall context of the case. When examined at the customer level, prices charged to customers covered average variable costs in every instance and on both measures.

46. We then examined whether there was pricing below total costs.

47. To do this, we repeated the steps described above in respect of total costs. We adopted the approach of aggregating every one of the costs requested from Wiseman, adding 3 per cent to reflect financial administration and central selling costs, and using that measure as a working proxy for total cost (although some elements of total cost – possibly up to 5 per cent - were left out of that proxy)[*]

48. On that basis, we found, in respect of May 2001, 495 instances of below total cost pricing at the outlet level for 3039 records (1150 outlets, each buying several products). This number seemed relatively significant and raised some cause for concern. As our measure of cost was probably a slight underestimate of the true total costs, we considered this evidence as a first indication of possibly significant pricing below total costs. In addition, the relative high frequency of below or near total cost pricing seemed to indicate either intense competition or possibly anti-competitive behaviour.

49. However, when we started to perform a qualitative analysis of the instances of below cost pricing in terms of type of outlet and geographical location, it soon became clear that it would not be possible to identify any pattern

[*] The footnote to this paragraph reads: "In order to check whether we had a measure of costs giving a reliably close approximate of costs as a whole, we compared the measure of costs reported in the CC report with the equivalent measure as calculated by us from the information collected from Wiseman. CWS is one customer account studied extensively in the CC report. We had available as part of our sample full data relating to the costs of supplying CWS during our sample periods. The average total costs to supply CWS in para. 4.342 of the CC report is […][**C**] ppl for May 2000. Our measure of the average total cost for May 2000 for the same account is […][**C**] ppl ([…][**C**] ppl when the 3 per cent mark-up is applied). The difference between these two measures is only about 5 per cent which we believed was acceptable for the purpose of what was an initial investigation into costs."

that indicated a predatory strategy against Claymore based on any commercial logic that we could identify to the standard of evidence needed to show a Chapter II infringement. A breakdown of average price/total cost margin by customer group is shown in the table at Annex J to RBL1 pages 116-118. Our analysis showed that negative values of the price/total cost margin were concentrated in customers belonging to the health sector (hospitals, health boards, health care). Those customers are relatively large customers, but not the largest, and at around 5 per cent of the total volume sampled, accounted for a relatively small share of supply. It is difficult to see any reason why Wiseman would adopt a strategy of trying to exclude Express/Claymore from the market by targeting the health sector. It should also be noted that the instances of selling below total cost in the health care sector were all outside the Highlands area, the area of Express/Claymore's principal concern.

50. We also took the view that there was no clear and compelling direct evidence of intent by Wiseman to eliminate Express/Claymore from the market. As I have said above, we did regard some of the documents obtained from Wiseman during the section 28 investigation on 10 May 2001 as showing that Wiseman tended to categorise Express/Claymore differently from other competitors and hence as lending some weight to a suspicion of exclusionary intent (see paragraph 37 of the section 35(1) notice at RBL1 pages 1-31). However, those documents fell well short of *demonstrating* any such exclusionary intent; it is hardly surprising that Wiseman should categorise the competitive challenge from Express — one of England and Wales' major dairies and with which it had been waging a fierce battle for market share in England and Wales — rather differently from established competition from smaller local competitors; in short, it is hardly surprising that Wiseman would want to keep a particularly close eye on Express/Claymore's progress. Wiseman may also have wanted to keep a close eye on Express/Claymore because Express/Claymore had made a complaint about it to the competition authorities. We did of course take account of the statement of Alan Wiseman made to the CC at the joint hearing, to which Express/Claymore drew our attention on 19 June 2002 (page 501 of the Application, paragraph 2.23, and set out at greater length in paragraphs 5.155 to 5.156 of the Application), but we did not regard that statement as in itself, even taken together with the evidence from Wiseman documents, as providing clear and compelling evidence of intent to exclude Express/Claymore from the market; in essence, what it showed was that Wiseman

categorised Express/Claymore differently from its other competitors.

…

53. We therefore took the view that there was little prospect of what we had providing clear and compelling evidence of predatory pricing by Wiseman."

55. As regards Claymore's suggestion that the OFT should have calculated the *incremental* profit or loss to Wiseman of supplying CWS in the Highlands, the OFT Witness Statement says "Our approach was to calculate the profitability of the CWS business as a whole, and we were not attracted in principle to the approach adopted by Express/Claymore and indeed the CC." (paragraph 92) According to the OFT, the principal difficulty with Claymore's approach is that a necessarily hypothetical assumption has to be made as to the price at which Wiseman would have retained the CWS business that it already had. The OFT considers Claymore's assumption in that regard to be unrealistic.

56. On the question of alleged targeted discriminatory pricing, the OFT Witness Statement reads as follows:

"54. The OFT also considered the question of whether Wiseman may have infringed Chapter II by engaging in price discrimination aimed at eliminating Express/Claymore from the market. We had in mind the principles outlined in cases such as *Compagnie Maritime Belge* and *Irish Sugar* to the effect, in broad terms, that in certain circumstances selective non-cost related discounts or price reductions targeted on particular customers with exclusionary intent or effect could be regarded as an abuse of a dominant position, even where the prices remained above the total or variable costs of supply. Our task was to examine whether the facts as we could establish them indicated that there would be a real prospect of establishing an infringement along those lines.

55. As I said above, we took as our starting point the CC report. The CC concluded that Wiseman had engaged in price discrimination. In particular, it relied on the analysis of the graph at figure 4.17 of the CC report at page 284 of the Application, which shows a scatter plotting of prices across volume. The graph demonstrates that higher volumes are correlated with lower prices, which is not itself surprising, and, more interestingly, that for lower volumes, price differentials that are not explained by

volume differences appear; that appears to emerge from the spread of prices at volumes between 6 and 8 on the x-axis of that table.

56. Price discrimination is generally understood to involve price differences that are not explained by cost factors. It was clear from the CC findings that extensive price differentials were observed, but the CC's analysis does not in itself provide clear and compelling evidence of price *discrimination* since costs may alter considerably between customers taking equal volumes. Nonetheless, the CC's analysis suggested that price discrimination *might* be occurring, particularly in the light of the other characteristics of the industry, such as the fact that delivered prices are charged and distribution costs are spread over all customers. A distinct possibility was that such discrimination might be driven by the desire to target some competitors and price them out of the market.

57. The examination of potential targeting was carried out chiefly by comparing Wiseman's data on price and price/cost margins using as benchmarks:

Wiseman's own conduct across market segments (geographic, customer, products), and across time.

Competitors' conduct (focusing mostly on pricing policies)."

57. The OFT's conclusion on price discrimination was:

"64. In conclusion, we found evidence of price discrimination at low to mid volume levels, but limited price discrimination at higher volume levels. In our view, these findings were more robust than the CC's conclusion at paragraphs 4.330-4.336 based on its table 4.17. However, the pattern of price discrimination did not provide clear and compelling evidence that Wiseman had been targeting particular customers in order to exclude Express/Claymore. Wiseman's discriminatory behaviour does not appear to be markedly different from the pricing behaviour towards middle-ground customers observed elsewhere (Express/Claymore and Lordswood). Insofar as there is some suggestion that Wiseman's margins are lower in the Highlands of Scotland, that may be explained by the cost of delivering milk there and by the presence of Express/Claymore, to which some reduction in margin would be a normal competitive response. Similarly low margins are observed elsewhere in Scotland far from Express/Claymore's area of activity.

65. As far as exclusionary intent is concerned, I refer to paragraph 54 above where I explained why we did not

believe that there was sufficient evidence of such intent to make a sustainable finding in that regard."

58. As to the question of exclusionary practices, the OFT Witness Statement explained the OFT's investigation as follows:

> "68. It is important here to distinguish between two types of arrangement. The first type of arrangement is an exclusive agreement under which a middle-ground retailer with several outlets across Scotland agrees to take all supplies of milk for all its outlets from, say, Wiseman, that is to say, that it agrees not to purchase milk from any other supplier. This type of agreement has to be distinguished from a second type of agreement under which, say, Wiseman agrees to supply any outlet of the retailer at a particular uniform price, but where the retailer remains free to take supplies for any outlet from any other supplier.
>
> 69. In relation to the first type of arrangement – exclusive agreements – the OFT would accept that it may well be an abuse of a dominant position for a supplier to enter into such agreements in circumstances where that will have the effect of foreclosing a significant part of the market to a competitor. The difficulty in the present case is to establish that any such agreements exist.
>
> 70. The circumstances and terms of the agreements between Wiseman and Aberness and between Wiseman and CWS are discussed by the CC in its report (see in particular paragraphs 2.107 and 2.117). In neither case did the CC reach a robust conclusion that the agreements in question were exclusive, in the sense set out above, although, as I have said above, we did take the view at the start of the investigation that the CC report gave rise to a reasonable suspicion that such agreements might have been entered into.
>
> …
>
> 72. During the section 28 investigation on 10 May 2001 we looked for any further indication in Wiseman's documentation that it had entered into exclusive agreements with Aberness, CWS or anyone else. We found no such evidence.
>
> 73. We received no further indication during the course of the investigation about any further allegedly exclusive agreements. Nor had we been alerted that the terms of any of the supply agreements alleged to be exclusive had been renegotiated until the very last minute when, by fax on 5 August 2002, Express/Claymore told us that one of the contracts in question (Aberness) had been re-awarded to

Wiseman on the same terms as before. However, the material relied on by Express/Claymore fails to demonstrate that an exclusive agreement has been entered into. Aberness refers to Wiseman as the "principle" [sic], rather than "exclusive", supplier to its own stores, i.e. AR Gray stores (Application, page 605), and even Express/Claymore accepts that it is free to bid for supply to those stores on whose behalf Aberness negotiates but which it does not own. The new material made no difference to the analysis and conclusion we had already come to. There was no indication in our correspondence with other smaller dairies, see paragraph 32 above, that exclusive agreements involving Wiseman were a feature of the market.

74. In the absence of any sufficiently compelling evidence of exclusivity, we were unable to conclude that the "all-Scotland" arrangements entered into by Wiseman infringed Chapter II of the Act. We did not believe that merely by committing itself to offer a single price for milk to all outlets of a particular retailer Wiseman had infringed Chapter II. There is no clear or compelling evidence that Wiseman had ever made supply in any area or to any outlet conditional upon supply on an all Scotland or regional basis. In such a case, it is difficult to see that we could have maintained a case to the standard of proof required that Express/Claymore is precluded by agreements of the type alleged from competing for the business of outlets in the Highlands area, and from gaining that business where it is able to offer a more competitive price."

59. The OFT's conclusion was as follows:

"76. By April 2002, for the reasons I have explained, we had therefore begun to take the view that the evidence gathered during the investigation was not conclusive on the existence or absence of infringement in any of the separate strands of the investigation. At a meeting on 14 March Wiseman had been able to provide alternative explanations for its pricing behaviour which we felt were logical and would undermine any attempt to prove that Wiseman's actions departed from a normal competitive response to Express's entry. Wiseman explained the mechanisms through which prices were arrived at for different classes of customer. As we understood it, for the smaller middle-ground retailer customers, this was done without specific reference to the cost associated with the particular run to which that customer might end up being allocated, although the overall depot cost would be a factor. This explained why our observations showed a

number of cases of below total cost pricing. For example, retailer A might be allocated by Wiseman to a high cost run (e.g. where the other customers served were all small and widely-dispersed outlets), while retailer B — perhaps identical in all respects and even quite close to retailer A geographically — might be allocated to a run serving a few high volume customers. The run costs for retailer A would obviously be much higher than for retailer B, but Wiseman would not wish to charge them different prices only on the basis of their allocation to different runs. It followed that retailer A might be regarded for the purposes of our observations as being supplied at below total cost.

…

78. … I should make it clear that we did not regard the work we had done as in any way demonstrating that Wiseman had not abused what we took to be its dominant position in any of the above ways. We would also accept that in theory further work could have been done on the case to test further the allegations that Wiseman was infringing the Chapter II prohibition. We took the view that on the basis of the evidence we had, such further work could not be justified in terms of the OFT's priorities. In effect, we decided to cut our losses on the case and move on to more productive work. It follows that our analysis of the issues in the case is not conclusive and contains some rough edges. Since we were not proceeding to a rule 14 notice, or issuing a detailed decision to the effect that Wiseman was not infringing the Chapter II prohibition, we did not feel that it was necessary to develop the case any further…

80. Secondly, as far as the allegations of exclusive contracts is concerned, it is, I suppose, possible that we could have pursued the allegation in respect of Aberness by, for example, using powers under sections 26 to 28 of the Act to obtain documents and information about its arrangements with Wiseman from Aberness. We could also, I suppose, have discussed with other retailers whether they were party to exclusive arrangements with Aberness. However, we bore in mind that in its evidence before the CC, Aberness had stated in terms that it was clear to Aberness that its arrangements with Wiseman were not exclusive (see paragraph 2.103 of the CC report, Application page 174). For reasons I have already explained, we did not regard the position in this respect as being affected by the material enclosed in Express/Claymore's letter of 5 August 2002 (Application, attachment 21)…"

60. A large number of exhibits are appended to the OFT Witness Statement, including various documents supplied to the OFT during the investigation. These exhibits include documents originating from Wiseman, as well as various compilations by way of graphs, maps and tables of the results that the OFT arrived at in the investigation.

IV THE PARTIES' SUBMISSIONS

A. CLAYMORE'S SUBMISSIONS

61. Claymore's written submissions are contained in the revised notice of application ("RNA") and its skeleton argument filed on 8 December 2004. In essence, Claymore contends that the OFT erred in its consideration of whether Wiseman had engaged in

    (a) predatory pricing;

    (b) targeted discriminatory pricing; and

    (c) exclusionary contracting.

62. We note that, for the purposes of these proceedings, Claymore and the OFT proceeded on the hypothesis that Wiseman was dominant in the market for fresh processed milk in Scotland. The questions of market definition and dominance were not the subject of argument and, accordingly, are not discussed further in this judgment.

Predatory pricing

Alleged errors in the calculation of cost

63. Claymore first submits that the OFT failed to explain its calculation of either Wiseman's average total cost ("ATC") or its average variable cost ("AVC"). The OFT's approach was "broad brush", despite the importance of determining precisely how total costs divide into fixed and variable costs.

64. As to the identification of Wiseman's ATC, Claymore submits that the only place in the OFT Witness Statement where the OFT does so is at footnote 8 to paragraph 47, where the OFT's calculation of ATC is said to be […][**C**] ppl, or […][**C**] ppl when the 3 per cent mark up to reflect financial, administration and central selling costs is applied. This is, in Claymore's submission, to be set against the conclusions arrived at by Messrs.

Haberman and Bezant. Both Mr. Haberman's and Mr. Bezant's assessments are approximately 5-6 ppl higher than that of the OFT.

65. Claymore contends that Wiseman has attempted, in Mr Sweeney's witness statement, to knock […][**C**] ppl off Haberman's assessment of costs by setting off 100 per cent of the revenues arising from bulk cream sales against the cost of milk. Claymore contends that it is illegitimate to set off against the costs the revenues arising from bulk cream sales.

66. Claymore further submits that even on its lower figure, the OFT still found significant evidence of below ATC pricing by Wiseman. However, if […][**C**] ppl is taken to be ATC, then a very high proportion of sales were below ATC. Even if the OFT's calculation had been awry by only 5 per cent, the effect of such an understatement would have been dramatic: the proportion of negative margins among the customer groups analysed by the OFT jumps from approximately 5 per cent of the sample to 67 per cent if one adjusts the figures.

67. Claymore submits that the difference between the OFT's calculation and those of Haberman and Bezant is stark, but the absence of analysis in the OFT Witness Statement makes it difficult to understand how the OFT reached its conclusion. Claymore submits, however, that it is possible to criticise the following aspects of the OFT's conclusion as to Wiseman's costs: the fact that the OFT admits omitting up to 5 per cent of total costs; the arbitrary addition of 3 per cent for financial administration and central selling costs; the omission of the cost of capital; the errors in the calculation of run costs; and the "bottom up" approach to the compilation of costs.

68. Claymore submits that the benchmarking exercise conducted by the OFT to determine whether its own calculation was viable was flawed. For May 2000, the OFT compared its own figure with that found in the CC Report for that date, […][**C**] ppl, and concluded that its own figure was sound. Claymore contends that the CC figure was some 2 ppl, i.e. approximately 5 per cent, higher than that of the OFT, which in an industry of low margins is commercially significant. In any event the CC figures were not calculated and verified as correct by the CC itself, but rather simply provided by Wiseman. Furthermore, Claymore states that there is no explanation of how the OFT arrived at a

calculation for May 2000, when elsewhere the OFT explains that it only analysed figures for May 2001.

69. Claymore further contends that the use of May 2000 as a benchmark is problematic in that there was a substantial and unforeseen fall in the price of raw milk in April and May 2000. In that period costs were the lowest recorded for the entire period November 1998 to September 2001.

70. Claymore also contends that the CC's calculation of Wiseman's ATC for May 2000 could not, in any event, be treated as a comparator for Wiseman's ATC in May 2001, since it would be necessary to add 3 ppl to reflect the increase in raw milk price. The comparator should therefore at least have been […][**C**] ppl, which would have been some 4 ppl higher than the OFT's calculation. Applying the ATC stated in the CC Report to the year to May 2001, the figure for ATC would be circa […][**C**] ppl, approximately 3 ppl higher than the OFT's calculation.

Omission of costs

71. Claymore submits that the 5 per cent of costs that the OFT accepts as having been omitted from its proxy of Wiseman's ATC is significant. The OFT did not appreciate the significance of the industry being a low margin business when it drew inferences based on the proxy estimates of Wiseman's costs.

72. In Claymore's submission, the OFT also admits that a range of costs were omitted from its calculation of AVC. Such omissions – of depot, trunking, central financial and administration, and vehicle depreciation, maintenance, insurance, licensing, and tax costs – highlight the danger of using a rough-edged approach to cost calculation as a basis for forming a conclusion of non-infringement. The OFT's justification – that it assumed all of the processing and packaging costs to be variable whereas some portion was in its view fixed – is in Claymore's view unacceptable: the OFT simply traded one laxity off against another.

Addition of 3 per cent financial administration and central selling costs

73. Claymore contends that costs may very well also have been concealed in the OFT's addition of 3 per cent to the aggregation of the costs requested of Wiseman to reflect financial administration and central selling costs. There was no independent verification of this figure. The OFT has refused to give an explanation of why 3 per cent was considered to be an appropriate figure despite Claymore's request to that effect.

