



# Competition newsletter

The latest update from the Competition team - February 2010

## Kraft/Cadbury – the merger decision

**The European Commission cleared the Kraft/Cadbury merger on 6 January 2010 – paving the way for the completion of one of the most talked-about deals in recent times.**

### Summary

Kraft Foods, Inc. (Kraft) notified its proposed takeover of Cadbury plc (Cadbury) to the European Commission (Commission) for mandatory merger clearance on 9 November 2009. [After assessing the takeover's likely impact on competition in EU markets, the Commission cleared the takeover throughout the EU on 6 January 2010.](#) The Commission found that the deal gave rise to competition concerns in the Polish and Romanian chocolate confectionary markets. To address those concerns and obtain clearance, Kraft committed to divest Cadbury's Polish confectionary business and its Romanian chocolate business. The Commission found no competition concerns in the UK and Irish markets.

### Background

Under the European Merger Regulation 139/2004 merger transactions which exceed certain turnover-based thresholds must be notified to the Commission for mandatory merger clearance before they can be completed. The Commission conducts a detailed analysis of each notified deal's likely effect on competition in the EU. At the end of a set review period, it can clear a deal conditionally or unconditionally, or block it.

Notification is mandatory where the Regulation's thresholds are met, and (with some exceptions) the Commission has exclusive jurisdiction to rule on mergers that qualify for its review. Clearance (or prohibition) by the Commission is valid throughout the EU, eliminating the need for 'national filings' where a Commission notification is made and giving rise to the idea that the ECMR can be used as a 'one-stop shop' for EU merger clearance for large M&A deals.

Where a transaction involves a public takeover bid, obtaining merger clearance can be an essential pre-requisite to a bid proceeding.

### Facts

The Commission observed that Kraft is a worldwide food and beverage company active in more than 150 countries, and that Cadbury is a worldwide producer and seller of chocolate and confectionary products in over 60 countries.

The Commission further noted that both Kraft and Cadbury are strong players in the chocolate confectionary business in the EEA. Kraft has a very strong presence in most Member States through its brands Milka, Côte d'Or and Toblerone – with the exception of the UK and Ireland where customer preferences for traditional British chocolate remain strong. Cadbury is the market leader in the UK and Ireland (in particular with Dairy Milk), whereas elsewhere in the EU it is mainly active in France, Poland, Romania and Portugal through local brands which it acquired.

As regards the UK and Ireland, the Commission found that whilst Cadbury's market share is very significant, the penetration of Kraft's brands remains low. It also found that the Kraft and Cadbury brands do not compete closely with each other, owing to the strong preference of British and Irish customers for 'traditional British chocolate' as opposed to 'continental types'. It concluded that the proposed takeover caused no competition concerns in the UK and Irish markets.

### Comment

Business news in early January 2010 was dominated by the Kraft/Cadbury takeover story. The timing of the later stages of the takeover bid was controlled to a significant degree by the EU merger clearance process.



Please email Toby Tyler at [toby.tyler@morgan-cole.com](mailto:toby.tyler@morgan-cole.com) with your feedback, comments and suggestions on this publication.

As regards the competition analysis, the case appears to have been perhaps surprisingly straightforward. This only emphasises that deals that are hotly debated on grounds of (for example) the national interest and job security for workers are often unproblematic in terms of their impact on competition in markets. And lest we forget, (with some limited exceptions) the only tests that the regulators apply in deciding to clear or block a deal are:

- whether it will significantly impede effective competition in the common market or a substantial part of it (the Commission's test for EU mergers)
- whether it will substantially lessen competition in any market in the UK (the test applied by the UK authorities for UK mergers).

## Can companies sue employees responsible for breaking the competition rules?

**In principle, YES, according to the High Court.**

### Summary

Companies in the Safeway group (now owned by Morrisons) (Safeway) may become liable to pay fines for infringement of UK competition law. They have claimed damages against former directors and employees alleged to have been responsible for the infringement, to compensate them for the losses to which they are exposed.

In the case of *Safeway Stores Limited and others v. Twigger and others*, the former directors and employees applied to the High Court for a judgment to dismiss the claims made against them.

On 15 January 2010 the High Court declined to dismiss the claims. It ruled that the Safeway companies have a real possibility at trial of defeating a defence based on the rule that the courts will not help a claimant to profit from its own wrongdoing, or on the argument that the claims are contrary to the competition regime.

