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Finally Over –ECJ Judgment Signals End of the Ice Cream Wars.

Introduction.

On 28th September, the European Court of Justice (ECJ) rejected Unilever's appeal in the long running ice cream freezers saga. The ECJ upheld the decision of the Court of First Instance that the exclusivity arrangements in respect of ice cream freezers supplied to retailers by HB were anti-competitive. The judgment was the final act in a marathon legal battle which lasted more than 15 years.

Background.

Unilever's Irish subsidiary, HB, was engaged in the supply and distribution of ice cream. HB supplied freezer cabinets free of charge to retail outlets but required that only HB's own ice cream products could be stored in such cabinets. In the early 1990s Masterfoods launched a range of ice cream versions of many of its popular confectionary products such as Mars bars and began supplying them to retailers. HB sought an injunction preventing Mars from using its freezer cabinets. Mars counterclaimed that the exclusive arrangements were contrary to Article 81(1) and/or amounted to an abuse of a dominant position by HB.

In 1993 the Irish High Court found in favour of HB. The EU Commission then commenced its own investigation. The Commission initially accepted proposed amendments to the agreements under which HB would offer freezers for sale to retailers after a number of years. It subsequently re-opened its investigation, arguing that the remedies offered had failed to address its concerns. The Commission decided that the exclusive agreements were anti-competitive. HB appealed the Commission decision unsuccessfully to the CFI and subsequently to the Court of Justice.

Economic Analysis.

The general consensus among economists is that vertical restraints, such as those involved in this case, cannot be deemed either pro or anti-competitive *per se.* Whether or not such a restriction will have anti-competitive effects depends on the actual circumstances of each individual case.

In contrast to the practice adopted by Unilever subsidiaries in some other EU Member States, most notably Germany, HB did not employ exclusive purchasing agreements with retailers, i.e. it did not enter into agreements that required retailers to sell only HB ice cream products. It entered into arrangements whereby it provided ice cream freezers free of charge to retailers on condition that those freezers would be used to stock only HB ice cream products. HB charged retailers the same price for its ice cream regardless of whether or not they took a HB fridge.

The Commission argued that many of the retail outlets involved were relatively small and, in practice, would only have room to accommodate one ice cream freezer in their premises. It further argued that even where a retailer had the physical space for a second freezer, installing one by definition meant using space which could be used to stock other products besides ice cream and that such retailers would have little incentive to stock a second freezer cabinet. In effect the Commission found that the freezer exclusivity arrangements were akin to an exclusive dealing requirement. Given HB's large market share, in excess of 75% of the impulse ice cream market, the Commission concluded that the arrangements effectively foreclosed entry to the market.

In economic terms, the argument was that the freezer exclusivity arrangements represented a "raising rivals costs" strategy designed to foreclose the market. Raising rivals' costs strategies have been identified in the economic literature as a mechanism by which dominant firms may seek to exclude rivals. There has been a considerable debate in this literature on the potential for dominant firms to use vertical restraints as a mechanism for raising rivals' costs. For example, exclusive dealing arrangements may block access to the best distributors. Alternatively, because distribution costs are fixed over a large range of output, exclusive arrangements between an incumbent and distributors mean that a new entrant may face higher unit distribution costs.

The free provision of freezers by HB involved an implicit reduction in the price of ice cream since HB charged the same price to retailers regardless of whether they had their own freezer or one supplied by HB. The effect of this was to require a firm wishing to enter the ice cream market to also enter the freezer market and supply freezer services at zero cost.

The benefit to the retailer and consequently the incentive for the retailer to take the HB freezer declined as their sales of ice cream increased. In other words the more ice cream a retailer sold, the lower is the implicit subsidy on the ice cream as a result of not having to pay for the freezer. Logically the outlets with the largest sales are more important to a supplier, yet the extent to which the provision of a free freezer ties outlets to a supplier declines, the larger the outlet's sales of ice cream. This seems inconsistent with the view that the arrangements result in foreclosure.

HB had put forward an alternative legitimate explanation for the arrangements. Traditionally ice cream sales in Ireland were highly seasonal and freezers were provided as a way of encouraging smaller retailers to stock ice cream. The short season and limited sales volumes meant that smaller retailers might not have been prepared to incur the costs of installing freezers themselves. This benign view was supported by evidence that it had been a common practice to provide freezers to retailers even when there were a number of rival ice cream manufacturers. This practice is also common in the US where there are a number of rival companies. On this view, suppliers provide freezers in order to increase sales of their products.