Omission of cost of capital

74. Claymore submits that the OFT erred in omitting Wiseman's cost of capital from its assessment of ATC. The CC Report suggests that a figure of 0.92 ppl should have been included, which would have been significant in the context of assessment of ATC. This admitted omission is also inconsistent with paragraph 370 of the Tribunal's judgment in *Aberdeen Journals v OFT (No 2)* [2003] CAT 11. Moreover, the OFT could simply have used the CC's figure, performed an analogous calculation or asked Wiseman for sufficient information in order to enable it to perform the equivalent calculation.

Calculation of run costs

75. Claymore submits that the OFT further erred in using exclusively volume as a driver for the purpose of allocating run costs to outlets, i.e. the costs of distributing milk from the depot to the middle-ground customer. The CC Report and evidence submitted to the OFT made it clear that other important drivers also determined the allocation of run costs, including distance.

76. Claymore submits that reliance exclusively on volume had as its effect that middle-ground customers were being subsidised because a disproportionately high portion of the run costs were allocated to purchasers outside the relevant product market (supermarkets) and concomitantly an artificially low portion of the costs were allocated to purchasers inside the relevant product market (middle-ground customers).

77. Claymore contends that the OFT's approach results in an element of cross-subsidy between supermarkets and middle-ground customers, the two of which operate in different product markets. The costs which should be calculated in seeking to

determine whether an undertaking is selling below AVC or ATC in a given product market should specifically be those which are attributable to serving that product market. It must be wrong in principle to devise a cost allocation exercise which risks understating the costs of supply in one market (middle-ground) and overstating the actual costs of supply in another market (supermarkets).

Bottom up approach

78. Claymore further criticises the OFT for adopting a "bottom up" approach to costs, under which the OFT compiled costs data by sending a request for costs under headings which it, the OFT, identified, requiring Wiseman to make various estimations and allocations. This contrasts with the "top down" approach, under which one starts with the totality of costs which it is known the dominant undertaking actually incurred and then disaggregates the costs as between lines of activity.

79. Claymore notes that the OFT justifies this bottom up approach on the basis the OFT was simply trying to decide whether to take the investigation any further. Claymore submits that this is not good enough. The internal documents show that the OFT had come to the end of the road and could confidently decide that there was no breach of the 1998 Act. Having failed to convince the Tribunal that it had not adopted a non-infringement decision, the OFT cannot now recycle the same arguments as justification for the fact that it failed to conduct a thorough investigation.

80. Claymore notes that the CC, on the other hand, adopted a "top down" approach. It required Wiseman to provide both a breakdown of profitability between Scotland and the rest of the United Kingdom and a line for an appropriate share of central costs. This ensured that all costs relevant to Wiseman's Scottish operations were included, as it required Wiseman to disaggregate its business from the whole into parts. It also required Wiseman to summarise all of its costs under a series of standard cost categories. In this way, the CC ensured that all relevant costs would appear in one or other category.

81. Claymore submits that even a minor underestimation could have materially influenced the legal inferences to be drawn from the cost analysis. Claymore further contends that the approach of the Court of Justice in Case C-62/86 *AKZO v Commission* [1991] ECR I-3359 to the assessment of costs was rigorous. In *Aberdeen Journals*, cited above, the Tribunal emphasised the duty of the OFT properly to assess costs.

82. Claymore further contends that where a top down approach is only, according to the OFT, "equally difficult" as a bottom up approach, it is illogical for the OFT to choose the less accurate and robust of the two.

83. Claymore submits that the OFT cannot seriously advance the argument that it was not efficient to cross-check the OFT's proxy of conclusions against the management or statutory accounts. The completeness of costs is best verified by reference to overall data beginning with the statutory and management accounts and then working through more detailed information. In any event, it appears from Bezant that Wiseman did maintain detailed management accounting records, thus emphasising that the raw material would have been available for the OFT to conduct a proper top down exercise had it decided to do so.

Assessment of time over which costs are to be categorised as fixed or variable

84. Claymore submits that the OFT erred in failing to determine which costs were fixed and which were variable by use of a relevant or proper time frame, thereby failing to follow the guidance of the Tribunal in *Aberdeen Journals*, cited above. The consequence was that the OFT wrongly calculated AVC. This was a manifest legal error going to the core of the question of abuse.

85. Claymore notes that the question of predatory pricing necessarily involves an assessment of AVC and ATC. This in turn involves a categorisation of different costs as fixed or variable. To determine whether the cost varies with output, one must ask over what period of time any cost becomes variable. Claymore contends that the Tribunal recognised the importance of the assessment of timeframe in *Aberdeen Journals*, cited above, at paragraphs 353 to 356.

86. Claymore contends that the OFT should, by reference to the evidence contained in the CC Report, have found or suspected abuse on the part of Wiseman over a lengthy time exceeding two years from December 1998 (from which date the CC examined Wiseman's prices) to May 2001 (the date upon which the OFT's investigation focussed), and should therefore have taken a lengthy time over which to determine whether costs were fixed or variable. Had it done so, it would in Claymore's submission almost inevitably have found all costs to have been variable: there would have been at least a very strong presumption that all or a very high proportion of costs were avoidable over such a period.

87. Claymore further submits that the OFT's treatment of this issue has been inconsistent. First, it originally asked Wiseman in October 2001 for costs to date for June and December 2000 and June 2001, but varied its request at Wiseman's suggestion to May and November 2000 and May 2001. Secondly, there is no explanation as to why only three months were chosen, which choice contrasts with the OFT's request for price data for the same customers as those for which it sought costs data. This latter request sought monthly price data for the whole period from 1998 to September 2001. Thirdly, the OFT states in its Reply that it had no conception as to the period over which predatory pricing might have occurred and, in its Defence, that it did not need to have any particular time frame in mind. Yet in the OFT Witness Statement the OFT states that it took a short term view in calculating its high and low levels of variable costs, and took only the May 2001 data-set for its analysis.

88. Claymore submits that if the OFT's supposition that it is not necessary to have any time frame in mind were correct, the approach set out in *Aberdeen Journals*, cited above, would always be inapplicable because in that case the Tribunal identified a test which, in principle, will be relevant to all cases. There was no conceivable obstacle to a proper assessment of the relevant time period.

Predatory pricing: intent

89. Claymore submits that the OFT should have found the requisite intent to establish predatory pricing by Wiseman. The OFT erred in concluding that "intent" meant an absolute intent to exclude, thus setting the bar at too high a level.

90. In Claymore's view, there was copious evidence before the OFT demonstrating the requisite intent:

(a) Wiseman's own evidence to the CC was that its aggressive approach to Claymore was justified on the basis that Express was not a "legitimate" purchaser of Claymore, and that if someone else had purchased Claymore Wiseman's reaction would have been completely different;

(b) Wiseman's position before the Tribunal, set out in Mr Sweeney's witness statement, is that its conduct was justified on the contradictory basis that it believed that Express' acquisition of Claymore was no more than an illegitimate spiking exercise designed to deter Wiseman from expanding in England where Express was inefficient. Even if that were true, this explanation cannot justify a dominant firm adopting abusive conduct in its own back yard on a "tit for tat" basis;

(c) The timing of Wiseman's reaction to Express is demonstrative of pre-emptive behaviour. Wiseman targeted Claymore's customers, certain of them for the first time, immediately upon the announcement of the acquisition of 51 per cent of the shares of Claymore by Express. There is no evidence that Wiseman would have expanded into the Highlands but for the acquisition;

(d) There is nothing to suggest that Wiseman's conduct was driven by a desire to make profits, as is clear from Mr Alan Wiseman's answers to questions posed by the CC.

(e) Wiseman's termination of its existing subcontracting arrangements with Claymore in relation to certain processing, packaging and distribution activities demonstrates that its reaction was abnormal;

(f) There is evidence that Wiseman did not evaluate or account for its reaction to Express' acquisition in the ordinary way. Wiseman produced no financial forecasts of the profitability of sales to Claymore's customers it targeted or do *ex post* evaluations of whether profits had in fact increased;

(g) It must have been foreseeable to Wiseman that if it, as the dominant incumbent, reacted aggressively to towards Express/Claymore, this would serve to warn off others considering market entry.

91. Claymore submits that even though much of the evidence referred to above pre-dates the coming into force of the 1998 Act, the evidence of below-cost sales and widespread discrimination found by the OFT post-dates March 2000. According to Claymore, the evidence given by Mr Sweeney is intended to and does relate to the entire period, including the period of the OFT investigation.

Price discrimination

92. Claymore also submits that the OFT erred in its analysis of the allegations of unlawful price discrimination. Its arguments are as follows:

(i) Despite finding extensive evidence of price discrimination, the OFT concluded that this was insufficient in the absence of "targeting". Yet even if this were the correct test, which in Claymore's view it is not, there was plenty of evidence of targeting (see above);

(ii) The OFT has decided the price discrimination element of this case on the basis of case law concerned with price discrimination above costs. Given the significant incidence of below-cost pricing, the OFT should have relied upon that fact to conclude that the pricing was *prima facie* abusive and then left it to Wiseman to attempt to advance an objective justification for the differentiation. The ousting of Express would not have sufficed as a justification.

(iii) The OFT did not examine the case from the perspective of long standing case-law on the need to "cost justify" widely differentiated discounts.

(iv) The OFT impermissibly took account of its conclusion that price discrimination was not uncommon in the dairy industry. The fact that non-dominant firms may also engage in low competing offers compared with those made by the dominant undertaking does not serve to exonerate the dominant undertaking.

(v) The graphs contained in the annexes to the OFT Witness Statement, upon which the OFT relied, are riddled with errors and imprecision. The OFT admits that they contain "rough edges". Such imprecision is insufficient for drawing definitive legal inferences and conclusions. The OFT appears in any event to have misread its own scatter graphs and underestimated the extent of price discrimination;

(vi) The OFT erred in concluding that Wiseman's price discrimination was similar to that of Express/Claymore: in fact, according to the analysis of Haberman, there are significant differences;

(vii) The OFT erred in omitting from its comparative analysis those customers with whom Wiseman had "All of Scotland" (or similar) contracts.

(viii) The OFT failed to have regard to documents in its possession taken from the dawn raid, such as document 2(f) at pp 38-39 of the Exhibit to the OFT Witness Statement, which according to Haberman shows that the drop in prices from the Keith depot was steeper than from other depots and should have been investigated by the OFT. The inference to be drawn is that Wiseman was operating a discriminatory policy.

(ix) Haberman identifies a number of key omissions from the OFT's analysis of prices and revenues which render the conclusions it reached unreliable. These include the failure to single out those customers which were the subject of the inquiry and the fact that the OFT's sample was unrepresentative.

Exclusionary and/or exclusive contracting

93. As to the allegations of exclusionary and/or exclusive contracting by Wiseman, Claymore submits that the OFT adopted a flawed approach to its investigation. First, it concentrated wholly upon a search for *de jure* exclusive contracts, thereby ignoring evidence that Wiseman was entering into contracts which had the object and effect of excluding third parties. The OFT wrongly drew a distinction between 100 per cent exclusive contracts and "All of Scotland" contracts, under which a flat price is offered irrespective of distance. In limiting its investigation to 100 per cent contracts, it ignored both contracts which were substantially but not wholly foreclosing, and contracts which were *de facto* foreclosing. In relation to Wiseman's contract with Aberness, for example, the OFT failed to take account of the actual or potential foreclosing effect of a contract that secured for the supplier the role of main or principal supplier in return for a "one-off loyalty" payment: see Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461 at paragraph 89, Case T-65/98 *Van den Bergh Foods v Commission* [2003] ECR II-4653.

94. Claymore contends that the OFT erred in considering that only contracts which were actually foreclosing were abusive rather than also contracts which have a potentially foreclosing effect. The Chapter II prohibition also prohibits conduct which might potentially harm competition.

95. As to the one-off loyalty payment to Aberness, noted in the CC Report, Claymore observes Wiseman's confirmation that the amount of the payment equated to between 10 per cent and 15 per cent of the sales revenue generated by Aberness in the first year of supplies by Wiseman. Claymore submits that even without knowing the actual figures involved, a "loyalty" payment of up to 15 per cent of revenues generated by Aberness is on any view substantial. The OFT failed to infer from the CC Report that Wiseman was engaging, and was willing to engage, in collateral transactions designed to ensure that it dominated the supply chain to the exclusion of third parties. Furthermore, Claymore criticises the OFT for not following up leads and asking customers for information as to the terms of their agreements with Wiseman. This amounts in Claymore's view to a serious procedural error: the OFT could never have unearthed the true position without asking customers of Wiseman for information. Finally, Claymore submits that the OFT should not have allowed its views in predation and price discrimination to taint its views on exclusivity. The *de facto* exclusive contracts could still have been abusive even in the absence of predation and price discrimination.

Standard of proof

96. Finally, Claymore submits that the OFT took an extremely restrictive view of the standard of proof. The OFT applied the *Napp* standard to each element of the investigation rather than considering the matter in the round. It also applied the *Napp* standard when considering whether to continue with an investigation, which is too early a stage.

B. THE OFT'S ARGUMENTS

General

97. The OFT's written submissions are contained in the Defence and the skeleton argument lodged with the Tribunal on 15 December 2004. First, the OFT submits that there is a fundamental difference between the parties with respect to the nature of the decision under appeal. Claymore's attack rests on the assumption that the OFT reached ultimate conclusions on three of the main issues in the investigation: predatory pricing, targeted discriminatory pricing and exclusionary conduct through exclusive contracting. This is misconceived. The OFT's decision was that it was not possible to reach a robust decision that Wiseman had infringed the Chapter II prohibition, based on the pertaining results. However, it was not possible to reach a decision that there had been no infringement. Further work could have been done, but there seemed little prospect that it would result in the basis for an infringement decision.

98. The OFT submits that the Tribunal's task here is to assess whether the OFT's view on the merits (and its reasoning for closing the file) was based on some error of approach. The Tribunal should take account of the nature of the OFT's investigative process which led to the decision to close the file, as well as the decision itself:

(a) the OFT built up a picture, using a large sample, of the extent to which Wiseman had been charging prices to customers which were below AVC and ATC. It found no instances of below-AVC pricing but did find some instances of below-ATC pricing;

(b) the OFT found no indications of targeting against Claymore from pricing patterns;

(c) it was given a credible account by Wiseman which could explain the instances of below-ATC pricing to some customers. The reason was that it was not practicable to charge individual custumers prices based on the costs of the particular run to which, for logistical reasons, they were allocated;

(d) the OFT found little evidence of intent to exclude Claymore from the market such as to support a finding of predatory pricing or targeted discrimination;

(e) whilst there was substantial price discrimination, Wiseman gave a benign explanation for it. Furthermore, it did not appear to have anti-competitive effects and appeared in general to be a feature of the industry;

(f) there was little evidence that Wiseman had entered into exclusive agreements with customers so as to exclude Claymore from the market or a part of it;

(g) the OFT also looked for evidence of excessive pricing to some customers, and concluded that this was mixed.

99. The OFT argues that by early August 2002 it had, in short, arrived at a point in the investigation where it felt it appropriate to review the prospects of uncovering an infringement. The OFT recognised that if the decision were made to press on, further work would have to be done – for example, to refine estimates of cost. Yet there was enough material for the OFT to reach an informed decision as to whether to take the matters forward.

100. The OFT submits that Claymore is asking the Tribunal to treat the file closure decision as if it were a final non-infringement decision, which it is not. Claymore therefore misunderstands the nature of the decision under challenge and attacks a false target, thereby undermining much of its submissions.

Predatory pricing

"Bottom up" v "top down"

101. The OFT contends that, contrary to Claymore's arguments that a top down approach to calculation of costs would necessarily have been more accurate and is the (only) correct approach, that approach was not sufficient for the OFT's purposes. The CC did not attempt to distinguish between the costs of supplying different customers depending on their location. Such costs vary significantly. Since a customer's location affects the costs of supply, taking a single figure for ATC or AVC for the business as a whole, as the top down approach does, produces a misleading result. There is, in the OFT's submission, no advantage in using the top down approach to assess costs of supplying individual middle-ground customers in a sample: it would not change the need to make assumptions about how to allocate costs between different parts of the business (e.g. supermarkets vs middle-ground customers), and then between different customers.

102. The OFT submits that it would not have assisted to take Wiseman's statutory or management accounts as the starting point for a top down analysis in that they do not show the costs of supplying middle-ground outlets or customers, or help in the estimation of run costs. In short, the OFT's bottom up approach was appropriate.

Below-AVC pricing

103. As to Claymore's argument that the OFT's estimation of AVC was flawed because it left out of account certain elements of variable cost, the OFT submits that the point is that the OFT included all processing and packaging costs in its high measure of AVC even though 35-47 per cent of those costs were estimated by the CC to be fixed. Packaging and processing costs accounted for 6.4-18.1 per cent and 5.9-28.7 per cent respectively of total costs. The net effect was that the estimates of AVC were likely to have been systematically overstated, rather than the reverse. The OFT's high measure of AVC was therefore robust. The OFT found almost no instances of below-AVC sales using the high measure.

104. As to Claymore's arguments concerning the correct time frame for analysing costs, namely that the OFT should have taken the maximum period over which the price could be below ATC, here over two years, and that almost inevitably all costs were avoidable over this period, the OFT submits that Claymore here fails to take account of the way in which the OFT's analysis develops over the course of an investigation. In the first phase, a general assessment of costs of supply is carried out, from most to least variable. In the event, the OFT carried out the first phase of its analysis using the high measure as well as the low measure of AVC. Had the results suggested the existence of significant below-AVC pricing, the OFT would have proceeded to refine its estimates, including adopting a particular time frame.

105. The OFT contends that there is in any event no basis for Claymore's suggestion that, in the light of the results in the CC Report, the OFT had no alternative but to begin its investigation by working out which costs were avoidable over a 2½ year period and take this as the correct measure of AVC: the CC's analysis in this regard was not sufficiently detailed to allow, or at least require, such an approach.

Other errors in cost estimation

106. As to Claymore's argument concerning the estimation of Wiseman's ATC, the OFT contends that Claymore has misunderstood the figures. The OFT's estimate of […][C] ppl is the cost of supplying one particular customer, CWS, in May 2000. Mr Haberman's calculation refers to something different: Wiseman's average cost of supplying all customers across the whole of the UK for the years ended 31 March 2000 and 31 March 2001. Similarly, Mr Bezant's figure refers to something different: he has aggregated a number of cost elements from different times and sources with a view to providing a basis for indicating roughly the relative size of the various cost elements, not to produce a reliable total.