### Background

In January 2005 the OFT launched an inquiry into alleged competition law infringement by supermarkets and dairy processors, arising from initiatives which allegedly raised prices of milk and dairy products for consumers (the milk initiatives). The price increases were apparently passed back to dairy farmers, who from 2000 had taken action to increase the 'farm gate prices' paid to them.

In December 2007, Safeway reached an early resolution agreement with the OFT in relation to the inquiry. That involved Safeway admitting that it had infringed UK competition law through the exchange and disclosure of commercially sensitive retail pricing intentions by participating in the milk initiatives.

The OFT has not yet finalised its infringement decision, since the investigation into some supermarkets remains ongoing. When it does so, the penalty that will be imposed on Safeway will be £16,449,893 – although this may be discounted by up to 35% (to £10,692,431) on account of Safeway's co-operation.

Safeway has brought a claim for damages against certain ex-directors and ex-employees who, it alleges, breached their employment contracts and/or fiduciary duties to Safeway by participating in the milk initiatives. It has also claimed that they were negligent, and that in breach of contract and/or fiduciary duty they failed to report the milk initiatives to their superiors or the boards of directors of any of the Safeway companies.

Safeway is seeking an indemnity from the ex-directors and ex-employees for the amount of the OFT penalty, and damages for the costs it incurred in the OFT investigation (around £200,000). The court acknowledged that the real target of the claim is not the assets of the ex-directors and ex-employees, but rather the directors' and officers' liability insurance available to them.

### Facts

The ex-directors and ex-employees applied to the High Court for summary judgment against Safeway, or for an order to strike out its claim.



They argued that Safeway's claim was barred as a matter of public policy for two reasons:

- it infringes the principle that a person should not benefit from his own wrongdoing, as expressed in the Latin maxim *ex turpi causa non oritur action*
- it is inconsistent with the UK competition law regime.

The High Court reviewed relevant case law, and concluded that the Safeway companies have "a real prospect of successfully defeating at trial any defence of *ex turpi causa* or that their claims are contrary to the competition regime". Accordingly, it dismissed the application for summary judgment/strike out.

### Comment

This judgment marks a new departure for UK competition law. Prior to the enactment of the Enterprise Act 2002, individuals were all but immune to legal consequences (beyond dismissal) of engaging their company in competition law infringement.

That Act introduced a criminal offence for individuals who dishonestly engage in cartel activity, punishable by up to 5 years' imprisonment (June 2008 saw the first convictions). It also introduced competition disqualification orders – allowing the court to disqualify directors for up to 15 years where (a) their company has breached competition law and (b) the court considers that their conduct makes them unfit to be involved in company management.

Now *Safeway Stores Limited and others v. Twigger and others* appears to have established the principle that directors and employees can be liable to their companies for the loss those companies suffer when they are led to infringe competition law. Whilst this development might have been expected to come through legislation, rather than through case law, it is consistent with the much harder line now taken on individuals whose actions produce competition law infringements. It emphasises the personal imperative individual directors and employees have to secure compliance – it is directly in their interests to do so.

Another side to this is the potential that the judgment has to re-allocate financial liability for competition law penalties from the infringing company to the insurance companies. For that reason, and others besides, we might reasonably expect *Safeway Stores Limited and others v. Twigger and others* to make a few more headlines before it is finally resolved. Round 1 to Safeway.

## New groceries laws - in force from 4 February 2010

**On 4 February 2010 new laws came into effect in the UK grocery sector which regulate trading relationships between supermarkets and their suppliers.**

### Summary

The Groceries (Supply Chain Practices) Market Investigation Order 2009 (the Order) made by the Competition Commission (the CC) came into force on 4 February 2010.

The Order imposes obligations on UK supermarkets relating to their dealings with suppliers. It is one of the outcomes of the CC's investigation of the UK groceries market between 2006 and 2008.

### Background

In May 2006, the Office of Fair Trading (OFT) asked the CC to conduct an in-depth market investigation into the retail supply of groceries in the UK. The CC's investigation lasted until April 2008, when it published its final report.

The CC concluded that "whilst UK grocery retailers are, in many respects, delivering a good deal for consumers, action is needed to improve competition in local markets and to address relationships between retailers and their suppliers." It decided to implement a number of measures to address its concerns, including (in the CC's words):

- a recommendation for the inclusion of a 'competition test' in planning decisions on larger grocery stores;
- action to prevent land agreements which can restrict entry by competitors;
- the creation of a new strengthened and extended Groceries Supply Code of Practice; and
- a recommendation to establish an independent Ombudsman to oversee and enforce the Code.