Conclusion.
The ECJ judgment has finally brought this long running saga to an end, 15 years after Mars originally complained to the Commission. The judgment establishes that, where a supplier has significant market power, the provision and maintenance of exclusive freezer cabinets without extra charge infringes Article 82. This judgment may have implications for the provision of equipment to retailers by manufacturers of other consumer goods where the manufacturer/supplier has a dominant market position.

Delayed Indefinitely - Regulatory Reform of the Irish Bus Industry.

Introduction.[1]
For the past 20 years successive transport Ministers have promised to reform the bus transport market in Ireland. Bus passengers are still waiting for such reforms to be delivered. The announcement by the current Minister in the Dail on 28th September, suggests that meaningful reform has been postponed yet again. What the Minister has proposed amounts to an attempt to copper fasten the existing Dublin Bus monopoly, with competitive tendering to be introduced only in respect of "new routes" in Dublin City. The Government appears unwilling to expose Dublin Bus and Bus Eireann to serious competition, despite widespread evidence from many other countries and indeed from within Ireland that competition can provide better quality bus services at a lower cost to the taxpayer.

Bus transport in Ireland is still largely governed by the Road Transport Act, 1932, which prohibits the operation of scheduled road passenger services except under licence. The majority of scheduled bus services in the Dublin City area are operated by Dublin Bus, a wholly owned subsidiary of the State owned CIE. A second CIE subsidiary, Bus Eireann provides bus services throughout the rest of the State. There are believed to be around 125 private bus firms with five or more buses operating scheduled services. Slightly less than half private sector licences are for local services outside of the major cities.

The current regulatory regime gives rise to a number of problems.

1. The monopoly afforded to Dublin Bus and Bus Eireann results in serious inefficiencies.
2. The current system of paying a block subsidy to CIE for operating so called social services distorts competition, results in inefficient cross subsidies and provides poor value for money for taxpayers.

[1] This article is based on a paper by Compecon Director, Patrick Massey, which was presented to the Dublin Economics Workshop Annual Economic Policy Conference in Kenmare on 15th October 2006. Compecon has prepared an economic analysis of the bus sector in support of a complaint lodged with the EU Commission by the Coach Tourism and Transport Council of Ireland.

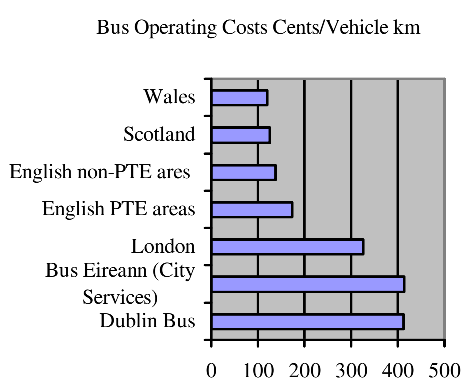
3. Existing licensing arrangements lack transparency and give rise to a clear conflict of interest.
4. Exchequer funding of new buses for Dublin Bus and Bus Eireann further distorts competition and is questionable on wider public policy grounds.

Performance of State Bus Firms

The economic case against monopolies is that they are inefficient, and provide poorer quality services at higher cost.

Dublin Bus' operating deficit has increased from just under €9m in 1998 to almost €63 in 2005. There has been a corresponding increase in Government subsidies from just over €11m in 1998 to €65m in 2005. Bus Eireann's provincial city network operating deficit has increased from €2.9m to €10m over the same period.

The following chart compares bus operating costs of the Irish State bus operators with those of British bus operators.



In Britain bus operating costs are significantly higher in London than elsewhere. Bus operating costs in Britain in 2004 ranged from 120.8c per vehicle kilometre in Wales to 325.6c per vehicle kilometre in London in 2004. The comparable figures for Dublin Bus and Bus Eireann's provincial city services were 411.7c and 413.5c respectively. These figures are higher than those for operators in London and substantially higher than those for other large urban centres in Britain. Operating costs in English Public Transport Executive areas, which are the major urban centres outside London, were only 173.9c per vehicle kilometre.

Subsidy Payments to State Bus Firms.

State subsidies paid to the two State bus companies have increased from €18m in 1998 to €90m in 2005. This figure excludes State payments of over €100m to Bus Eireann in respect of the school transport service. Serious questions need to be asked as to whether tax payers are receiving value for money for such payments.

No attempt is made to identify which services are commercial and which are not. Instead both companies simply receive a block allocation and define all of their services as non-commercial public service obligation (PSO) routes.[2]

EU regulations provide that only services which an undertaking acting in its own commercial interests would not provide or would not provide to the same extent as it does can be classified as PSO services. There is considerable evidence to suggest that many of the existing Dublin Bus and Bus Eireann routes are commercially viable and do not satisfy the definition of PSO. Both companies include routes which compete with services run by private operators as

[2] Dublin Bus define all services except private hire and coach tours as PSO routes in its Annual Reports while Bus Eireann classes all services except *Expressway* and, somewhat bizarrely the school transport service as PSO routes.