107. As to Claymore's argument that the OFT's cost estimates are wrongly depressed because Wiseman netted off revenues from bulk cream sales, the OFT argues that Claymore is mistaken to refer to cream sales as an unrelated activity. Cream is a by-product of producing milk: it was not unreasonable to follow Wiseman's internal accounting convention of taking into account cream revenues when assessing the profitability of its milk business. Moreover, the OFT submits that this approach was industry practice and reflected commercial reality, as the CC Report acknowledged.

108. As to Claymore's argument that the OFT's cost estimates can be shown to be wrong by the cross-check carried out between the OFT's estimate of total cost of supplying CWS in May 2000 and the CC's estimate of total cost of supplying CWS in the two months to May 2000, the OFT contends that that cross-check actually gave the OFT comfort that its estimate was likely to be accurate since there was only a 5 per cent difference between the figures. The figures were unlikely to be the same in part because the periods were not co-extensive. As to Claymore's argument that May 2000 was problematic as a benchmark, the OFT contends that the cross-check exercise had the limited ambition of comparing two sets of figures relating to broadly the same time; it was not the lynchpin of the cost estimation process.

109. As to Claymore's contention that run costs were inappropriately allocated by volume, the OFT submits that its approach was reasonable in view of the characteristics of Wiseman's business. The main "driver" of Wiseman's business concerns the supply to

supermarkets. Costs would be incurred supplying them even in the absence of middle-ground business. Wiseman's deliveries to middle-ground customers are, in essence, arranged around its supermarket deliveries. To split costs on the basis of distance travelled or time spent would be misleading in that the cost of supplying supermarkets would fall significantly and the cost of supplying middle-ground customers would appear high even though the additional cost, taking the supermarket as a given, was relatively low.

110. The OFT submits that Claymore's suggestion of "activity-based" costing is not workable. It would be extremely time consuming, and allocation would be difficult. Mr Haberman recognises that difficulty at paragraph 5.90 of his report, suggesting that for simplicity all run costs should be shared equally between outlets on a run. The OFT submits that this notion is problematic. If, for example, there are two customers, a supermarket taking 950 litres per day and a new middle-ground customer taking 50 litres per day, on a route, on Mr Haberman's approach the run cost of supplying the new middle-ground customer is to be taken as 50 per cent of the cost of the run. That approach does not match commercial reality. The OFT's approach would attribute 5 per cent of the run cost to the new outlet. The OFT's approach was both reasonable and in touch with the reality of Wiseman's business.

Below-ATC predatory pricing

111. As to Claymore's submissions that the OFT overlooked significant below-ATC pricing by Wiseman, the OFT notes that it found 495 out of 3039 instances of such pricing in the sample it analysed. The OFT submits that it was prepared to regard this as potentially significant, and went on to consider whether there was any pattern to that pricing. However, no pattern suggestive of anti-competitive intent could be discerned from the data, particularly when analysed at customer level.

112. As to its use of a 3 per cent mark up to reflect central selling, financial and administrative costs, the OFT contends that such a figure was not arbitrary. It was based on information provided to the OFT by Wiseman at the time of negotiating the assurances (although not recorded in writing). This figure is confirmed by Mr Sweeney.

113. As to the omission of the cost of capital, the OFT submits that it was unnecessary to calculate that cost at this stage of the investigation in the present case. Adding a fixed percentage to the costs of all customers within the sample would make little difference to patterns the OFT was examining. Nor is estimating the cost of capital straightforward. It was not unreasonable for the OFT to assess the results of its initial work and look for a pattern suggesting anti-competitive intent, which might point in favour of deepening the investigation.

114. As to Claymore's contention that the OFT overlooked significant evidence of abusive intent, the OFT did not uncover any pattern indicative of such an intent. The evidence put forward by Claymore is in fact limited. When Alan Wiseman stated that Express was not a "legitimate purchaser of Claymore", he meant he did not believe that Express was interested in making normal commercial profits. The background was that Express was seeking to supply the whole of the Scottish market from a single depot in Nairn, some considerable distance from the Central Belt where most of the market was concentrated. Wiseman's "hit list" does not demonstrate exclusionary intent, particularly when set against that background. Furthermore, the OFT submits that:

(a) there was a benign commercial justification for price discrimination;

(b) there was nothing odd about Wiseman wishing to terminate its sub-contracting arrangements with Claymore following its acquisition by a major competitor; and

(c) Claymore's submissions wrongly convey the impression that Wiseman did not supply CWS, Alldays and Aberness/Mace at all before 1998; in fact it did, albeit Wiseman and Claymore did not tend to compete for business in the Highlands and outside the Highlands respectively.

Price discrimination

115. The OFT submits that whilst it found evidence of price discrimination, this does not mean targeting or, more generally, abnormal commercial behaviour which may exclude competition and be abusive.

116. In the OFT's view, Claymore takes the extreme position that any price discrimination is automatically abusive, or at least that there is a need to cost-justify discounts. The OFT contends that the cases referred to by Claymore do not support Claymore's propositions.

117. The OFT submits that Wiseman had a benign and credible explanation for instances of price discrimination, relating to the way in which customers were allocated to particular runs for logistical reasons. Price discrimination is, moreover, a feature of the industry, as can be seen by a comparison with the pricing of Lordswood, based in South West England, where price discrimination was also present despite that the dairy was neither dominant nor facing competition from a dominant firm.

118. The OFT rejects the criticism that it did not single out customers allegedly taken by Wiseman from Claymore by abusive conduct. The sample in fact over-sampled the Highlands, Claymore's core area. In any event, Wiseman would have had to offer similar low prices to others within the geographical area affected, including to existing customers.

119. As to the graphs exhibited to the OFT Witness Statement, the OFT argues that these were not the exclusive basis for the OFT's conclusions. Also, large numbers of operations were done on the data to identify patterns, without saving every step. There were no patterns indicating targeted behaviour. The so-called errors in the graphs are either misunderstandings on Claymore's part or are trivial.

120. The OFT further submits that:

    (d) there was no flaw in not separately analysing Wiseman's "All of Scotland" customers: whilst there is no graph showing a comparison of such customers with others, the case team studied the results for national customers and found no pattern;

    (e) there was no flaw in allegedly failing to investigate a larger than normal fall in prices offered to customers served from the Keith depot: in fact, all runs from Keith were included in the sample. Comparisons were made with other customers for evidence of targeting or predation;

(f) contrary to Claymore's argument that the sample was unrepresentative, the OFT's sample was not intended to estimate population averages. The OFT wished to consider both large and small customers. It was important to include some large customers (in particular CWS) as it was the loss of these customers that might be expected to have the most serious effect on Claymore.

Exclusionary exclusive contracting

121. As to Claymore's contentions regarding Wiseman's alleged exclusive contracting, the OFT first contends that its views were not "tainted" by its views on predation and price discrimination, and there is no basis for Claymore asserting to the contrary.

122. As to the supposed failure to appreciate the problem of "All of Scotland" contracts which involve a single price regardless of distance, the OFT contends that such contracts are not abusive in themselves. Unless the supply to any area or outlet is made conditional upon supply on an "All of Scotland" or regional basis, or involves some other restrictive provision or is priced at a predatory level, there is nothing objectionable.

123. As to the alleged failure to consider contracts falling short of 100 per cent requirements, or which had potential effects on competition, the OFT argues that it would have readily examined evidence of a pattern of requirements contracts which was causing difficulty for competition. The fact is, however, that there was no such evidence.

124. As to Claymore's argument that the OFT failed sufficiently to investigate problems with the Aberness contract, said to be *de facto* or near *de facto* exclusive, and that the OFT overlooked the significance of a loyalty payment made by Wiseman to Aberness in 1999, the OFT submits that the only evidence, from the CC Report, of exclusive agreements was (i) the attempt in 1999 by Wiseman to enter into a "sole supplier agreement" with Aberness; (ii) a "gentleman's agreement" in relation to Aberness company stores (not including Mace) in relation to which Wiseman would remain a main supplier; this agreement was said by Aberness to be terminable at will by Aberness; and (iii) that one of 526 smaller retailers claimed to have such a provision in the period 1998-2000.

125. The OFT argues that the only other evidence was supplied by Claymore in August 2002, which related to an exclusive dealing arrangement with Aberness in respect of one chain of middle-ground stores (AR Gray), terminable at notice and in any event running for only 12 months. It was not explained how that would foreclose competition.

Standard of proof

126. As to Claymore's argument that the OFT set itself too high a hurdle by supposing that it would have to establish each aspect of the case to a very high standard, the OFT submits that the inference to be drawn from Claymore's approach is that the OFT should be willing to make infringement decisions not supported by robust evidence because more material might turn up on appeal. The OFT rejects such a proposition.

C. WISEMAN'S ARGUMENTS

127. Wiseman's written submissions are contained in the Statement of Intervention and the skeleton argument lodged with the Tribunal on 20 December 2004. Wiseman submits that the case has got out of hand. Claymore is unwilling to engage in reasoned debate about the scope of its appeal or the role of the Tribunal in a complainant's appeal of this kind. Wiseman suggests that the Tribunal take an overall view from first principles.

Scope and standard of review

128. Wiseman refers to the Tribunal's judgment in *Freeserve (merits)* [2003] CAT 5 in which the Tribunal said that there were no hard and fast rules as to the Tribunal's approach given the circumstances in which appeals may arise (at paragraph 101): everything will depend on what is necessary to meet the justice of the case, bearing in mind the need for fairness, expedition and saving costs (at paragraphs 112-114).

129. Wiseman submits that the primary purpose of the present appeal was said by the Tribunal to be (a) whether the OFT has made a material error of law; (b) whether it has carried out a proper investigation; (c) whether the reasons are adequate; and (d) whether there are material errors in its appreciation: see *Claymore (Recovery and Inspection)*, cited above, at paragraphs 109-110 and the transcript of the case management

conference on 2 September 2004 at p 7. Wiseman contends that the following matters are relevant when making that assessment: (a) the type of decision under appeal; (b) the nature of the challenge; (c) the nature of the issues before the Tribunal; (d) the extent of the OFT's prior knowledge and experience; (e) the history and length of the investigation; and (f) the scope of the original complaint.

130. As to the first of these six factors, the Tribunal has characterised the decision at issue as being that "no infringement of the Chapter II prohibition could be established on the evidence, or to put the matter the other way round, that there was insufficient evidence to establish an infringement": *Claymore (Admissibility)*, cited above, at 144. Whilst the parties accept that the decision at issue is a decision "as to whether the Chapter II prohibition has been infringed", it would be unsubtle and simplistic to equate the decision at issue for all purposes with a decision such as those in *Bettercare* and *Freeserve*, where the unequivocal conclusion was that there had been no infringement of the 1998 Act. The same position was not adopted by the OFT in this case. At a certain point in its investigation it took the view that the evidence did not disclose an infringement and it therefore closed its file.

131. Wiseman submits that Claymore, by contending that the decision is defective because it does not contain the reasoning or depth of analysis that a non-infringement decision should contain, is impermissibly attempting to collapse all appealable decisions into a category in which the OFT has positively concluded that there is no infringement. Criticisms that the OFT's appraisal is essentially inconclusive have no force in respect of a decision of the type at issue. The Tribunal should be slow to criticise such a decision as having rough edges or appearing less well reasoned.

132. As to the second factor, Wiseman submits that the Tribunal should pay particular attention to the fact that Claymore no longer challenges the OFT's view that there was insufficient evidence before it on which to establish an infringement of the Chapter II prohibition. The appeal now concerns the sufficiency of the OFT's investigation and robustness of methodology used. However, different approaches are always capable of yielding different results: the Tribunal should require persuasion that the OFT has made serious errors of approach.

133. As to the third factor, Wiseman submits that Claymore ignores the extent to which the appeal concerns a challenge to the OFT's exercise of its discretion. The key question for the Tribunal is whether, in carrying out its investigation, the OFT acted fairly, lawfully, rationally and proportionately. In view of the OFT's wide responsibilities and finite resources the Tribunal should be careful to apply a proportionality test when deciding how far down the path the OFT should have gone, at what point it was reasonable to stop etc. It is unrealistic to say, as Claymore does, that the only correct approach was to conduct a "full and exhaustive" investigation. Moreover, the OFT must adopt a proportionate approach in respect of the burdens it imposes on undertakings under investigation.

134. Wiseman points to *Freeserve (merits)*, cited above, in which the Tribunal said that in matters of economic assessment the OFT has a certain margin of appreciation. Wiseman submits that that is *a fortiori* the case when considering how the OFT conducted its investigation, as this will always raise issues on which reasonable minds may differ. A manifestly erroneous approach should have to be shown.

135. Wiseman further submits that the Tribunal should allow the OFT appropriate latitude in the evaluation of facts and the drawing of inferences, as distinct from making findings of primary fact (of which Wiseman can find none in the decision): see *Assicurazioni Generali v Arab Insurance Group* [2003] 1 WLR 577 at paragraph 16. The key question, in Wiseman's submission, is whether the OFT asked itself the right legal questions, e.g. as to the test for predatory intent. The OFT's concession that errors of principle need not be shown to have actually made a difference does not alter the approach the Tribunal should adopt. The effect of that concession is not that immaterial errors now suffice to undermine the decision: such approach would be inconsistent with the requirements of fairness, expedition and saving costs.

136. Wiseman submits that the level of reasoning must be sufficient to enable the addressee to work out what the OFT in fact did and enable him to assess whether the decision is well founded. The reasons do not have to deal with all the issues and set out all the material considerations. The key question in Wiseman's view is whether the OFT has put forward reasoning that is appropriate for the decision actually taken.

137. As to the fourth factor, Wiseman submits that the OFT had considerable relevant understanding and knowledge from previous merger reports in 1992 and 1996, Wiseman's quarterly price reporting since 1997, its own investigation prior to the referral to the CC in 2000, its review of the Gilmours and AMCo acquisitions in 1999, the CC Report, and the negotiation of and information from the voluntary assurances. Some steps that might have been appropriate for a body looking at the matter *de novo* were not necessary in circumstances where the OFT already had extensive prior knowledge of the market and undertaking in question.

138. As to the fifth factor, Wiseman submits that regard should be had to the history and length of the investigation, and to the commercial realities underpinning the complaint. This is not a "David and Goliath" contest. Express had a turnover and operating profit three times that of Wiseman at the time of the original complaint and double Wiseman's market share in the market for fresh processed milk in the UK. Arla's turnover remains three times that of Wiseman. Moreover, in Wiseman's view the complaint is commercially motivated: in the early 1990s Wiseman broke the stranglehold of the incumbents in the English dairy business, and was a threat to the *status quo* in England, where Express was the market leader and has been struggling to compete in terms of efficiency. Wiseman submits that Express' entry into Scotland was based on a flawed commercial strategy.

139. Wiseman submits that the Tribunal should have regard to the time that has already been taken by the UK authorities in reviewing these matters and the enormous strain this has placed on Wiseman, not to mention the costs it has incurred. It is the longest running case before the Tribunal, and is one where the processes of all the UK competition authorities are being used by Express to damage Wiseman's reputation. Wiseman submits that it offends against the principle that there must be an end to litigation and to regulatory investigations of complaints, especially from well-resourced players who can defend their own interests.

140. As to the sixth factor, Wiseman notes the Tribunal's judgment in *Freeserve (merits)*, cited above, at paragraph 116, that the starting point is that the original complaint sets the basic framework within which the merits of the decision are to be judged. The Tribunal should be wary of allowing Claymore to put forward new criticisms.

Moreover, the nature of the complaint and complainant are relevant: the more sophisticated and better resourced the complainant, the better supported the complaint should be. The Tribunal should be demanding and require that the challenge to the OFT's approach be made with rigour and precision.

Relief

141. Wiseman submits that even if the Tribunal were persuaded that there were serious flaws in the OFT's approach, it would still be a matter of discretion as to whether to remit the matter to the OFT. Wiseman suggests various matters to be taken into account:

(a) it is inherent in the word "remit" that the review body "sends back" to the decision maker the issue that was before it. What is remitted is the original complaint. Wiseman submits that it should be no part of the Tribunal's direction that the OFT should also consider subsequent events or further submissions or evidence from the applicant: that is a matter for the OFT's discretion.

(b) This is essentially an historic complaint;

(c) There is no serious prospect of Claymore going out of business: on the contrary, Arla/Express now plan to open a large dairy to service the Central Belt in 2005;

(d) Two thorough expert competition inquiries have failed to reach any conclusive view;

(e) The decision has only limited effects: it does not preclude the OFT from reopening the investigation if new evidence comes to light;

(f) Express/Arla is a well-resourced competitor which does not need the OFT to do its work for it;

(g) The overall principles of saving costs and fairness in proceedings which the Tribunal directs to take place.

Predatory pricing

142. First, Wiseman sets out its summary of what the OFT investigation revealed, against which Claymore's criticisms can be evaluated:

(a) the OFT sampled 809 customers with 1,150 outlets. A total of 3,039 different products was sold from these outlets. Only 33 products were found to be being sold at less than the high measure of variable cost (0.8 per cent of the total volume). Of the 495 out of 3,039 products found to have been sold at less than ATC, it was found that these instances of customer groupings with revenues below ATC accounted for less than 5 per cent of volumes, were concentrated on the health sector and were not in the Highlands, the core area of Claymore's complaint;

(b) no pattern suggestive of anti-competitive intent was found by the OFT. In any event, Wiseman's approach is to set prices across customer accounts and not outlets, thereby seeking to make a profit from each customer taking all products and deliveries into account. This may, as the OFT recognises, have affected the results.

143. Secondly, Wiseman submits that Claymore's description of supposed differences between the OFT, the Haberman report and the Bezant report in the calculation of ATC is inaccurate. Claymore compares different customers over different time periods using different methodologies and present the results as being weighty evidence that the OFT erred in its approach. However, it is clear from the OFT Witness Statement that the CWS calculation for May 2000 was only ever intended to cross-check for completeness of costs. The price-cost analysis was based on the sample of runs and costs for May 2001; nevertheless, Claymore inappropriately compares the OFT's figure for the ATC of supplying CWS in the month of May 2000 with (i) the Haberman report's estimate for Great Britain-wide ATC for the years ending 31 March 2000 and 2001; (ii) the CC's estimate of the ATC of serving CWS in the year to May 2000 and in the ten months to March 2000; (iii) the Haberman report's estimates for May 2001 based on the CC's figure for the ATC of serving CWS in May 2000 erroneously adjusted for a change in Wiseman's raw milk prices; and (iv) the Bezant report's illustrative costing estimating the relative percentage proportion of total costs represented by various categories of cost, all of which comparisons were invalid.

144. Wiseman confirms that the figures put forward by the Bezant report were not advanced for the purpose of calculating Wiseman's ATC at any particular point in time but were taken from a variety of sources from various years for illustrating the proportions

within Wiseman's total costs of certain types of cost. Furthermore, the suggestion that Wiseman improperly depressed its costs by covertly adding back in cream revenues is misplaced: it is simply industry practice (indeed, it is what Claymore does).