The Order that took effect on 4 February 2010 includes the new Groceries Supply Code of Practice (the Code).



Please email Toby Tyler at [toby.tyler@morgan-cole.com](mailto:toby.tyler@morgan-cole.com) with your feedback, comments and suggestions on this publication.

## Summary of the details of the Order and the Code

The Order and the Code contain a range of requirements, which are summarised below.

### What do the Order and the Code relate to?

The Order and the Code cover the purchasing relationships between supermarkets and their grocery suppliers. (Groceries for these purposes means food, pet food, drinks, cleaning products, toiletries, and household goods. A number of products commonly sold in supermarkets are excluded from what is meant by groceries, and are not covered by the Order).

### Who does the Order apply to?

It applies to 'designated retailers' – Asda, the Co-operative Group, Marks & Spencer, Morrison's, Sainsbury's, Tesco, Waitrose, Aldi, Iceland and Lidl. Other grocery retailers with an annual turnover exceeding £1 billion from grocery sales can be added to the list of designated retailers by the OFT.

### What are the main requirements of the Order?

- All agreements between the designated retailers and their grocery suppliers must incorporate the Code, and must not contain provisions that are inconsistent with it
- The terms of any agreement with a groceries supplier must be recorded in writing, the supplier must have a full written copy, the designated retailer must hold the written terms for 12 months after the end of the agreement, and the terms must be made available to the grocery supplier on request
- Before entering an agreement with a grocery supplier, each designated retailer must provide the supplier with a notice setting out specific information relevant to the supplier's rights under the Order and the Code (where a relationship consists of a number of separate contracts, this need only be done at the outset, provided that any changes in the information are notified to the supplier)
- Where a supply agreement is made, and related arrangements are later made orally, the designated retailer must confirm those arrangements in writing with the supplier within three working days
- Designated retailers must take specific compliance measures – such as annual training for buying staff on the Order and the Code, appointing a Code Compliance Officer, and delivering an annual compliance report to the OFT

### What are the main requirements of the Code?

- Retailers are obliged to deal with suppliers 'fairly and lawfully' at all times
- Except in limited circumstances, retailers cannot retrospectively change the terms of supply agreements or request supplier consent for retrospective variations
- Retailers must pay suppliers in accordance with the terms of their supply agreements, and within a reasonable time of the date of the supplier's invoice
- Retailers cannot require suppliers to contribute towards specific marketing costs listed in the Code – unless provided for in the supply agreement
- Supply agreements cannot require suppliers to compensate retailers for 'shrinkage' (loss of stock that occurs after delivery to the retailer)
- Retailers cannot require suppliers to make payments to cover wastage of the supplier's goods at the retailer's stores, except in limited circumstances
- Except in limited circumstances, retailers cannot require suppliers to make payments for their products to be stocked
- Retailers cannot require payments by suppliers to secure better positioning in-store or more shelf-space, except in relation to promotions
- Retailers can only de-list suppliers for genuine commercial reasons (which do not include the supplier having exercised its rights under a supply agreement or the Code, or the retailer having breached the Code or the Order)
- Before delisting a product, a retailer must give reasonable notice to the supplier, setting out reasons for its decision; the retailer must also permit the supplier to have the decision reviewed by a senior buyer, and to discuss it with the retailer's Code Compliance Officer



## CAMRA fights for a better deal on beer

**Looking for a better deal on beer: CAMRA challenges the OFT's decision not to refer the UK pub beer market to the Competition Commission.**

### Summary

The Campaign for Real Ale (CAMRA) has appealed to the Competition Appeal Tribunal (Tribunal) against the decision by the Office of Fair Trading (OFT) not to refer the UK pub beer market to the Competition Commission for in-depth review. As a result of the appeal the OFT has opened a consultation on its decision, and will allow interested parties to make representations about its findings. The appeal proceedings have been stayed pending the outcome of the consultation.

### Background

On 24 July 2009 the OFT announced that it had received a 'super-complaint' from CAMRA concerning the supply of beer in pubs.

Under the Enterprise Act 2002, designated consumer bodies (such as CAMRA) are permitted to make 'super-complaints' to the OFT where they believe that features of a UK market are significantly harming the interests of consumers. The OFT must publish a response within 90 days stating how it proposes to deal with the super-complaint.