PSO routes raising questions about possible distortions of competition.

A further issue arises in the case of the school transport service due to the failure to put the contract for that service out to tender. A judgment by the European Court of Justice is awaited in a similar case regarding the award of contracts for the payment of welfare benefits to An Post without a tender.

The Licensing System.

The existing regime for licensing bus services suffers from a number of serious shortcomings. These include:

- A lack of transparency in the licensing process;
- Lengthy delays;
- No objective mechanism for evaluating the merits of licence applications;
- Where licences are granted, they are frequently subject to restrictions which may impede the development of services; and
- Allegations of favourable treatment toward Dublin Bus and Bus Eireann.

At the very least there is considerable potential for conflicts of interest, given the dual role of the Department of Transport which is the owner of Dublin Bus and Bus Eireann, while simultaneously being responsible for dealing with licence applications by their competitors.

The record shows that private bus operators have persistently been refused licenses to operate on routes serviced by CIE or its various subsidiaries, while licence applications are often subject to lengthy delays. Forfas reported that in some cases it had taken several years before operators received a response to a licence application (successful or otherwise). In January 2004 the then Minister, Seamus Brennan T.D., told the Dail:

> "Let us be clear about delays and giving out licences. The people who are waiting for the licences are almost exclusively, with the odd exception, private operators. *The people we are holding up are the private sector by not giving them the licences they are demanding. There are substantial companies, including international, multi-national and local companies being held up. We are not holding back Bus Eireann, Dublin Bus and others.*"[3] (Emphasis added).

Exchequer Funding of Buses.

Questions also arise as to whether Exchequer funding for the purchase of new buses by both Dublin Bus and Bus Eireann constitutes an illegal State aid. Such a policy provides little incentive for operators to use buses efficiently and effectively to satisfy the needs of passengers. Indeed statements contained in the Annual Reports of Dublin Bus and CIE indicate that these buses are primarily for peak-only operation and increased operating subsidies have been required "to offset the shortfall due to the sub-optimal utilisation of these vehicles."[4]

The obvious question is whether it makes sense for the State to undertake increased capital expenditure to meet peak load demand, when such investment is unprofitable, given that private operators are prepared to undertake such investments. Ironically the Government has exacerbated the peak load problem by abolishing the restrictions on free bus travel for social welfare recipients at peak times.

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[3] Dail Debates

[4] CIE Annual Report 2001.

Competition Postponed Indefinitely.

The Minister's recent proposals for a new regulatory regime for bus transport in Dublin involve the retention of the current Dublin Bus monopoly on all its existing routes. Private operators will exclusively be permitted to tender for new services up to a limit of 100 buses. Any further new services will be subject to open tender. Such proposals protect the existing inefficient Dublin Bus monopoly and clearly give rise to serious competitive distortions as Dublin Bus would have two major advantages in any open tender due to:

1. Exchequer funding of new buses; and
2. The protection of its existing monopoly which would give it considerable scope to cross subsidise new routes and undercut rival bids.

While no formal announcement has been made regarding services outside Dublin, it appears that the Department favours retaining Bus Eireann's monopoly control with private operators being largely confined to acting as sub contractors for the State company.

Conclusions.

International experience clearly demonstrates that state monopoly bus operators are inefficient and provide poor value for money. While there has been much criticism of British experience with deregulation, in terms of operating costs and customer satisfaction, the State companies' performance compares unfavourably with that of British operators. Rather than maintaining the existing State monopolies a more radical approach is required.

- A full audit of all Dublin Bus and Bus Eireann services (excluding coach tour and Expressway to identify which services are commercial and which are genuine PSO routes.
- PSO routes should be put out to competitive tender with such tenders being phased in over a five year period.
- There should be some liberalisation of the licensing regime. This would involve
  - Reversing the burden of proof so that there was a presumption that approval of applications was in the public interest with the onus being on objectors to prove otherwise.
  - Automatic approval of new licence applications on non-PSO routes where entrants commit to offering lower fares and/or higher service frequencies for a minimum period of time.[5]
- The potential for performance based contracts as employed in Norway and New Zealand should be examined.

Speaking in the Dail in respect of the Ryanair bid for Aer Lingus, the Minister for Transport stated:

> "A monopoly is bad for business. It is bad for this country, the customer, the travelling public and tourism interests."

It is somewhat disappointing that he has failed to apply the same logic in the case of bus services.

[5] This requirement would apply for a period of 2-3 years and is designed to prevent predatory price cuts.