145. Wiseman further submits that Claymore's arguments that the OFT's calculation was understated by 5 per cent, and that this is potentially significant, are invalid for the reasons set out by the OFT. The Bezant report explains why it is not right to suggest that there was a 5 per cent understatement: the CC and OFT used different methodologies.

146. The key question, in Wiseman's view, is whether the OFT omitted material categories of cost. The CC Report is not, as Claymore suggests, "precedent".

147. Wiseman contends that another example of Claymore drawing an inappropriate comparison is its suggestion that the OFT's calculation of total costs could be understated by 11-15 per cent, without seeking to counter the Bezant report's demonstration that the Haberman report's observations are wrong because they result from false comparisons between months on the one hand and years on the other, and/or figures erroneously adjusted prior to the comparison and using different methodologies.

148. Thirdly, Wiseman submits that Claymore's arguments as to the use of high and low measures of AVC are also flawed. First, the OFT was not, as Claymore suggests, "forming a definitive conclusion of non-infringement". The issue is rather whether the OFT's approach was appropriate for checking at that stage in its investigation whether there was some evidence of abusive pricing of the kind alleged by Claymore. The OFT found that no customers were paying prices below either the high or low measures of AVC and only a small subset fell below ATC.

149. Wiseman submits that the OFT did not, as Claymore suggests, overlook any categories of cost. They rather took an approach that all costs were either fixed or variable. Whilst some of the costs treated as fixed had small variable elements, those variable elements were smaller than the fixed elements of packaging and processing costs treated by the OFT as entirely variable. The OFT's approach led to AVC being

overstated, not understated. The approach taken was therefore not one of double laxity but an appropriate and reasonable basis for the exercise at hand.

150. Fourthly, Wiseman submits that the OFT's addition of 3 per cent to cater for central selling, financial and administration costs is appropriate. No case has been advanced by Claymore as to why it might be wrong.

151. Fifthly, Wiseman submits that Claymore's criticism of the OFT's decision not to add a figure for the cost of capital when considering whether Wiseman was pricing below ATC is misplaced. The incremental business won from Claymore involved no or almost no capital investment since the Keith depot and the dairy which serviced it already existed. Customers whose prices exceed ATC – including all ex-Claymore customers – are in any event contributing to a return on total capital.

152. Sixthly, Wiseman submits that the allocation of run costs by volume was appropriate. It is agreed that volume is not the only driver of run costs, but the great majority of Wiseman's costs does vary according to volume; moreover, Wiseman did not maintain detailed records that would allow the calculation of the costs of the minor elements of run costs that were not volume-related. But the central and most erroneous submission, in Wiseman's view, is Claymore's contention that the OFT was incorrect to take the view that there is no right way to allocate run costs and that allocation is inevitably subjective and artificial. The Haberman report itself suggests, when it states that delivery costs based on time spent at outlets should "for simplicity" be shared equally between outlets, that there is no right way of costing on the basis of activity as Claymore suggests.

153. Wiseman rejects Claymore's suggestions that allocation by volume will inevitably understate the true cost of serving a middle-ground customer whenever that customer is on a run which includes a supermarket and suffers from the flaw of resulting in a cross-subsidy. There is no "correct" answer for assessing the "true cost" of serving a particular customer on a delivery run where a range of diverse customers is being served. From the dairy company's perspective it is efficient to serve an additional customer on an existing run if that customer is contributing to fixed costs. Allocation of such costs by volume reflects the fact that these costs are influenced by volume-

related matters. As to alleged cross-subsidy, Wiseman contends that a small customer on a run which includes a supermarket is not being cross-subsidised if it makes a contribution to fixed costs.

154. Seventhly, as to whether the OFT erred in calculating costs "bottom up" or "top down" Wiseman submits that Claymore does not identify any costs that were omitted from the OFT's analysis, and so the criticism is essentially sterile. In any event, the inference that "top down" is the more, and "bottom up" is the less, accurate is simply not valid. Each approach has its own place and may depend on the level of disaggregation that is desired to be achieved. Given that the OFT wanted to investigate a small part of Wiseman's business in detail, the bottom up approach made more sense: there was no need to start with the whole of Wiseman's business and progressively strip out costs that were not related to the parts under investigation. Furthermore, it would not have been helpful to use the top down approach as a cross-check, as the choice between top down and bottom up was not finely balanced.

Time frame

155. As to the whether the OFT erred in failing to determine the time period over which costs should be assessed, Wiseman submits that Claymore's approach makes it necessary for the OFT to assume that predation has been taking place over the specified period before it makes its investigation into whether it has been occurring at all. Where the alleged period is lengthy, as here, Claymore's test would result in many costs being treated as variable, making a finding of predation much more likely and eliminating the need to demonstrate intent. The OFT was right not to take that approach but to consider first whether there was any evidence of predation directed at Claymore. *Aberdeen Journals*, cited above, does not lay down a firm rule that in all alleged predation cases the OFT must make an assessment over the whole period in which it is alleged or suspected that predation may have been occurring. Such an inflexible rule would be contrary to paragraph 354 of that case, where the Tribunal said that it did not rule out the OFT taking other periods if to do so would be reasonable from a business perspective.

156. Wiseman adds that the high and low measures of AVC used by the OFT were reasonable proxies for different time periods, with the high measure representing a long run estimate, especially given the natural constraints on the availability of data. One should bear in mind the discretion the OFT enjoys. In all the circumstances the OFT's approach was appropriate.

Predatory intent

157. Wiseman submits that there is no support for the test Claymore proposes, namely that the requisite predatory intent where costs are above AVC is an intent simply to "hinder or deter competition" or even to "eliminate some increment of competition": that would be to set the bar too low and would be contrary to the case law of the Court of Justice. If a test of intent to eliminate "some increment of competition" were adopted, then almost any practice by a dominant firm would give rise to an inference of anti-competitive intent. As is clear from *AKZO v Commission*, at paragraphs 71-72, pricing below AVC is presumed to be abusive, whilst pricing above AVC but below ATC is abusive only where an intent to eliminate a competitor can be established. The necessity of an intent to eliminate competition is, says Wiseman, clear from subsequent case law, including *Napp* [2002] CAT 1 and *Aberdeen Journals*, cited above.

158. As to the appraisal of the evidence of intent, Wiseman submits that the OFT made no error. There are several reasons why Wiseman might view Express differently from other competitors without having an illegal intent, such as Wiseman's views that Express' investment in Claymore was motivated primarily by a desire to punish Wiseman and not by the pursuit of profit, and that it was necessary to keep an eye on the competitor who had complained to the authority.

159. Wiseman submits that Claymore makes too much of Alan Wiseman's comment that Express was not a "legitimate purchaser" of Claymore. This does not equate to Express being an "illegitimate competitor", the inference drawn by Claymore. Nor may Claymore state that the CC members found that Wiseman adopted an abnormal strategy because it perceived Express' acquisition of Claymore as illegitimate: Messrs Clothier and Mackay took the view that Wiseman's actions were legitimate.

160. As to the "hit list", that list pre-dates the entry into force of the 1998 Act and relates to the whole of Great Britain, not just Scotland. It does not show exclusionary intent. Finally, Wiseman contends that Claymore makes various false statements in regard to Wiseman's relations with Claymore's (then) customers.

161. Wiseman accordingly submits that no error on the part of the OFT has been demonstrated as regards its assessment of Claymore's allegations of predatory pricing.

Price discrimination

162. Wiseman contends that the OFT was not wrong to conclude that the necessary targeting element was missing: Claymore simply relies on its overblown inferences from Wiseman's understanding of Express' motives for investing in Claymore and the existence of hit lists. Furthermore, the fact that price discrimination is a feature of the industry is, contrary to Claymore's submission, a relevant factor: the CFI only said in *Van den Bergh Foods*, cited above, that industry practice is not to be accepted "without reservation" (paragraph 159). As the comparison with Lordswood shows, price discrimination is not forced upon non-dominant players because of dominance on Wiseman's part.

163. Wiseman submits that Claymore fails to deal with the critique by the Bezant report of the Haberman report's criticisms of the way in which the OFT drew up and interpreted the graphs it analysed. Wiseman refers the Tribunal to that critique.

Exclusionary/exclusive contracting

164. Wiseman rejects Claymore's arguments concerning exclusionary or exclusive contracting. In addition to the OFT's arguments, which it adopts, Wiseman submits that Claymore failed to address whether there was sufficient evidence that the arrangements imposed a *de jure* or *de facto* obligation on the purchaser to take its requirements for all its Scottish outlets exclusively or almost exclusively from Wiseman, and whether there was sufficient evidence that such arrangement had the actual or potential effect of foreclosing a significant share of the market.

165. Wiseman submits that Claymore's criticism that the OFT distinguished between 100 per cent exclusive contracts and "All of Scotland" contracts is hard to understand. Claymore says they are two different types of contract. Its distinction actually goes to price discrimination, "All of Scotland" deals having a flat price regardless of distance.

V THE TRIBUNAL'S ANALYSIS

A. INTRODUCTION

The revised notice of application

166. The RNA is wide-ranging, running to eighteen grounds of appeal. They are set out as follows:

> "Ground 1
> In failing to identify the relevant time period of the abuse (in particular for the purposes of the identification of elements of avoidable cost) the Respondent erred in law and/or in its assessment in respect of pricing below AVC.
> …
> Ground 2
> The OFT erred in its approach to and assessment of AVC generally.
> …
> Ground 3
> The OFT erred in its approach to and assessment of Average Total Costs.
> …[2]
> Ground 5
> The OFT erred in its approach and/or failed to provide any adequate reasons in respect of the relevance of incremental customers and/or outlets.
> …
> Ground 6
> The OFT erred in its approach and/or failed to provide any adequate reasons in respect of its appraisal of below cost pricing generally.
> …
> Ground 7
> The OFT erred in its appraisal of the evidence of intent generally.
> …
> Ground 8
> The OFT misdirected itself in law in requiring evidence of intent to eliminate Claymore from the market.
> …
> Ground 9
> The OFT misdirected itself in law in requiring clear and compelling "direct" evidence of intent to eliminate Express/Claymore from the market and that relevant documents should "demonstrate" such intent.

[2] The RNA does not contain a Ground 4.

…
Ground 10
The OFT erred in its appraisal and/or failed to provide any adequate reasons in respect of its assessment of the available evidence of targeted price discrimination.
…
Ground 11
The OFT erred in law in that it failed to address its mind to whether the significant evidence of price discrimination amounted to abusive conduct in the context of all the circumstances of the case and, in particular, whether it tended to exclude Claymore.
…
Ground 12
The Respondent erred in law and approach in assessing Wiseman's conduct in committing itself to single price all of Scotland contracts.
…
Ground 13
The investigation undertaken by the Respondent was inadequate and/or the Respondent erred in its approach to the all of Scotland arrangements generally.
…
Ground 14
The OFT erred in law and approach in failing to consider whether Wiseman's reaction to Express' investment in Claymore in the form of the all of Scotland contracts was reasonable and proportionate and complied with the special responsibility placed upon dominant undertakings not to weaken the structure of the market generally.
…
Ground 15
The OFT's methodology, approach and standards of care in respect of data gathering and analysis failed to comply with minimum adequate standards.
…
Ground 16
The OFT erred in law by failing to assess the overall impact of Wiseman's conduct upon the structure of the relevant market.
…
Ground 17
The OFT erred in law and approach in its failure to pay any or any adequate regard to the evidence or findings made in connection with the Chapter I cartel investigation.
…
Ground 18
The OFT erred in law and approach by examining the three heads of investigation that were investigated as separate strands of inquiry rather than paying due regard to the cumulative effect of the three abuses upon each other and the market as a whole.
…
Ground 19
The OFT erred in law and approach in relation to the application of the standard of proof.”

The Tribunal's approach

167. In *Claymore (Admissibility)* at paragraphs 144 and 145 the Tribunal characterised the decision under appeal in this case as a decision that

> "no infringement of the Chapter II prohibition could be established on the evidence or, to put the matter the other way round, that there was insufficient evidence to establish an infringement"
>
> and that
>
> "the Director has reached a firm decision that no infringement of the Chapter II prohibition is established on the evidence before him."

168. In *Freeserve (merits)* at paragraphs 109 to 122 the Tribunal said that, at this stage in the development of this jurisdiction, it was undesirable to lay down hard and fast rules as to the Tribunal's approach in cases where the OFT has declined to find an infringement of the Chapter II prohibition, although the Tribunal also emphasised that in non-infringment cases the appeal remains an appeal "on the merits". In *Claymore (Recovery and Inspection)* at paragraph 109 the Tribunal confirmed its earlier judgment of 9 June 2003 [2003] CAT 12 to the effect that in this particular case the primary purpose of these proceedings is to identify whether the OFT has made a material error of law, whether it has carried out a proper investigation, whether its reasons are adequate and whether there are material errors in its appreciation.

169. In applying that approach, we bear in mind that in this case the OFT's view essentially was that it had uncovered insufficient evidence to justify proceeding further. We also bear in mind that the OFT has a discretion as to the lines of inquiry that it pursues in its investigations. In our view we should not find, in a case such as the present, that an OFT investigation leading to an appealable decision as to whether the Chapter II prohibition has not been infringed was legally flawed unless we are satisfied that the OFT has made a material error.

170. For the purposes of this judgment we do not need to address each and every ground of appeal advanced by Claymore.

Some comments on procedure

171. The CC investigation which led to the *Scottish Milk* report lasted some nine months, and led to a detailed report covering some 261 pages. The OFT investigation which followed the CC Report lasted nearly two years and led to a case closure letter of just over four pages. Although the members of the CC were in the end split as to the judgment to be applied to the facts before them, the facts they were considering appear clearly from the CC Report. By contrast, a substantial part of these proceedings has been concerned with establishing what it was that the OFT did to ascertain the facts, what facts were identified, and what analysis was applied to those facts, in sufficient detail to enable the parties and the Tribunal to ascertain whether or not the OFT made a material error.

172. We accept that a CC inquiry and an OFT investigation under the Chapter II prohibition are not the same thing; that the OFT must juggle competing demands on its resources; and that issues of commercial confidentiality also arise. On the other hand, as the OFT itself accepts, this was a major investigation which had been commenced under section 25 of the 1998 Act and lasted nearly two years. The sector concerned, milk, is of major importance to consumers and to the economy generally. The Highlands and Islands of Scotland is an important region. Important interests were at stake, as regards both Wiseman and Express, and as regards the ambit of the Chapter II prohibition. Express, so it told the OFT, was sustaining Claymore's losses pending the outcome of the case. In those circumstances, in our view, it would have been appropriate, and in the interests of transparency, for the OFT's decision letter of 9 August 2002 to have set out the facts, matters and legal considerations relied on in considerably more detail, so as to enable all interested parties to understand the analysis on which the OFT based its decision to close the file. Indeed, the OFT indicated that such was its intention during the meeting of 19 June 2002 referred to in paragraph 140 of the Tribunal's judgment in *Claymore (Admissibility)*.

173. At the case management conference on 27 March 2003, the Tribunal was assured by the OFT that no detailed case summary existed. However, just before the hearing of this case, the OFT produced, annexed to its skeleton argument, the memorandum of 7

August 2002 summarising the case team's reasons for proposing the closure of the file. Earlier production of that document would in our view have been appropriate.

174. We note in particular that the memorandum of 7 August 2002 contains a number of elements apparently taken into account which are not, or only scantily, referred to in the OFT Witness Statement, for example in relation to exclusionary exclusive contracting (paragraphs 21 to 23) exclusionary behaviour (paragraphs 26 to 34) and Express' allegedly erroneous strategy (paragraphs 38 to 39). In particular, the memorandum concludes:

> "38. The analysis of the team is that the present situation could be the result of an inefficient entry by Express in the Scottish market that would have triggered a Stackelberg-warfare type of situation. This would mean that Express's strategy in entering in the market would have been a mistaken move, the outcome of which would be mutual aggression. Views in the industry have tended to find Express strategy suboptimal, as entry in the Central belt sounded like the legitimate move. The "illegitimacy" of Express in Scotland could stem from its location in Nairn.
>
> 39. Wiseman recognised Express as a serious contender for leadership and due to the oligopolistic situation in the market had to react to Express' all-Scotland strategy."

175. No hint of that analysis was contained in the Decision letter of 9 August 2002, or the OFT Witness Statement. We give credit for the fact that the memorandum of 7 August 2002 was eventually produced to the Tribunal, but we would trust that, in future, in the interest of the parties and the public, more complete statements of the OFT's reasons are given to complainants when decisions are made to close lengthy formal investigations of national or regional importance opened under Section 25. We revert to this document later in our judgment.

176. It has also emerged in the course of the proceedings that various meetings took place between the OFT and Wiseman, notably on 14 March 2002, of which no notes were formally kept. The meeting of 14 March 2002 was an important meeting at which Wiseman apparently persuaded the OFT that there were plausible explanations for some of the results of the OFT's pricing analysis. Some private notes of this meeting made, and quite properly but belatedly produced by a member of the OFT case team, do

not seem to us to throw light on the matter. We understand that within the OFT the routine practice of keeping file notes of important meetings is now in force.

The focus of Claymore's complaint

177. It is important to identify what was the original focus of the matters which had been brought to the OFT's attention by Claymore's complaints, and by the findings of the CC in *Scottish Milk*, at the time when the OFT opened its investigation on 26 October 2000. It may reasonably be assumed that those were also the matters which the Secretary of State had in mind when she asked the OFT to keep the Scottish milk market under "close review" for possible breaches of the 1998 Act in December 2000.

178. In broad terms, the main matters giving cause for concern were Wiseman's alleged attacks, beginning in 1999, on Claymore's principal customers serviced from its Nairn dairy, which allegedly started to take place after Express' acquisition of a major stake in Claymore in December 1998. The principal allegations were that Wiseman was taking customers from Claymore by "below cost" pricing, reinforced by discriminatory prices, and by the offer of "All of Scotland" contracts with which Claymore found it very difficult to compete. As a result, as it is alleged, Claymore had lost 40 per cent of its business.

179. The competition that was taking place in Scotland, particularly as regards the Highlands and Islands, during 1999 and the first part of 2000 is extensively described in the CC Report: see in particular the section headed "Competition and pricing" at paragraph 2.108 et seq. Claymore's account of events during this period is set out in Mr. Larg's witness statement of 6 November 2002 at paragraphs 18 to 41, 45 to 51, and 68 to 71.