One option open to the OFT on receipt of a super-complaint is to make a 'market investigation reference' to the Competition Commission – triggering a detailed in-depth review of how competition functions (or fails to function) in the market referred.

CAMRA's super-complaint raised concerns about 'beer ties'. A beer tie is a contractual obligation on a pub lessee to purchase beer and other drinks exclusively from the company that owns the pub (a Pubco). According to the OFT, CAMRA's case is that beer ties protect Pubcos from competition and lead to higher beer prices and less choice for consumers.

### Facts

On 22 October 2009 the OFT published its response to CAMRA's super-complaint. [The OFT concluded that it had not found evidence that beer ties were leading to competition problems that were having an adverse impact on consumers.](#) It considered that the issues did not warrant further assessment and decided to take no further action.

On 22 December 2009 CAMRA challenged the OFT's decision not to make a market investigation reference to the Competition Commission, by appealing to the Tribunal. According to CAMRA, beer ties are operated in 54% of UK pubs, and 41% of pubs are under beer ties imposed by Pubcos which tie more than 500 pubs.

[CAMRA asked the Tribunal to quash the OFT's decision, and to order the OFT to reconsider whether to conduct a preliminary market study or refer the matter to the Competition Commission.](#)

On 5 February 2010 the OFT announced that it had opened a consultation on its response to CAMRA's super-complaint.

It stated: "Having carefully considered CAMRA's grounds of appeal, the OFT believes it has a firm basis to defend the appeal. However, the OFT is mindful of the substantial resource that both it and CAMRA would need to invest in litigation. The OFT has therefore decided that it would be a more constructive use of resources to allow CAMRA and any other interested persons or groups the opportunity to make representations about the findings it reached in its response to the super-complaint."

The OFT has invited comments on its 22 October response to CAMRA's super-complaint, which it will consider before deciding how to proceed and publishing its final views.

### Comment

When the OFT made its original decision in October 2009, [Simon Williams, Senior Director at the OFT](#), commented: "Any strategy by a pub-owning company which compromises the competitive position of its tied pubs would not be sustainable, as this would result in a loss of sales. Pub-owning companies are not therefore protected from competition by virtue of the supply ties agreed with their lessees".



Please email Toby Tyler at [toby.tyler@morgan-cole.com](mailto:toby.tyler@morgan-cole.com) with your feedback, comments and suggestions on this publication.

By contrast, [Mike Benner](#), CAMRA Chief Executive, said:

"CAMRA has taken the decision to appeal due to the inability of the OFT to deal with the problems affecting the UK pub sector. CAMRA's super-complaint to the OFT was based on securing a fair deal for the pub-goer, and building a sustainable future for Britain's pubs. However, we believe the OFT did not take reasonable steps to understand the pub sector, and more generally why over 50 pubs are closing per week across the UK".

There is a precedent for CAMRA's appeal: in 2005 the Association of Convenience Stores (ACS) launched a similar appeal against a decision of the OFT not to make a market investigation reference in relation to the grocery retailing market. The OFT withdrew that decision and conducted a further investigation. That led ultimately to the OFT referring the UK grocery retail market to the Competition Commission in May 2006, and to the Competition Commission's two-year in-depth investigation which ended in April 2008. CAMRA's appeal looks to have achieved a similar result to ACS's (reconsideration of the issues by the OFT), but without any real litigation occurring: the prospect and cost of it seem to have been sufficient. This might be seen to be a "victory without a shot being fired" for CAMRA, but such conclusion would be premature. The OFT's consultation process gives it the opportunity to reconsider the issues over a longer time period than the 90 days afforded to it when CAMRA lodged its super-complaint. After further and more detailed consideration, and obtaining more evidence, it may yet reach the same conclusion as before.

For now though, the last word goes to [Mike Benner](#):

"We are delighted that the OFT has responded to our appeal by agreeing to conduct an open consultation and I encourage all parties to use this opportunity to submit further evidence of anti-competitive practice. The consultation will lead to a new and final decision from the OFT. We are hopeful that on re-examination of the pubs market the OFT will decide to act against anti-competitive behaviour in order to deliver a fair deal for consumers. CAMRA looks forward to working with the OFT to deliver reform of the beer tie so that the pub market works in the interests of consumers."