180. The CC was not, of course, investigating whether there were any breaches of the 1998 Act. However, the CC's findings in its report were in our view of obvious relevance to the question whether any such breaches had in fact occurred after 1 March 2000. The CC Report covered the period up to May 2000, and in the case of Aberness up to July 2000. In our view, it is not unreasonable to assume, in the absence of evidence to the contrary, that the state of affairs described in the CC Report continued for some time after these dates.

181. However, the difficulty faced by the OFT was that most of the events giving rise to alleged abuse took place before 1 March 2000. The OFT, therefore, had to rely either on the continuing effect after 1 March 2000 of conduct occurring before that date, or fresh facts occurring after that date. While in our view the OFT needed to pay close attention to the facts regarding Claymore's former customers in the Highlands, in order to deal properly with Claymore's complaint, we can also understand why the OFT thought it appropriate to widen its investigation to other parts of Scotland regarding the years 2000 and 2001.

B. THE RELEVANT CASE LAW

182. Against the background of the evidence in the CC Report, it is convenient at this point to summarise the main legal tests for establishing a breach of the Chapter II prohibition which needed to be taken into account.

183. This case proceeds on the hypothesis that Wiseman had at the material time a dominant position in the supply of fresh processed milk to middle-ground retailers in Scotland. The issue of dominance is not, however, before the Tribunal.

184. As regards abuse, the general principle is set out in *Hoffmann-La Roche* v *Commission* [1979] ECR 461, at paragraph 91:

> "The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition".

185. It is well established that a dominant firm has a "special responsibility" not to distort competition, and that certain actions which might be open to non-dominant firms are not permitted for a dominant firm: see Case 322/81 *Michelin v Commission* [1983] ECR 3451, at paragraph 57; Cases C-395/96P and 396/96P *Compagnie Maritime Belge v Commission* [2000] ECR I-1365, at paragraph 37; Case T-65/98 *Van den Bergh*

Foods v Commission, cited above, at paragraph 158; and *Genzyme v OFT* [2004] CAT 4, at paragraph 484 (summarising case law of the Community Courts).

186. As regards the question of how far a dominant firm may respond to competitive pressure, the Court said in *United Brands* v *Commission* [1978] ECR 207 at paragraph 189:

> "Although it is true, as the applicant points out, that the fact that an undertaking is in a dominant position cannot disentitle it from protecting its own commercial interests if they are attacked and that such an undertaking must be conceded the right to take such reasonable steps as it deems appropriate to protect its said interests, such behaviour cannot be countenanced if its actual purpose is to strengthen this dominant position and abuse it".

187. And in Case T-65/89 *BPB Industries* v *Commission* [1993] ECR II-389 the Court of First Instance said at paragraph 118:

> "The Court considers that it is not appropriate for an undertaking in a dominant position to take, on its own initiative, measures intended as retaliation against commercial practices which it considers unlawful or unfair. Accordingly, it is irrelevant whether the measures referred to in the Decision were adopted in response to an 'appeal' price, applied by certain competitors … The only important issue is whether, through recourse to methods different from those governing normal competition in products based on traders' performance, the conduct at issue was intended or likely to affect the structure of a market where, as a direct result of the presence of the undertaking in question, competition had already been weakened".

188. Thus, among the relevant considerations are (i) whether the actions of the dominant firm go beyond what may be considered "normal" competition in a market where competition is already weak as a result of the presence of the dominant firm; (ii) whether the dominant firm's conduct was reasonable and proportionate; and (iii) whether the conduct was intended or likely to affect the structure of the market, by preserving or strengthening its dominant position.

189. As regards more specifically predatory pricing, the relevant case law was considered by the Tribunal in *Aberdeen Journals (No. 2)* [2003] CAT 11. After referring to the case law of the Court of Justice, the Tribunal said in paragraphs 350 to 356:

"350. The cases cited above demonstrate, in our view, that the question whether a certain pricing practice by a dominant undertaking is to be regarded as abusive for the purposes of the Chapter II prohibition is a matter to be looked at in the round, taking particularly into account (i) whether the dominant undertaking has had "recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators" (*Hoffmann-La Roche*, cited above, at paragraph 91); and (ii) whether such conduct has the effect of weakening or distorting competition in the relevant market, having regard to the special responsibility of a dominant firm not to impair genuine undistorted competition. In our view, these principles apply particularly to the case of a dominant firm facing new entry, where retaliatory measures going beyond what is reasonable and proportionate are likely to require close scrutiny under the Chapter II prohibition.

351. Within that framework, the cases of *AKZO*, *Tetra Pak II* and *Compagnie Maritime Belge*, cited above, give further guidance as to when prices below costs are likely to be regarded as abusive. As the Director points out at paragraphs 151 to 152 of the decision, *AKZO* (at paragraph 71) and *Tetra Pak II* (at paragraph 41) show that pricing below average variable costs by a dominant firm is normally to be regarded as an abuse. "Variable costs" are those which vary with the unit of output produced as distinct from "fixed costs" which do not vary with the output produced. An example of a "fixed cost" might be the monthly rental of a company's premises. Examples of "variable costs" in the present case include, but are not necessarily limited to, newsprint (the paper on which the newspapers are printed), distribution (the cost of distributing the copies produced), and other costs such as ink, plate and film charges, electricity, fuel for transport, overtime and "pre-press production" costs (see paragraph 162 of the decision). Thus, for example, to sell the *Herald & Post* below average variable cost, as so defined, is to sell each copy of the newspaper for less than the average cost of producing that copy. As Mr Fennelly points out at paragraph 127 of his opinion in *Compagnie Maritime Belge*, cited above, it is not normally rational for an undertaking to act in this way (see also paragraph 4.7 of OFT 414, *Assessment of Individual Agreements and Conduct*). When undertaken by a dominant firm, such conduct will normally constitute "recourse to methods different from those which condition normal competition" within the meaning of *Hoffmann-La Roche*.

352. Similarly, *AKZO* (at paragraph 71) and *Tetra Pak II* (at paragraph 41) show that it may be an abuse by a dominant undertaking to price between average variable cost and average total cost, if the intention is to eliminate a competitor. Total costs are variable costs plus fixed costs including, in our view, where appropriate, a share of general overheads. In our view, pricing between average variable cost and average total cost is likely to be abusive when undertaken in anticipation of competitive entry or in order to undercut a new entrant.

353. One particular aspect of the distinction between average variable costs and average total costs, not yet explored in the case law, but relevant in the present case, is the period of time over which costs are to be assessed as "fixed" rather than "variable". The longer the period that is taken, the more likely it is that cost will be classified as variable since, for example, over a longer timescale, employees can be dismissed or plant closed in response to changes in output. Indeed, in the long run, almost all costs are "variable".

354. The Director suggests, at paragraph 4.6 of OFT 414, referred to in paragraph 175 of the decision, that the period to be used for determining which costs are to be treated as "variable" and which "fixed", is "the time period over which the alleged predatory price or set of prices prevailed or could reasonably be expected to prevail". Despite some possible circularity in this approach, paragraph 4.6 of OFT 414 seems to us to be a useful starting point. What the Director should do, in the first instance, is to identify provisionally the period over which pricing below cost is suspected. He should then take that period and examine whether costs are variable over that period. We do not exclude the possibility of the Director taking other periods, for example a year or a period of months, or even less, as a cross check, if to do so would be reasonable from a business perspective. Whether the period taken is a reasonable period will be a matter of fact and degree, to be judged in the circumstances of each particular case.

355. The consequence is that the longer a dominant undertaking prices at some level below total costs, the more likely it is that costs which might be treated as "fixed" in the short run should be treated as "variable" for the purpose of applying the *AKZO* test. In applying the Chapter II prohibition, that would not seem to us an unreasonable approach. In order to survive in the market a competitor needs to cover total costs, including overheads. The longer a dominant undertaking prices below total costs, the more likely it is that an equally efficient competitor

> will be forced to exit the market. That risk is not averted simply because the dominant firm may be covering its average variable costs as measured on a short-run basis.
>
> 356. Similarly, it seems to us, the longer the prices of a dominant undertaking remain below total costs the easier it is likely to be to infer an intent to eliminate competition, in accordance with the *AKZO* test, absent special circumstances such as recessionary conditions… Such an intention may be inferred, of course, from other circumstances such as selective price cutting."

190. Although the above judgment in *Aberdeen Journals (No. 2)* post-dates the decision here under challenge, the case law referred to in that judgment was known to the OFT at the time of the closure of the file on 9 August 2002.

C. THE OFT'S APPROACH TO THE PREDATORY PRICING ISSUES

The course of the investigation

191. On the basis of that case law, it seems to us that the OFT found itself in a situation in October 2000 in which there was a case to investigate as to whether Wiseman was abusing a dominant position after 1 March 2000 in relation to its pricing policy and contractual arrangements. Whether Wiseman's conduct was in fact abusive would depend on many elements, including Wiseman's intentions, the likely effect of Wiseman's conduct on competition, and whether such conduct was proportionate and reasonable in all the circumstances, bearing in mind not only the position of Claymore's dairy in Nairn, but also the fact that Wiseman's reaction took place after Express had acquired a stake in Claymore, and that Express and Wiseman are competitors throughout Great Britain, as Mr Clothier and Mr Mackay emphasised at paragraphs 2.127 to 2.138 and 2.146 to 2.160 of the CC Report. It was, however, for the OFT to investigate and assess all these matters, among others, on a proper factual basis.

192. The OFT, as we understand it, accepts that the matters set out at paragraph 2.116 to 2.138 and 4.267 of the CC Report gave rise at least to reasonable grounds to suspect an infringement of the Chapter II prohibition in respect of predatory pricing, the one-off 'loyalty' payment to Aberness and the fact that the CWS contract applied to all CWS'

stores in Scotland (OFT Witness Statement, paragraph 8). We note that CWS and Aberness represented about one-third of Claymore's former business.

193. However, notwithstanding the matters mentioned in the CC Report and the opening of the investigation in October 2000, little appears to have happened until 30 March 2001, when Claymore made its application to the OFT for interim measures under section 35 of the 1998 Act.

194. Following the OFT's visit to East Kilbride on 10 May 2001, which seems to have yielded little material evidence of abuse (OFT Witness Statement, paragraph 10), on 25 June 2001 the OFT issued a notice under section 35 of the 1998 Act indicating their intention to adopt interim measures against Wiseman. At this stage the OFT was still relying principally on the findings of the CC Report. It does not appear from the evidence before us that, up to June 2001, the OFT had carried out any further investigation of Wiseman's prices and costs, or of the arrangements with CWS and Aberness, at least to any material extent.

195. On 18 July 2001 the OFT asked Wiseman under section 26 of the 1998 Act for cost information regarding Wiseman's 10 lowest delivery cost outlets in the Highlands and Wiseman's 10 highest delivery cost outlets in Scotland. The OFT does not appear to have been able to deduce very much from the information provided by Wiseman in answer to this request on 1 August 2001. Wiseman emphasised, in particular, the difficulty of allocating costs to customers on particular runs. It does not appear, from the information before us, that the OFT sought details of Wiseman's management accounts at this or any later stage.

196. A number of meetings then took place between Wiseman and the OFT, minutes of which were apparently not always taken. On 21 September 2001, the interim measures proceedings were resolved when Wiseman offered the assurances to which we have already referred. Again, it appears that the OFT had not, at this stage, obtained cost information from Wiseman's internal management accounts. We were told at the case management conference of 2 September 2003 that the data supplied by Wiseman up to this point "did not feed into the OFT's analysis" in the decision of 9 August 2002 (transcript, p.86). Wiseman's evidence is that the assurances led to few changes in the

prices then being charged by Wiseman. Although the OFT's Press Release of 21 September 2001 envisaged the possibility that "some national contracts may have to be split", this did not apparently occur.

197. In October 2001 the OFT decided to investigate Wiseman's prices and costs in much more detail. By a request under section 26 of the 1998 Act dated 3 October 2001, the OFT sought details of all Wiseman's middle-ground customer delivery points in Scotland in June 2001, the value delivered, the run number and the post code, together with a complete list of all Wiseman's runs, identifying those in the Highlands, and also details of the most important pack sizes and loads of milk, by volume. From this information, the OFT aimed to draw up a statistically representative sample of customers, covering all the outlets of those customers, and the principal pack sizes sold. It appears that all the CWS outlets were included in the sample. Apparently, the OFT did not check whether any other of Claymore's former customers – such as Aberness – were included in the sample. The sample eventually covered 1150 outlets on 135 runs, apparently accounting for some 13 per cent of Wiseman's middle-ground outlets and 38 per cent of Wiseman's runs serving middle-ground customers in Scotland. Wiseman contends that all runs from the Keith depot, which serves the Highlands, other than Sunday runs, were included.

198. The OFT then followed matters up with a further request under section 26 dated 25 October 2001, in which the OFT sought (a) the prices charged to each of the 809 customers in the sample for each month between November 1998 and September 2001 for 10 identified products, and the total quantities delivered to each delivery point; and (b) the cost of supplying each of the 1150 outlets of those customers in June 2000, December 2000 and June 2001, split between run costs as defined by the OFT, depot costs, trunking costs from the dairy to the depot, and the dairy cost of the milk. Costs such as run costs were to be allocated according to the volume of litres delivered on the run. Thus, for example, if on a particular run 90 per cent of the volume supplied was delivered to supermarkets and 10 per cent to middle-ground customers, the costs would be allocated to each customer in accordance with the volume taken by that customer. In this example 90 per cent of the cost would be allocated to the supermarkets.

199. Wiseman supplied the information requested by letters dated 29 November 2001 and 13 December 2001, although by agreement with the OFT the information supplied related to May 2000, November 2000 and May 2001, apparently to avoid possible distortion which might occur if the Christmas period in the month of December were included. The data supplied by Wiseman included a good deal of estimating, not least since for the purposes of its business Wiseman does not calculate costs of serving individual outlets of particular customers. In supplying the requested information to the OFT, Wiseman emphasised that it did not itself use the OFT's methodology, and that the matter was also complicated by the fact that run schedules change over time.

200. In the period from about December 2001 to March 2002, the OFT sought to analyse the data supplied by Wiseman to see how far it supported allegations of possible abuse. Section 26 notices were apparently also sent to other smaller dairies, and farmers, but these do not appear to have yielded any useful evidence. The OFT also interviewed the two processors with experience of operating in Scotland, one of which was Arla, which had not then merged with Express. In March 2002, the OFT also asked for management cost information relating to the Edinburgh and Manchester depots of Wiseman.

201. The OFT's investigation thus sought to cover the whole of Scotland, rather than focusing narrowly on the specific customers and former customers of Claymore in the Highlands, albeit that the CWS outlets were apparently included in the sample, and most of the runs from the Keith depot. The investigation was wide ranging and ambitious.

The result of the OFT cost analysis

202. We are told that the official who carried out the OFT's analysis focussed his attention on May 2001, having apparently concluded from preliminary work that the results for May and November 2000 would be similar. Although the price information sought had covered three years, the OFT's conclusions on costs seem to have been largely based on a single month, May 2001. As a result, we do not have a continuous picture of trends in cost over time. Nor did the OFT continue, as it were, where the CC left off in mid-2000, but adopted a different methodology.

203. The OFT's results for May 2001 are summarised in various maps and graphs that have been produced to the Tribunal. In particular, the OFT took two measures of variable cost, a "high" measure and a "low" measure. In the "low" measure the OFT included raw milk, drivers' wages, fuel costs, and tyres. In the "high" measure the OFT included these items plus packaging and processing costs, notwithstanding that, according to the OFT, certain packaging and processing costs could be regarded as fixed. Which costs are "fixed" and which costs are "variable" has been a matter of some debate in this case.

204. On the "low" measure of variable costs the OFT found no instances of pricing below AVC. On the "high" measure the OFT found a few instances of pricing below AVC (some 33 instances at outlet level out of 2646), and apparently found that the lower margins were to be found outside the Highlands "close to Wiseman's dairies and to population centres" (OFT Witness Statement, paragraph 44). We observe in parenthesis that this result is the opposite of what might have been expected, since the costs of serving customers closer to the depot are generally lower than the cost of serving customers further away, as Wiseman pointed out in its letter of 3 August 2001. Customers in the health sector had the lowest margins, but as the OFT subsequently pointed out in the letter of 9 August 2002, there seemed to be no obvious reason for this.

205. The OFT also considered ATC, which it arrived at by adding 3 per cent to the costs figures it had calculated from the information supplied by Wiseman, to reflect financial, administration and central selling costs. The cost of capital was not included. The OFT found 495 instances of below total cost pricing at the outlet level, out of 3039 records. Although the OFT considered that this could be significant, further analysis showed that the customers concerned were mainly in the health sector, outside the Highlands. The OFT felt that it could not establish a link between the results of its price/cost analysis and the allegation that Wiseman was attempting to target Claymore in the Highlands (OFT Witness Statement, paragraphs 48 to 49).

206. As regards price discrimination, the OFT found that there were significant differences between customers (mark ups varying from […][**C**] per cent to […][**C**] per cent) but, according to the OFT, a similar pattern was seen amongst Claymore's customers and

the customers of an English dairy, Lordswood, then recently acquired by Wiseman. The OFT considered that "price discrimination for small middle-ground customers is probably a feature of the industry as a whole" (OFT Witness Statement, paragraph 59), and that the evidence did not support an allegation of targeting by Wiseman against Claymore, albeit that margins were lower in the Highlands.

207. Although some customers were paying considerably more than others, the OFT considered that its findings were inconclusive, not least because of the uncertainty and arbitrariness surrounding the allocation of transport costs (OFT Witness Statement, paragraph 66; Reply, paragraph 25).

The problem of determining the costs

208. In any investigation of alleged predatory pricing, one of the first tasks for a competition authority is to obtain detailed and reliable evidence of the prices and costs involved. The prices in question can then be compared to the costs over an appropriate period, in order to determine whether the prices are "unfairly low" – i.e. predatory – for the purposes of the Chapter II prohibition.

209. As already indicated, according to the case law of the Court of Justice in *AKZO* at paragraphs 71 to 72:

> "71. Prices below average variable costs (that is to say, those which vary depending on the quantities produced) by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss, namely the total amount of the fixed costs (that is to say, those which remain constant regardless of the quantities produced) and, at least, part of the variable costs relating to the unit produced.
>
> 72. Moreover, prices below average total costs, that is to say, fixed costs plus variable costs, but above average variable costs, must be regarded as abusive if they are determined as part of a plan for eliminating a competitor. Such prices can drive from the market undertakings which are perhaps as efficient as the dominant undertaking but which,

because of their smaller financial resources, are incapable of withstanding the competition waged against them."

210. However, before even reaching the issue of what costs are fixed and what are variable, determining "the costs" may not be a straightforward exercise. Where the alleged conduct relates to only one part of the business of a dominant firm, certain common costs may need to be allocated to the business in question. There are conventional accounting methods for making such allocations (e.g. by volume, value, time, etc.) but the most appropriate yardstick to use may be debateable. One approach, shared by the expert witnesses in the present case, is to seek to identify "the cost drivers", i.e. to determine the factors that cause the costs to be incurred and then make allocations appropriately.

211. So far as possible, cost allocations should reflect the underlying business reality. A reasonably detailed understanding of the nature of the business, and how costs arise, is generally necessary when determining how particular costs should be allocated. Similarly, how the business itself treats the costs in its internal management accounts will normally be an invaluable source of information.

212. In the present case, the elements which make up "total costs" are

- Raw milk, including the cost of collection and delivery from the farm
- Dairy costs, principally the costs of processing and packaging
- Trunking costs, mainly the cost of transporting the finished product from the dairy to the depot
- Depot costs, i.e. the cost of the depot from where the product is delivered to the retail customer
- Distribution costs, i.e. the cost of distribution from the depot to the retailer, also referred to as "run costs"
- Marketing and selling costs, i.e. the cost of marketing, sales force etc.
- Administrative and financial expenses, mainly central administration, and other group overheads.

213. In addition, when determining total costs, it may well be appropriate to include an amount representing the cost of capital. The CC did so, but the OFT did not.

214. Those being the main cost headings, it is apparent that many costs (e.g. ingredients, packaging, processing) are common costs incurred in supplying all customers irrespective of their location. Other costs such as distribution costs depend on the nature and location of the customers in question. It was therefore necessary in our view to determine the costs associated with supplying the middle-ground sector in Scotland, that is to say excluding on the one hand supermarkets, and, on the other hand, door-step delivery, as the CC did. The information available to the Tribunal suggests that Wiseman regards its depots (such as the Keith depot which serves the Highlands) as one of the important cost centres. The management information available for Wiseman's different depots in Scotland would, it seems to us, have thrown considerable light on the issue of costs.

215. However, Wiseman told us that it does not maintain information as to the costs of individual runs or of supplying individual outlets. One particular problem in the present case is how to allocate costs between different classes of customer when supermarkets and middle-ground customers are served by the same run.

216. However the allocations are ultimately to be made, it is important in our view that the investigation is grounded on a firm and reliable assessment of what the total costs are, cross-checked as far as possible against the dominant undertaking's statutory and management accounts. The Court of Justice in *AKZO* took a rigorous approach to costs issues.

The OFT's "bottom up" approach

217. As set out in the OFT Witness Statement at paragraphs 25 to 30 and 42 to 53, the OFT received from Wiseman (i) run costs (broken down into wages, fuel, tyres, insurance etc., vehicle depreciation, maintenance) (ii) depot costs (iii) trunking costs and (iv) dairy costs (ingredients, packaging and processing) expressed as a cost per litre for ten different products for May 2000, November 2000, and May 2001. The OFT worked in detail only on the figures for May 2001. The OFT allocated costs to the 1150 outlets in the OFT's sample according to the volume supplied to that outlet. Apparently a similar exercise was done for customers in the sample.

218. As already explained, the OFT took two measures of average variable cost. The first "low" measure for AVC comprised ingredients, driver's wages, fuel costs, and tyres. The second higher measure included all packaging and processing costs.

219. To arrive at total costs, the OFT told us at paragraph 47 of the OFT Witness Statement:

> "47. To [arrive at total costs] we repeated the steps described above in respect of total costs. We adopted the approach of aggregating every one of the costs requested from Wiseman, adding 3 per cent to reflect financial administration and central selling costs, and using that measure as a working proxy for total cost (although some elements of total cost – possibly up to 5 per cent – were left out of that proxy)[8]."

220. According to footnote 8 of paragraph 47:

> "[8] In order to check whether we had a measure of costs giving a reliably close approximate of costs as a whole, we compared the measure of costs reported in the CC report with the equivalent measure as calculated by us from the information collected from Wiseman. CWS is one customer account studied extensively in the CC report. We had available as part of our sample full data relating to the costs of supplying CWS during our sample periods. The average total costs to supply CWS in para. 4.342 of the CC report is […][**C**] ppl for May 2000. Our measure of the average total cost for May 2000 for the same account is […][**C**] ppl ([…][**C**] ppl when the 3 per cent mark-up is applied). The difference between these two measures is only about 5 per cent which we believed was acceptable for the purpose of what was an initial investigation into costs."

Costs apparently left out of account in calculating total costs

221. From those passages it seems clear to us that during its investigation the OFT left out of account "some elements" of total costs, up to 5 per cent.

222. The uncontested evidence of Mr. Haberman is that in 2000 and 2001 the operating profit of Wiseman as a whole was on average some 6.8 per cent. In the year to 31 March 2002, the margin was, according to Mr. Haberman, 5.3 per cent. In a relatively low margin business of that kind, the omission of up to some 5 per cent of total costs is likely, in our view, to undermine significantly the credibility of the resulting cost calculations.

223. Annex J to the OFT Witness Statement indicates that the margins for at least three of the customers of potential importance in the investigation namely […][**C**], […][**C**], and […][**C**] were less than 5 per cent above what the OFT considered to be total costs. If, in fact, some 5 per cent of costs was omitted from the OFT's calculations, those customers may well have been being supplied at margins below total cost. Mr. Haberman's evidence is that if such an adjustment were to be made for all the customers in Annex J, around 67 per cent of the sample would have a negative margin. Similarly the number of other outlets being supplied below total cost (Annex G) would have increased if more costs had been included.

224. Mr. Bezant, in his report, contends that it is not necessarily the case that the OFT left certain costs out of account, since the method of calculations of the OFT was different from that of the CC. We find that argument difficult to accept, since in our view paragraph 47 of the OFT Witness Statement contains a clear admission that elements of total cost, apparently up to 5 per cent, were left out of the OFT's proxy for total costs. We add, incidentally, that no challenge has ever been made to the CC's calculations.

225. Mr. Bezant also points out, correctly, that this point affects ATC, not AVC. However in our view a proper determination of total costs is necessary in a predatory pricing case, for two reasons. First, unless there is a clear and reliable determination of total costs, it is difficult to go on to determine which costs, out of the total, are fixed and which are variable. Secondly, and importantly, pricing below average total cost may still, in certain circumstances, be abusive, as indicated by the Court of Justice and by the Tribunal in the passage from *Aberdeen Journals (No. 2)* cited above.

226. We find it difficult to accept the OFT's submission that the omission of up to 5 per cent of total costs was acceptable for what was "an initial investigation" into costs. First, 5 per cent is a significant figure in a low margin business such as this. Secondly, the OFT's investigation had already been proceeding for a year before the OFT sought the cost information in question. The information sought was detailed and extensive, and the OFT itself emphasises the resources which it devoted to the task. A heavy burden was being imposed on Wiseman. At that stage of the investigation, in our view, it was necessary to take steps to ensure that all relevant costs had been included, if the investigation was to be effective.

Verification of cost information

227. Those observations take us on to a second point of a major concern, namely that the cost information sought and relied on by the OFT was not cross-checked, for example against Wiseman's internal management accounting information. We make no criticism of Wiseman. However, as regards "run costs" the exercise embarked on by the OFT included at least two stages of estimation and allocation, first determining the cost of individual "runs", and secondly allocating such (estimated) cost to individual outlets on the run. In addition other costs such as trunking and the remaining depot costs had to be allocated. As already indicated, the OFT built up its cost picture "bottom up" on the basis of the allocations for individual outlets made by Wiseman, in accordance with the cost breakdown required by the OFT, rather than following a "top down" approach, which would have started with total costs and then progressively broken down the costs until a usable sub-set was reached. In Wiseman's internal accounting system it appears that detailed information is available at least down to the level of the depot.

228. We share Mr. Bezant's view that a "top down" or "bottom up" approach if properly conducted should in principle reach the same result. While in our opinion a "top down" approach is more likely to ensure that all relevant cost information is included, the principal point, it seems to us, is that, whichever approach is adopted, sufficient cross-checks should be made to ensure that any cost information supplied by a company under investigation is capable of being reconciled back to its management or statutory accounts.

229. In the present case, no cross-checks of that kind seem to have been carried out. The only cross-check that was done by the OFT was to check one figure (the CWS costs for March 2000) with the CC's report, as already mentioned. However, that check revealed a divergence which in our view was significant, for the reasons already given. It is not satisfactory in our view for the OFT to have made no apparent attempt to determine why its figure differed from the CC's figure. Moreover the OFT's check related to the single month of May 2000 whereas the OFT was working on May 2001.

230. None of the information upon which the OFT was relying was cross-checked to or reconciled with Wiseman's management or statutory accounts for May 2001 or otherwise. The only other cross-check with original information that we have been told of is that, in February 2002, the OFT asked for Wiseman's internal management accounts for the Manchester and Edinburgh depots. However, only the broadest consideration seems to have been given to those documents. As seen below, it is difficult to correlate the figures shown in those documents with other information before the Tribunal. It is not clear to us why information was not sought, over an appropriate time frame, from the management accounts for the Keith depot, from which Claymore's former customers were largely serviced.

231. Mr. Bezant contends that Mr. Haberman is suggesting that the OFT should have made various comparisons which in Mr. Bezant's view would have been inappropriate. In our view Mr. Haberman is merely saying that the costs information and calculations used by the OFT should have been cross-checked in some appropriate way with Wiseman's internal management information. We agree.

Variations in the figures

232. The question whether sufficient cross-checks were made is not in our view an abstract question, because of the widely differing figures which appear at various places in the Tribunal's papers. For example, we have the following figures:

	ppl
CC calculation of cost of supplying CWS in the 2 months to May 2000	[…][**C**]
OFT calculation of cost of supplying CWS in the month of May 2000, excluding finance and administration costs	[…][**C**]
Ditto, including finance and administration costs	[…][**C**]
Mr. Haberman's calculation (based on CC's figure) of supplying CWS in May 2001, taking account of a 3p increase in the raw milk price	[…][**C**]
Mr. Haberman's calculation of Wiseman's overall average total cost in year to 31 March 2000, based on statutory accounts	35.5
Ditto for the year to 31 March 2001	34.5

Mr. Bezant's indicative estimate on behalf of Wiseman of Wiseman's total costs	[…][**C**]
Depot costs for Edinburgh in the eleven months to February 2002 (Cost of sales […][**C**] p, operating costs […][**C**] p)	[…][**C**]
Depot costs for Manchester (serving mainly supermarkets) in the eleven months to February 2002 (Cost of sales […][**C**] p, operating costs […][**C**] p)	[…][**C**]

233. As regards the cost information from the Manchester and Edinburgh depots in February 2002, the figure for the Manchester depot, serving mainly supermarkets, shows a higher cost per litre at depot level ([…][**C**] ppl) than the OFT's figure for total cost to CWS for May 2000 ([…][**C**] ppl). Similarly depot costs for Edinburgh in February 2002 ([…][**C**] ppl) are substantially above the OFT's estimate of CWS costs for March 2000 even allowing for changes in the raw milk price. As we understand it, the depot costs include cost of sales and operating costs, but not other elements of total costs such as central administration and finance.

234. We note also that Mr. Bezant's indicative estimate of total costs ([…][**C**] ppl) is broadly in line with Mr. Haberman's estimate (34.5/35.5 ppl in 2000 and 2001 respectively), both of which are well above the OFT figure for CWS in 2000 and, indeed, such information as we have as to the price being paid by CWS. Wiseman denies that Mr. Bezant ever intended his figure to be used for identifying Wiseman's ATC at any particular point in time. While we accept that Mr. Bezant's figure is indicative, and constructed from two different sources, combining different periods, we feel entitled to take into account the figure that Mr. Bezant, as an expert witness for Wiseman, has given us as a broad indicative figure of Wiseman's likely ATC during periods with which the Tribunal is concerned.

235. In our view, the combined effect of the above figures is to suggest that the OFT's calculation of ATC was too low.

Bulk cream

236. One apparent explanation for some of the discrepancy in the cost figures may be suggested in paragraph 9.4.1 of Mr. Sweeney's evidence where he says that in

compiling product costs "either for internal purposes, or for the CC or the OFT" revenues from sales of bulk cream were offset by Wiseman from milk costs, reducing total costs by some […][**C**] p in 2000 and 2001 respectively. Paragraph 3.76 of the CC Report suggests that this is common practice within the industry.

237. Claymore argues that it is not permissible for a dominant undertaking to "set off" revenues from another market (here bulk cream) for the purpose of determining the costs of supply in the market in which dominance is alleged (here milk). The opposing view is that cream is automatically produced in the course of producing fresh milk and that, since other competitors benefit from cream revenues, and follow a similar accounting practice, there is nothing objectionable.

238. This point is not dealt with in the OFT's evidence, and is not considered in the pleadings. It does not appear that it was addressed in the course of the OFT's investigation. We note that the deduction made would apparently include the margin made on cream sales, and deducting an element of profit to arrive at costs may be questionable. We also note that the internal management accounts for Manchester and Edinburgh show cost of sales but still give figures for total costs at depot level which are above the OFT's figures. We are not, on the evidence available, in a position to determine either whether the alleged "netting off" of bulk cream sales is legitimate for the purposes of the Chapter II prohibition, nor what, if any, effect the alleged deduction would have on the figures before us. We also note that Mr. Bezant, in his expert evidence, does not mention this point in his calculations of Wiseman's relevant costs.

Cost of capital

239. The CC Report contained a proxy for the calculation of the cost of capital. The OFT implicitly accepts, in paragraph 58 of its skeleton, that the cost of capital should be included in the calculation of total cost in a predatory pricing case but argues that it was unnecessary to do so at this stage of the investigation. For the reasons already given, we find it difficult to accept that by early 2002, when the investigation had been continuing since October 2000, the omission of the cost of capital can be justified on the basis that the investigation was still only "preliminary", as suggested by the OFT.

Nor do we think that it would have been particularly difficult to include an estimate for the cost of capital, since the CC had already done the exercise.

240. We add that Wiseman's argument that only the "incremental" cost of capital should have been included was not the approach adopted by the CC. In our view the concept of "total" cost implies looking at the cost of capital of Wiseman's middle-ground business in Scotland as a whole (as the CC did) rather than considering the matter on a marginal basis.

Allocation of costs by volume alone

241. A further issue regarding the reliability of the OFT's figures is the much debated question of whether, when allocating "run costs" to specific outlets, it was appropriate for the OFT to do so on the basis of volume alone. "Run costs" appear to account for 7-10 per cent of total costs. Most but not all run costs are regarded as variable. Mr. Haberman takes the view that allocation of run costs solely by volume is inappropriate, because the principal "driver" of run costs is likely to be distance. There is likely to be little relationship between volume and the total costs of the run, particularly in the Highlands. Other things being equal, says Mr. Haberman, it will be less costly to deliver to supermarkets than to scattered smaller middle-ground customers, but loading the costs onto supermarkets, on a volume-based approach, does not reflect that. The exercise also has arbitrary elements, since the cost figures for particular outlets will vary according to whether they happened to be served by a run which includes high volume supermarkets. Another approach, says Mr. Haberman, would be to allocate costs equally between outlets on the run.

242. The OFT, supported by Mr. Bezant, emphasises that many of Wiseman's costs are driven by volume, which represents a simple and effective way of allocating run costs to outlets. While volume is not the only driver of costs, the CC appears to have used volume for its cost allocations. The CC also pointed out that the cost of delivery to smaller customers can be mitigated by "dropping off" on a run that includes supermarkets. In practice, says the OFT, runs are designed around supermarket deliveries, taking higher volumes, so it is natural to allocate costs to the higher volumes. Allocation by number of outlets on the run would be artificial. Given

particularly that the figures are not readily available, it would be impracticable to conduct any detailed "distance related" allocations for Wiseman's 135 runs. Mr Bezant emphasised, in particular, that volume influences the size of the delivery vehicle and its running costs, which in turn are influenced by the volume the customer orders.

243. We share Mr. Bezant's reservations (at paragraph 2.8, third indent of his report) as to the practicality of making detailed allocations of the common costs involved. In this case, despite the good intentions and hard work of the OFT, whatever method is chosen there seems to us to be substantial practical difficulties in disaggregating costs down to the level of individual runs or even outlets, so as to obtain a meaningful result.

244. Our first problem with the OFT's approach is that it appears to be accepted that the allocation by volume in this case produced anomalous results. When the OFT came to look at the results, it appeared that the customers with the lowest margins were health sector customers, apparently situated far from the Highlands. As paragraph 76 of the OFT Witness Statement points out, at a meeting on 14 March 2002 Wiseman explained why the OFT's work showed some apparently low margins, in these words:

> "Wiseman explained the mechanisms through which prices were arrived at for different classes of customers. As we understood it for the smaller middle-ground retailer customers, this was done without specific reference to the cost associated with the particular run to which that customer might end up being allocated, although the overall depot cost would be a factor. This explained why our observations showed a number of cases of below total cost pricing. For example, retailer A might be allocated by Wiseman to a high cost run (e.g. where the other customers served were all small and widely dispersed outlets), while retailer B perhaps identical in all respects an even quite close to retailer A geographically might be allocated to a run serving a few high volume customers. The run costs for retailer A would obviously be much higher than for retailer B, but Wiseman would not wish to charge them different prices only on the basis of their allocation to different runs. It followed that retailer A might be regarded for the purposes of our observations as being supplied at below total cost".

245. A similar point, which illustrates the difficulty, is made at paragraphs 4.18, 4.19 and 4.90 of Mr. Haberman's report, where he takes two "[…][**C**]" stores in different locations. One store was situated on a run where 53,000 litres of milk were delivered, at an average cost of 1.52p per litre. The other store was situated on a run where

between 1000 and 1600 litres were delivered, giving an average delivery cost per litre of 34.80p to 53.70p per litre. The selling price to both stores was similar (some […][**C**] ppl) and the volumes were not dissimilar (200 litres and 120 litres respectively). However, one store showed a good margin because the delivery cost was spread over a high volume run, while the other store was shown as unprofitable because it happened to be on a run where the volume delivered was much lower.

246. In our view, results of this kind are purely arbitrary, depending on the run to which the outlet is assigned. Wiseman's evidence is that these kinds of calculations do not affect the prices it charges, and it does not, for the purposes of its business, calculate costs in this way. We can see that it would be impractical for Wiseman to base its prices on arbitrary allocations of this kind. Because of this arbitrary element, it seems to us difficult to say that the OFT's costs analysis represents a robust basis for studying whether or not the Chapter II prohibition has been infringed.