## Hold tight! Local bus services are heading for the Competition Commission

**The Competition Commission will investigate local bus services, a sector that since deregulation has seen 'bus wars' and the emergence of a few large national operators.**

### Summary

The OFT has referred local bus services to the Competition Commission (CC), having conducted a market study into this sector that painted a picture of an industry where a small number of large operators provide most local services and largely respect each others' territories, new entrants may be put off by the prospect of 'bus wars', and there are often few bidders for subsidised services.

### Background

The OFT is able, where it has reasonable grounds for suspecting that features of a market are damaging competition, to refer that market to the CC. The CC has wider investigative powers than the OFT, and if it upholds the OFT's concerns it can impose remedies on the industry.

### Facts

The OFT's report outlined a number of features that it suspected were damaging competition. At the time of deregulation of local bus services in 1986, it was hoped that competition within local markets would lead to an improvement in services. However, this was not always the case, with 'bus wars' making headlines (operators deliberately driving others out of the market), and numerous mergers in which smaller operators have been bought up by a few major players. **The result has been that there is often only a single operator for services (whether at the level of individual routes, towns, or regions), and large national operators appear to stay away from other operators' 'territories' rather than attempt to compete in them.** Where only one large regional operator offers services, commercial fares are on average 9% higher than in areas where two or more operate.



Another concern is the practice of ousting competitors by 'overbussing' – crowding out a particular route or putting on busses just ahead of those of a competitor – and by slashing fares or even running free busses. While these might appear beneficial for passengers, these measures would typically be short term until the competitor gave up, at which point the main operator resume 'normal' service free of competition. The OFT noted that passengers will (not unsurprisingly!) get on the first bus that is going where they want, without worrying about which operator is running it, which makes overbussing an effective strategy. A further concern is the apparent reluctance of large operators to participate in multi-ticketing schemes, which makes it difficult for smaller operators to get a foothold in a market.

As well as purely commercial services, the OFT looked at 'Supported Services' – routes that are not viable without subsidy (e.g. some rural routes). These are let by tender by local transport authorities, and in some areas such tenders receive few bids. The OFT is concerned that the system may be open to 'gaming', where an operator withdraws from a commercially viable route, obliging the local authority to subsidise supported services on that route, and then – given lack of local competition – re-enters that route and benefits from additional subsidised revenue. [The OFT has similar concerns that concessionary fare schemes \(e.g. subsidised travel for pensioners\) may encourage operators to raise standard fares, knowing that any loss of fare-paying passengers may be more than offset by the increase in subsidised fares.](#)

The OFT suggests that possible remedies that the CC could impose include:

- making multi-ticketing schemes compulsory
- controls on 'overbussing'
- requirements for certain depots to be shared or sold, to encourage new operators
- encouraging the use of 'Quality Contract Schemes', whereby a local authority sets services standards for an area, and grants an operator the exclusive right to provide those services by tender – in other words, promoting competition [for](#) a market rather than [within](#) a market.

## Comment

In relation to the report, [Heather Clayton, OFT Senior Director](#), commented: "This is certainly not about a return to 'bus wars' or unmanaged 'head to head' competition on every route, but we do think large bus operators should face a healthy level of competitive constraints. Given the size and importance of this industry, with at least £1.2 billion coming from the public purse every year, the OFT believes that it is appropriate for the Competition Commission to investigate how, in its various forms, competition can be harnessed to deliver what passengers want and the best value for money for the tax payer."

The OFT's reference confirms that achieving an effective competitive structure in transport services is difficult. The sector has unique issues, including low demand on some routes which can make sustained competition unviable, and the fact that passenger journeys are inextricably linked to set routes, meaning that passengers cannot readily switch to other nearby operators. The report hints that a return to a more controlled form of competition may be possible – in particular, that granting exclusive rights to run services to specified standards could have benefits. [The report concedes that many operators contest the OFT's conclusions and concerns, and those operators will be eagerly awaiting the outcome of the CC's investigation.](#)

---

This publication is © Morgan Cole and may not be reproduced without our express permission. Recipients may forward this publication and view, print and download the contents for personal use only. The contents must not be used for any commercial purposes and the material in this publication or any part of it is not to be incorporated or distributed in any work or in any publication in any form without the prior written consent of Morgan Cole.

Professional advice should always be sought where you require assistance in specific areas of the law. No responsibility can be accepted for any action based on these articles.