247. It appears that the potentially arbitrary nature of the results of the OFT's allocation of run costs was not fully appreciated by the OFT team until the meeting with Wiseman on 14 March 2002, by which time several months had been spent analysing the data provided by Wiseman. The fact that light dawned only after the event suggests that the OFT's detailed knowledge of the practical working of the industry was limited, contrary to various submissions that have been made to us.

248. Our second concern of this aspect of the case relates to the fact that the OFT's volume-based approach does not take into account distance as one of the drivers of costs. While we accept that volume has the attraction of simplicity, and has an important influence on several aspects of costs, distance is also an important factor affecting run costs. The CC found that the cost drivers for run costs were "volumes, drop density and distance" and that larger outlets were in general cheaper to supply on a cost per litre basis (CC Report, paragraphs 4.67 to 4.72). Wiseman in its letter to the OFT of 1 August 2001 pointed out that both the size of the vehicle and the distance from the depot were cost drivers and that, all else equal, customers at the beginning of the run were cheaper to serve than customers further away, although that might be different if the customer further away was a large drop.

249. In the present case, it seems to us, the issue of distance is a central feature. For example, one of Claymore's principal complaints is that while it can offer competitive prices in the Highlands, Nairn, the centre of Claymore's distribution system, is too distant from the Central Belt for Claymore to be able to compete with Wiseman there. Claymore's argument on "All of Scotland" customers is that because of the economics of its distribution system, it is hard to offer contracts to customers whose outlets are scattered all over Scotland. Wiseman, by contrast, can offer "All of Scotland" prices in a way which Claymore cannot match. The OFT Witness Statement mentions that lower margins in the Highlands are partly explicable by "the cost of delivering milk there" (paragraph 64). To leave distance out of account completely when it comes to considering the costs of supplying customers in different locations does not seem to us to take into account the specific features of this particular case.

250. The point is illustrated by considering briefly some of the figures we have for run costs from Keith. We have the following figures for the runs from Keith for May 2000.

Table A May 2000

		2	3	4	5	6	7	8	9	10	
Requested Run Number	Actual Run Number	Wages	Fuel	Vehicle depreciation	Vehicle insurance, licence and road tax	Tyres	Maintenance	Haulage revenue from non-milk customers	Total (Sum of 2,3,4,5,6,7 minus 8)	Litres delivered	Cost per litre (9 divided by 10)
Runs operated by Wiseman											
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
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[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
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[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]
[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]	[…][**C**]

251. There seems to us to be little discernable relationship between the costs of each run, as estimated by Wiseman, and the volume delivered. Broadly speaking, wages remain the same irrespective of volume. Fuel cost differs by run, but not in relation to volume. ABER 1 had a cost of fuel of £[…][**C**], but delivers less than one-fifth of the volume of ABER 6, where the fuel cost was £[…][**C**]. Similarly other costs do not appear to have a relationship with volume. Vehicle depreciation, fuel and tyres are much higher for ABER 1 than others – ABER 6, for example.

252. While we can, up to a point, understand the OFT's desire to look at Scotland as a whole, the breadth of the OFT investigation eventually undertaken in 2001 may have tended to lose sight of the original focus and central issue in the case, namely whether Claymore, allegedly able to operate competitively in the Highlands, to which it says its distribution system is well adapted, was being prevented from doing so by anti-competitive practices being engaged in by Wiseman in the Highlands. In that connection, as we understand it, all or most of the customers in question are served by Wiseman from its Keith depot, from which there are only some 12 runs. It appears that in the period of the alleged anti-competitive practices prices from the Keith depot fell substantially, by up to 33%, while volumes increased. In the circumstances it seems to us that it would not have been unduly difficult or time consuming to focus on the runs from the Keith depot and to consider whether, in relation to those key runs, run costs could be calculated on a basis more closely related to cost drivers other than volume.

253. As to the OFT's argument that the run is geared to supplying the supermarket, we have no evidence as to how far that it is so in relation to runs in the Highlands, which may present different characteristics from runs in the Central Belt. The OFT concedes that it did not know whether or to what extent the sampled runs served supermarkets.

254. We accept the OFT's point that there is no "right way" to allocate costs. However, if the exercise was worth embarking upon at all – a point we leave open – we reach the conclusion that the solely volume-related method used by the OFT produced anomalies and arbitrary results. In relation to run costs in the Highlands, we doubt whether the use of volume alone gave a realistic picture, having regard to the issue of distance in

that region. While we by no means underestimate the difficulties faced by the OFT, and understand the attempt to investigate costs to a deeper level, we do not find ourselves persuaded that allocations of run costs to individual outlets or customers on a run could be satisfactorily and reliably done on the basis of volume alone, particularly as regards the allocation of run costs in the Highlands.

255. As we understand it, the OFT's volume-based methodology formed the "bottom" of its "bottom up" approach to costs. Since the foundation was in our view insecure, we are not persuaded that the OFT's resulting estimate for ATC was secure either.

Conclusions on the OFT's approach to total costs

256. We accept that figures for different periods will give different results, for example due to changes in the raw milk price. However, given (i) the variations in the figures before the Tribunal, which suggest that the OFT's figure for ATC was too low (ii) the absence of any reconciliation of the OFT's calculations to Wiseman's management or statutory accounts, (iii) the fact that the CC found that Wiseman was selling to CWS and Aberness at prices below total cost after March 2000, (iv) the admission in the OFT Witness Statement that certain elements of total costs up to 5 per cent were omitted, (v) that 5 per cent of costs is likely to be material, (vi) that costs were studied for a single month, rather than over time, (vii) that the allocations by volume gave rise to anomalous and arbitrary results, and (viii) that such allocations did not reflect distance, at least for the Highland runs, we are unable to be satisfied that the figures the OFT used for total costs were reliable. That in turn undermines the robustness of the OFT's conclusion that Wiseman's prices were above total costs to the extent that the OFT found.

Issues relating to AVC

257. As we understand it, variable costs are relatively high. The cost of ingredients (a variable cost) is approximately 60 per cent of total costs. Mr Bezant estimates that variable costs could account for up to 79 per cent of total costs, depending on how processing costs are treated. In relation to run costs, which represent about 7 – 10 per

cent (according to Mr. Bezant 8 per cent) of the total, it is common ground that a substantial proportion of run costs are variable.

258. The observations we have made above about allocating run costs on a volume only basis to individual outlets and customers also undermine the OFT's calculations of AVC, particularly as regards runs in the Highlands. In effect, the arbitrary and anomalous results we have already identified would affect the calculation of AVC as well as ATC.

259. In addition, no elements of the following costs were apparently included as variable in the OFT's investigation:

- vehicle depreciation, vehicle insurance, licence and road tax, vehicle maintenance;
- depot costs other than run costs;
- trunking costs;
- marketing, selling and administration expenses.

260. We cannot, on the information available, decide how far the above costs should be treated as "variable", but we could have thought that elements of vehicle costs are arguably variable, and we note that the CC decided that 50 per cent of trunking costs should be treated as variable. Figures in Mr. Haberman's report (paragraph 5.60) suggest that depot costs do vary from month to month. The CC Report indicates that the proportion of variable cost also varies by depot, up to 69 per cent at Keith: Table 3.19. We note that, rather than obtaining Wiseman's monthly management accounts for depots (such as Keith) which would have permitted a month on month study of which costs were variable, the OFT in the end relied only on the figures for May 2001. That approach, in our view, risks leading to an incomplete picture of which costs in fact vary over time, or by output.

261. The Tribunal pointed out in *Aberdeen Journals (No.2)*, cited above, that the question of which costs are "fixed" and which are "variable" also depends on the time period under consideration. A cost that may be "fixed" in the short term (say a month) may be "variable" if a long period is taken (say a year): see *Aberdeen Journals (No. 2)* at paragraphs 353 to 356, cited above. In any case in which pricing below AVC is alleged it is important to consider over what period it is appropriate to regard costs as

"variable". For example, Mr. Sweeney tells us that the incremental business from the Keith depot involved acquiring additional delivery vehicles (paragraph 5.2.2). How far in such circumstances vehicle costs such as depreciation should be treated as 'fixed' is an issue which arises. The OFT's failure to have in mind any particular period is in our view a weakness in its approach to AVC. We cannot, however, on the information available, determine whether costs regarded by the OFT as fixed could properly have been treated as variable, if a longer period had been taken.

262. As to the OFT's submission that any error would have been taken care of by the use of the OFT's "high" measure of AVC to include all packaging and processing costs, we would have thought that packaging costs were variable in any event, as Mr. Bezant says. As to processing costs, the CC apparently considered that between 53 per cent (Wiseman's figure) and 65 per cent of processing costs were also variable: see paragraph 3.94 of the CC Report. Nor would we accept the argument that the inclusion in AVC of some arguably "fixed" processing costs is an appropriate substitute for a proper analysis of what was "fixed" and what was "variable".

263. We do not have figures to substantiate the claim that the inclusion in AVC of all packaging and processing costs could necessarily compensate for the omission of other variable costs, although that may be the case.

264. On the other hand, despite all these weaknesses, Claymore has produced no evidence, and does not allege, that Wiseman was pricing below AVC, except on the basis of the "incremental" cost of supply. Although Mr. Larg's statement details what he believes were Wiseman's prices, neither he nor Mr. Haberman allege that Wiseman was pricing below AVC, except on the "incremental" basis. The CC did not find any pricing by Wiseman below AVC, except on the "incremental" basis favoured by Mrs Kingsmill and Professor Cave.

265. As regards the issue of the "incremental" cost of supply, Claymore's main argument is that in 1999 Wiseman gained the whole of the CWS business (including the Highlands stores previously served by Claymore) by reducing its price across the board to CWS. The net effect, according to Claymore, was that Wiseman gained an additional volume of some […][**C**] litres per week, but an additional revenue (compared with Wiseman's

previous revenue from the part of the CWS business previously supplied by Wiseman at a higher price) of only £[…][**C**]. That, according to Claymore, equates to a marginal price for the additional volume of some […][**C**] ppl, well below AVC. In the CC Report, Mrs Kingsmill and Professor Cave accepted this argument, with the qualification that it could not be assumed that Wiseman would have retained its existing CWS business at the pre-1999 price, so that assumptions had to be made as to what that price should be. Mr Clothier and Mr Mackay considered that the approach was not correct in principle, and that the contract should be viewed as a whole.

266. In this case in our view Claymore's submission faces two main difficulties. First, the prices here in question were agreed in February 1999, a year before the 1998 Act came into force. It seems to us difficult to apply the concept of 'incremental' price and cost retrospectively to 1999, a period when the 1998 Act was not in force. Secondly, in this case a great deal depends upon what assumption is made as to the price at which Wiseman would have retained its existing CWS business. Claymore's argument, as we understand it, assumes no change in that price, but that assumption was not accepted by the CC. The CC made a number of different assumptions about what Wiseman's price would have been if it had simply retained its existing CWS business, but it is only on some of these assumptions that Wiseman's incremental revenue was arguably below AVC. The hypothetical nature of the various alternative assumptions inevitably complicates the analysis of abuse under the Chapter II prohibition.

267. We do not therefore accept Claymore's "incremental" argument in this case, although we accept, in principle, that a comparison of incremental revenue and incremental cost is likely to be a valid approach in some predatory pricing cases.

268. It results from the foregoing that, despite our criticisms of aspects of the OFT's approach to AVC, we do not have evidence suggesting that Wiseman's prices were below AVC in a respect material to the analysis.

The issue of intent

269. As already seen, the *AKZO* test presumes predation if prices are below AVC, but if the prices are between AVC and ATC an "intention to eliminate a competitor" must be

shown. On the hypothesis there is little relevant evidence of pricing below AVC, at least after 1 March 2000, a pricing abuse in this case could nonetheless arise from pricing below ATC. But that requires "an intention to eliminate a competitor". The OFT considered that there was insufficient evidence of intent.

270. The phrase "intention to eliminate a competitor" is not entirely straightforward to interpret, since in one sense any competitor, competing in the market, is striving to eliminate – i.e. to drive out – a less efficient rival competitor. What is meant in our view is conduct on the part of a dominant firm which (i) has the reasonably foreseeable result of driving a rival from the market; (ii) goes beyond a normal competitive response and is disproportionate to the threat; and (iii) has the object or effect of preserving or strengthening a dominant position.

271. As to the evidence necessary to establish the necessary intention, the OFT accepts that it is unnecessary to produce a document showing an intention to eliminate: intention can be inferred from all the circumstances. Among the relevant elements may be the circumstances in which the alleged price cutting takes place. On the other hand, price cutting, in itself, is not predation: circumstances may arise in which prices are above competitive levels, and new entry simply brings prices down to competitive levels to the benefit of consumers. Similarly inefficient competitors are not protected by the Chapter II prohibition. Nor do we accept Claymore's suggestion that merely "hindering" the activities of a rival is sufficient. However, a willingness by a dominant firm to accept prices below ATC for a significant period without any other explanation (e.g. a short-term recession) may indicate an intention to eliminate a rival from the market: see *Aberdeen Journals (No 2)*, cited above, at paragraph 356.

272. It is true that if we start chronologically in 1999, there is in our view evidence from which intention could be inferred. For example:

    (i) Wiseman's pricing strategy was in direct response to Express' "entry" via the purchase of the stake in Claymore.

    (ii) Wiseman targeted specific Claymore customers, including CWS and Aberness. Messrs Clothier and Mackay accepted: "the speed and wide ranging manner in which Wiseman went about targeting Express/Claymore's major customers in Northern Scotland…could have had as part of its purpose the maintenance of Wiseman's monopoly position".

(iii) Prices at the Keith depot fell more sharply than elsewhere, by up to 33 per cent, and the volume supplied by the Keith depot increased substantially.

(iv) Wiseman's strategy resulted in the loss of about 40 per cent of Claymore's businesses.

(v) It was in our view foreseeably likely that the loss of business on that scale would put Claymore in a loss making position. Its closure would have been foreseeable (CC Report, paragraph 2.123).

(vi) Had, in fact, Express abandoned Claymore, Wiseman's dominant position (on the assumption that Wiseman was dominant) would have been protected and strengthened.

273. The foregoing applies, however, to 1999, which is before the Chapter II prohibition contained in the 1998 Act came into force. To establish an abuse on the basis of pricing below ATC after 1 March 2000, the OFT would have needed to show to the civil standard of proof that an intention existed after that date. However, events before 1 March 2000 may be relevant to establishing the existence of intent after that date, particularly if there is no reason to suppose any change of intent.

274. It is true that during the visit to East Kilbride the OFT found various documents including one entitled "Express hit list Spring 1999". However, that document is not confined to Scotland, and predates 1 March 2000 by a year. It is not in our view determinative.

275. We note Mr Alan Wiseman's comments during the CC investigation in 2000 to the effect that Wiseman did not regard Express as a "legitimate" purchaser, and that Express' investment in Claymore in his view had "nothing to do with making normal commercial profits" (p 35 of the transcript of the CC hearing, 27 April 2000).

276. Mr Sweeney, in his witness statement to the Tribunal, also states his view that Express' strategy was to cause harm to Wiseman, was not motivated by normal commercial considerations, and was in any event flawed because of the costs of serving the Central Belt, which in Wiseman's view Express had always intended to do, from Nairn.

277. These statements by Mr Wiseman and Mr Sweeney reflect one of the underlying disputes between the parties as to whether Express' strategy (in Wiseman's view

flawed) always was to attack Wiseman's position in the Central Belt from Nairn, and whether it was Express, rather than Wiseman, who started to offer "All of Scotland" contracts in early 1999. These are not matters that the Tribunal can resolve in the context of the present case.

278. However, we would regard those statements by Mr Wiseman and Mr Sweeney made after 1 March 2000 as evidence of intent. Similarly, for example, the new arrangements with Aberness in 2002 discussed later in this judgment could in our view also have been relevant to the issue of intent.

279. We do not accept the over-benign suggestion contained in paragraph 50 of the OFT Witness Statement where it is implied that Wiseman was doing little more than "keeping a close eye" on Claymore/Express. We also emphasise that any undertaking has the right to complain to the OFT about an alleged abuse of dominance. The apparent suggestion in paragraph 50 of the OFT Witness Statement that Wiseman's attitude to Claymore/Express was explicable because Claymore/Express had complained to the OFT was in our view inappropriate.

280. We do accept, however, that to show abuse on the basis of pricing below ATC, the OFT needed evidence of such conduct after 1 March 2000. In our view, the sequence of analysis is first to consider whether there is pricing below ATC, and then to consider whether an intention to eliminate can be inferred. That sequence of analysis is difficult in this case because the OFT found few instances of pricing below-ATC, on the basis of an investigation of that issue which we have already found to be unsatisfactory. For example, had the OFT found that the below ATC pricing found by the CC in respect of CWS and Aberness had continued during 2000 such a finding would have been relevant both to the extent of pricing below ATC, and to the issue of intent.

281. However, since the OFT's investigation as regards ATC did not yield reliable results, it is difficult to examine the issue of intent after 1 March 2000 in the abstract.

282. Our general view on the evidence before us is that the OFT was somewhat overcautious on the issue of intent, taken separately, but the real question was whether, and to what extent, and for what period, Wiseman was pricing below ATC and, if so, whether that

was a proportionate response to Express' acquisition of a stake in Claymore. It is hard to examine the issue of intent in its proper context without a reliable finding of pricing below ATC.

Conclusions on the OFT's approach to the predatory pricing issues

283. Summarising the foregoing, (i) we are driven to the conclusion that the OFT's findings on pricing below ATC were not reliable, and that the issue of ATC was not properly investigated, for the reasons summarised in paragraph 256 above; (ii) there are various difficulties with the OFT's investigation of AVC, but there is little or no evidence to suggest that Wiseman's prices were below a reasonable estimate of AVC at a material time after 1 March 2000, given that we do not accept Claymore's "incremental" argument in the specific circumstances of this case; and (iii) there was evidence of intent, but such evidence related mainly to 1999: it is difficult to examine further the issue of intent in any useful way without a reliable finding by the OFT of pricing below ATC after 1 March 2000.

D. "ALL OF SCOTLAND" CONTRACTS: CWS AND ABERNESS

284. Claymore submits that in the circumstances of this case it was an abuse for Wiseman to offer customers such as CWS and Aberness an "All of Scotland" contract, since that excluded Claymore, *de facto*, from the business of the Highlands outlets of those customers, notwithstanding that in the Highlands Claymore's prices were competitive with those of Wiseman.

285. In response, the OFT distinguishes between two situations, one where the agreement is "exclusive" in the sense that the retailer agrees not to take milk from any supplier except Wiseman, and the other where Wiseman simply offers to supply any outlet of the retailer at a single price, the retailer remaining free to take supplies for any outlet from any other supplier. According to paragraph 74 of the OFT Witness Statement:

> "74. In the absence of any sufficiently compelling evidence of exclusivity, we were unable to conclude that the "all-Scotland" arrangements entered into by Wiseman infringed Chapter II of the Act. We did not believe that merely by committing itself to offer a single price for milk to all outlets of a particular retailer Wiseman had

> infringed Chapter II. There is no clear or compelling evidence that Wiseman had ever made supply in any area or to any outlet conditional upon supply on an all Scotland or regional basis. In such a case, it is difficult to see that we could have maintained a case to the standard of proof required that Express/Claymore is precluded by agreements of the type alleged from competing for the business of outlets in the Highlands area, and from gaining that business where it is able to offer a more competitive price."

286. The distinction drawn by the OFT, although valid in theory, may be difficult to apply in practice. In the present case we have some evidence about two relevant arrangements, concerning CWS and Aberness. In both cases, there is a factual dispute as to whether, de facto, the arrangement was 'exclusive' or not.

The CWS contract

287. In the case of CWS, Claymore lost the Highlands and Islands stores of CWS to Wiseman under an "All of Scotland" contract in February 1999. According to Claymore, the CWS contract was *de facto* exclusive, in that CWS had said that it was a condition of their agreement with Wiseman that Wiseman had to have all of CWS' Scottish business (paragraph 32 of Mr. Larg's statement). Claymore contends that they were effectively excluded from the CWS' Highlands and Islands stores from February 1999 to October 2002 when Claymore successfully bid again for CWS' Highlands and Islands business. CWS on the other hand apparently told the CC among other things that Wiseman's offer was more attractive than Claymore's, and that CWS favoured a single supplier, albeit that "a single supplier should not dominate the market". It was CWS who had sought an "All of Scotland" contract (paragraphs 2.127, 2.130, and 6.109 to 6.110).

288. Although admittedly there was no clear finding by the CC on the single supplier point, it seems to us, at first sight, that there was material before the OFT from which it could be inferred that, implicitly, Wiseman's price in 1999 was offered on the basis that Wiseman would be CWS' sole supplier. That was, apparently, what CWS wanted at the time, and it is somewhat hard to see why Wiseman should have reduced its price to CWS to the extent that it did had it not had the expectation that it would thereby gain

CWS' Highlands and Islands stores. From CWS' point of view, the incentive for an arrangement of this kind would be the obtaining of a lower price for all its stores. In practice, Wiseman became CWS' sole supplier.

289. The arrangement with CWS continued after the 1998 Act came into force up to 2002. However, as far as we can see, the OFT did not investigate which side of the line drawn in paragraph 74 of the OFT Witness Statement (sole supply or single price without exclusivity) the arrangement with CWS fell. The OFT contented itself with regarding the CC's findings about CWS as "inconclusive", without itself following up the matter in any way, for example by asking Wiseman, CWS, or Claymore.

290. We regard the failure to investigate the issue of whether Wiseman was *de facto* the sole supplier to CWS as a significant omission, considering that the CWS issue formed a central part of Claymore's case to the OFT.

291. In any event, it seems to us that the offer of the CWS contract on an "All of Scotland" basis was not free of difficulty under the Chapter II prohibition in the particular circumstances of this case. The relevant law is stated clearly in *Hoffmann–La Roche v. Commission,* cited above, at paragraph 89:

> "89. An undertaking which is in a dominant position on a market and ties purchasers – even if it does so at their request – by an obligation or promise on their part to obtain all or most of their requirements exclusively from the said undertaking abuses its dominant position within the meaning of Article [82] of the Treaty, whether the obligation in question is stipulated without further qualification or whether it is undertaken in consideration of the grant of a rebate."

292. At the material time, the situation in this particular market was asymmetric, both in terms of market shares and geographically. Wiseman supplied about 74 per cent of fresh processed milk in Scotland (66 per cent of milk supplied to the middle-ground). Claymore supplied about 6 per cent of fresh processed milk in Scotland (7 per cent to the middle-ground). In terms of market share, Wiseman was nine to ten times larger than Claymore. Geographically, we have no reason to suppose that Claymore was unable to supply at competitive prices in the Highlands to which its distribution system was geared. However because of its geographic location and distribution structure,

Claymore was apparently unable to supply CWS at the "All of Scotland" price Wiseman was able to offer.

293. As a consequence of Wiseman's offer, Claymore was excluded from the CWS' Highlands and Islands stores, and lost 30 per cent of its business. It is, in our view, at least plausible that the loss of such a contract in ordinary circumstances threatened Claymore's viability. If repeated across other symbol groups, Claymore's future would in our view have become very doubtful. We thus have the particular circumstance that, at the time, the sustained offer of "All of Scotland" contracts by Wiseman could have led to Claymore's elimination.

294. Analysing this unusual situation in terms of the Chapter II prohibition, it can in our view be argued that Wiseman's "All of Scotland" deal with CWS was exclusionary *de facto*. It also had the effect of materially weakening Claymore and, taken to its logical conclusion, had a potentially eliminating effect, thereby strengthening Wiseman's dominant position. If Claymore had exited the market, Wiseman would apparently have been left with an effective monopoly in the Highlands and Islands, unless new entry were to come in. How far in such circumstances any new entry would have occurred, or could plausibly have offered effective competition to Wiseman in the Highlands and Islands, is not clear.

295. In those circumstances, it can be argued that by offering, in effect, a delivered price, irrespective of any differences in the costs of serving different localities, Wiseman was potentially able to exclude from a local market a competitor who was apparently equally efficient in serving that local market, thereby achieving a de facto monopoly. It is also material that the CWS contract seems to have lasted for three years.

296. These issues become in our view even more acute in a context where, according to the CC, on the basis of Wiseman's figures, the CWS contract was priced below total cost, including for a period that post-dated 1 March 2000. We do not think it is correct to put the allegation of "below cost pricing" into a separate box from the allegation of the exclusionary effect of the CWS "All of Scotland" contract. In our view, the apparent exclusionary effect of the CWS "All of Scotland" contract, combined with a price below total cost, would have at least presented a serious case for investigation under the

Chapter II prohibition, although on the material before us we cannot reach a view as to what the outcome would have been.

297. Unfortunately the OFT did not in our view get to the bottom of this important aspect of the case. The OFT did not actively investigate whether the CWS contract was originally intended to be exclusive or remained exclusive, *de facto*, after 1 March 2000. Although the decision letter of 9 August 2002 states that "the evidence available to [the OFT] was not sufficiently persuasive" it appears that, having found nothing on the visit to East Kilbride, the OFT did not in fact seek any evidence, other than reading the CC Report. Nor did the OFT act on the CC's finding that the CWS contract had been taken at a price below ATC or consider whether the CC's conclusion also applied after 1 March 2000. The OFT's own investigation of ATC was flawed, for the reasons already given.

298. In those circumstances we find it hard to see that the issues regarding CWS were properly investigated.

299. Various other points are made by the case team about "All of Scotland" contracts in the OFT's internal memorandum of 7 August 2002 (see e.g. paragraph 29). Those points are somewhat theoretical, and do not seem to us to be directed to the CWS contract. In any event, the points do not figure in the OFT Witness Statement or pleadings. We do not therefore deal with them further.

Aberness

300. Three separate matters arise as regards Aberness, which apparently owns the AR Gray stores and acted as a buyer on behalf of stores under the Mace and Morning Noon and Night symbols:

(i) Sales by Wiseman to Aberness below total cost;

(ii) The arrangements entered into by Wiseman with Aberness from July 1999 to 2002, involving a "loyalty" payment; and

(iii) The new arrangements made between Wiseman and Aberness in August 2002.

Sales to Aberness below total cost after March 2000

301. The CC found that sales were being made to Aberness (Mace) below total cost in the year to July 2000 (paragraph 2.122). Up to 1999, Aberness apparently accounted for around 2 ½ per cent of Claymore's business. Claymore apparently lost a large proportion of that business, but retained certain stores (e.g. some Mace stores) for whom Aberness acted as a buyer.

302. The OFT did not approach Aberness and did not apparently conduct any investigation as to whether Wiseman's sales to Aberness continued to be below total cost in the period subsequent to the CC Report. That seems to us to be an omission in the investigation, considering that Aberness too figured in Claymore's case to the OFT.

The arrangements with Aberness from 1999 to 2002

303. According to paragraph 2.103 of the CC Report, Wiseman wrote a letter dated 7 July 1999 to Aberness proposing an agreement under the terms of which Wiseman would make a one-off "loyalty" payment to Aberness of a substantial sum in return for Wiseman becoming Aberness' sole supplier of milk for three years. The figure has been disclosed to the Tribunal, and is described by Wiseman as representing 10 to 15 per cent of the relevant revenue in the first year.

304. Aberness apparently told the CC that it regarded the agreement as being one in which Wiseman would remain as a "main supplier" to the company's own stores (AR Gray). It was a "gentleman's agreement", open ended, easy to get out of and not legally binding. Certain Mace stores had continued to buy from Claymore. Before the CC, Wiseman does not seem to have disputed that there was an exclusive element in the Aberness arrangement (see paragraph 5.29), and said that its practice was to amortise the cost of such advance payments over the life of the agreement (paragraph 2.104 of the CC Report). At paragraph 2.107 Mrs. Kingsmill and Professor Cave concluded that this arrangement was a step taken by Wiseman for the purpose of maintaining its monopoly position. Mr. Clothier and Mr. Mackay disagreed.

305. According to the OFT Witness Statement, the CC did not reach a robust conclusion that the arrangement with Aberness was exclusive (paragraph 70). However, the OFT does not appear to have conducted any investigation as to whether this arrangement was

exclusive or not. As far as we can see, Aberness accepted the "loyalty payment" and in fact dealt mainly with Wiseman for the three years that the arrangement existed. In our view, a "gentleman's agreement" whereby a dominant firm offers, and the customer accepts, an inducement to be "loyal" to the dominant firm, is likely in principle to be abusive for the purposes of the Chapter II prohibition, even if the arrangement concerns a major part, but not the whole, of the customer's requirements. The fact that Aberness considered that the arrangement was only a "gentleman's agreement", and was not wholly adhered to, is neither here nor there. In our view, the CC Report contains evidence to suggest that there was an 'exclusive' element in the arrangement, albeit that the arrangement was not legally binding.

306. We were told that the arrangements applied only to Aberness' own (AR Gray) stores, some 27 in total. The OFT submitted to us that the arrangement, even if exclusive, was thus too small to worry about and was "below the radar" as far as the OFT is concerned. We cannot on the evidence determine if the inducement related only to the AR Gray stores, or if it affected the other stores for which Aberness negotiated as a buying agent, such as Morning Noon and Night, as paragraphs 48 to 51 of Mr. Larg's statement and Claymore's letter to the OFT of 5 August 2002 suggest.

307. However, even on the assumption that only the AR Gray stores are concerned, we do not share the OFT's view that an arrangement of the kind suggested by the evidence could be treated as *de minimis*. The effect of loyalty inducements in return for single supplier status by a dominant undertaking is at first sight a classic abusive practice. The watering down of the principle expressed in *Hoffmann–La Roche*, cited above, by the introduction of a *de minimis* exception could in our view introduce uncertainty and is not justified by authority. In any event Aberness was a strategically important customer – Claymore's letter of 27 June 2002 describes Aberness as "one of the largest potential customers in the region". The arrangement was still in force after the commencement of the 1998 Act. We would hope and expect that the OFT would fully investigate such practices in the future.

308. We add that it is not clear from the CC Report whether Wiseman's loyalty payment to Aberness was included in the CC's calculation of ATC. If it was not included in that calculation, but were to be included, it would appear likely that the resulting price to

Aberness would have been below AVC, as well as ATC. In a business where average margins are of the order of 5 per cent, a payment representing 10 to 15 per cent of revenue in the first year is in our view highly material.

The 2002 Arrangements with Aberness

309. On 5 August 2002 Claymore informed the OFT that Wiseman's arrangements with Aberness had been renewed on the same terms as before, apparently for a 12 month period. The OFT considered, however, that it was not demonstrated that an exclusive arrangement had been entered into, and that this new material made no difference to the analysis (OFT Witness Statement, paragraph 73).

310. The figures referred to in the letter of 5 August 2002 illustrate the difficulty that Claymore alleges that it has in competing for "All of Scotland" contracts. According to Claymore, its weighted average "All of Scotland" price to Aberness was more than 14 per cent higher than its 'Highlands only' price, reflecting the higher costs of supplying the Central Belt from Nairn. Claymore believed that it could not match Wiseman's "All of Scotland" price because of its location, albeit that its prices in the Highlands were competitive, according to Claymore. Claymore further alleged that Aberness' statement that it "required a supplier who could supply the whole of Scotland as one brand" was not the real reason for the exclusivity, and that Wiseman was to be the single supplier for the AR Gray and Morning Noon and Night stores, and the main supplier to the remaining stores.

311. Aberness' letter to Claymore dated 26 July 2002 refers to Aberness having "decided to remain with Wiseman's as our principle [sic] supplier of milk to our own stores". In our view there is evidence, in Claymore's letter of 5 August 2002, that the effect of this arrangement is that Wiseman continued as the de facto exclusive supplier to Aberness' company stores and possibly Morning Noon and Night Stores. In our view, for the reasons already given, there is evidence of a sufficient element of exclusivity accorded to Wiseman by Aberness to be of concern to the OFT.

312. Although the OFT said in the decision letter of 9 August 2002 that it had "looked closely" at the information provided by Claymore on 5 August 2002 (by which time the

OFT had already, apparently, told Wiseman that it was closing the file), in our view the information provided by Claymore amounted to a matter that could have warranted investigation under the Chapter II prohibition.

General conclusion on Aberness

313. Each of the three matters referred to above in relation to Aberness were not in our view satisfactorily investigated by the OFT.

E. PRICE DISCRIMINATION

314. Both the CC and the OFT found considerable variation in Wiseman's prices. The OFT also found widely varying price/cost margins and "distinct evidence of price discrimination". However, the OFT did not consider that it had found evidence of price discrimination targeted against Claymore. Claymore attacks the reliability of the OFT's findings, drawing attention to possible distortions, omissions and anomalies. Claymore also submits that the OFT erred in finding that, to be abusive, discriminatory pricing has to be targeted at particular competitors.

315. In view of the conclusion we have already reached as regards the OFT's methodology in establishing the costs of supplying different customers and outlets, we do not think we have a secure factual basis for investigating the issue of price discrimination as a separate head. Our conclusions above as regards the OFT's investigation of costs and the circumstances of Wiseman's dealings with CWS and Aberness suffice in our view to show that significant aspects of the OFT's investigation are open to criticism.

VI CONCLUSIONS AND RELIEF

Summary

316. The foregoing leads us to have serious doubts as to:

(i) the adequacy of the OFT's investigation into Wiseman's average total costs in this case (paragraphs 202-256 above); and

(ii) the adequacy of the OFT's investigation in relation to Wiseman's arrangements with CWS and Aberness (paragraphs 287-313 above).

317. We also have serious doubts as to the adequacy of the OFT's investigation into Wiseman's average variable costs in this case, albeit we are unpersuaded that there is relevant evidence that Wiseman was pricing below AVC (paragraphs 257 to 268 above). We regard the OFT's approach to the issue of intent as overcautious (paragraphs 269 to 282 above).

318. In *Claymore (Recovery and Inspection)*, cited above, at paragraph 109, the absence of a proper investigation is identified as one of the grounds on which the Tribunal may set aside a decision of non-infringement. In so far as the decision letter of 9 August 2002 decided that there was no infringement of the Chapter II prohibition on the evidence available, it seems to us that that conclusion was reached on the basis of an investigation that was, for the cumulative reasons we have already set out, not an adequate investigation in respect of (i) the costs issues and (ii) the issues relating to the CWS and Aberness contracts. On that basis, the decision of 9 August 2002 should be regarded as without any legal effect and therefore set aside.

The internal memorandum of 7 August 2002

319. In those circumstances, we do not need to deal in any detail with the internal memorandum of 7 August 2002. We note, however, that the reasons set out in the OFT Witness Statement do not fully reflect the reasons given in the internal memorandum, and that a number of the views there expressed were not, as far as we are aware, ever put to Claymore for comment. In our view these matters would give rise to further grounds for setting aside the contested decision.

320. The case team's references to Express' "inefficient entry", "Stackelberg-warfare", Express' "suboptimal" strategy, "mistaken move" and "illegitimacy" in Scotland in the internal document of 7 August 2002 at paragraphs 38 and 39 suggest that the OFT did, in fact, prefer views similar to those of Mr. Clothier and Mr. Mackay, although that is nowhere stated in the OFT Witness Statement or pleadings.

321. However, there is no analysis in that document of the relevance of the EC case law the OFT is bound to follow under section 60 of the 1998 Act, nor of the relevance of the

assumption that Wiseman was dominant in the middle-ground sector in Scotland, a separate market from the market in Great Britain.

322. In our view the question whether Express' then strategy in Scotland was "mistaken" or "sub-optimal" is wholly irrelevant to the analysis in law of whether there was an abuse by Wiseman, the dominant firm. The case team's conclusion that Wiseman "had to react" seems to us not to address the correct question, namely whether Wiseman's conduct was contrary to the special responsibility of the dominant firm.

323. Had the facts of Wiseman's costs been satisfactorily established, and had the exclusivity issues in relation to CWS and Aberness been more fully investigated, no doubt the issue on which the members of the CC split, namely whether Wiseman's actions were taken anti-competitively for the purpose of securing its dominance in Scotland, or were a reasonable response to Express' entry, could have been addressed within the rules and framework of the Chapter II prohibition. The difficulty in this case is that there was in our view no adequate factual substratum on the basis of which the conceptual issues could be addressed.

Relief

324. Although the Tribunal has power to remit "the matter" to the OFT, the events here in question now date back over six years. The OFT's investigation of costs related to mid-2001. The CWS arrangements changed in late 2002, when Claymore recovered some business, and the 2002 arrangements with Aberness related, as we understand it, to a twelve month period. In the meantime, Express had merged with Arla, Arla/Express being in April 2003 the largest processor in Great Britain, according to the CC report on that merger (at p. 93).

325. In these circumstances, given the historical nature of this dispute, we see no purpose in making any further order. It is for the OFT, given the time that has elapsed, to decide what, if any, further action should be taken.

Christopher Bellamy Peter Clayton Peter Grant-Hutchison

Charles Dhanowa 2 September 2005
Registrar