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31 May 2007

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**Attention:** Scott Gregson

Your Ref: N92536  
Our Ref: 2550662

Dear Scott

**Bakers Delight Holdings Ltd - Third Line Forcing Notification N92536**

I refer to your letter dated 11 May 2007 in which the Australian Competition and Consumer Commission (**ACCC**) requested further documentation and details in relation to the above notification. Please find below Bakers Delight Holdings Ltd's (**Bakers Delight**) responses.

Bakers Delight requests that the underlined portions of this letter and its annexures remain confidential and do not form part of the public record. Bakers Delight considers the information identified to be of a commercially sensitive nature.

**1. Supply arrangements**

- 1.1 The ACCC has sought clarification as to the difference between "approved suppliers", "nominated suppliers", and "sub-suppliers" as referred to in the Notification and our previous correspondence.
- 1.2 We have outlined these terms in the context of Bakers Delight's current and proposed supply arrangements, referring to the Annexure A (list of current Approved Suppliers) and Annexure B (diagram of Bakers Delight's Supply Chain) as appropriate.

1.3 **Current supply arrangements**

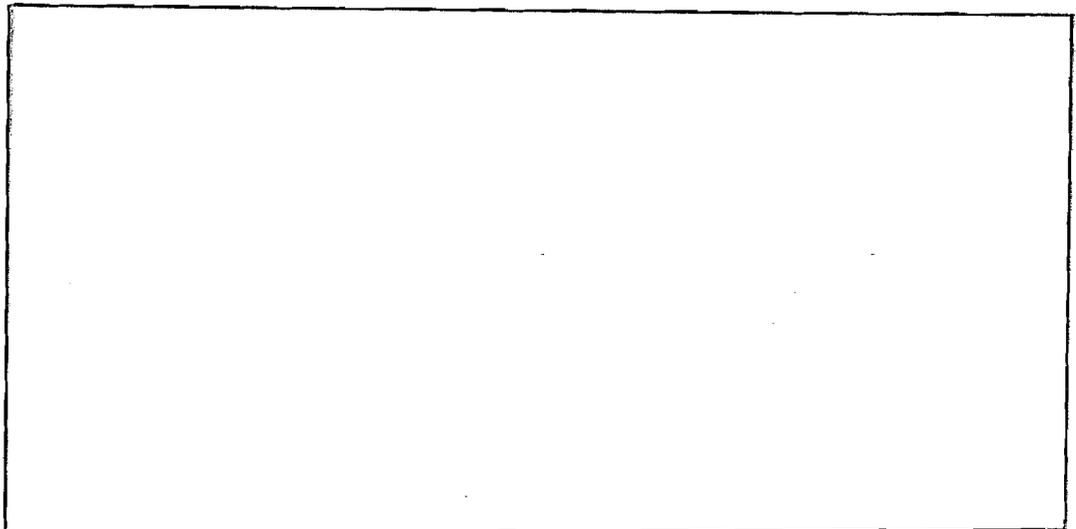
1.4 Under the current Bakers Delight franchise agreement franchisees are obliged to comply with the "Bakers Delight System", which includes the use of:

*...raw materials, ingredients, packaging and uniforms that meet the Franchisor's stringent quality and reliability requirements, sourced from suppliers who meet the Franchisor's stringent supply and service requirements (clause 37(i) of the Franchise Agreement).*

1.5 This clause essentially creates an **Approved Product / Approved Supplier** regime whereby franchisees are not compelled to purchase specific products from specific suppliers, but are prohibited from selling non-approved products (which includes products made from ingredients purchased from non-approved suppliers).

1.6 We have referred to those suppliers assessed by Bakers Delight to comply with its "supply and service requirements" (the mechanics of which is explained in paragraph 2 below), as Approved Suppliers. The incumbent Approved Suppliers are listed in Annexure B, and have been cross referenced with the relevant products that they supply in Annexure A.

1.7 Manildra, which manufactures flour based Approved Products has its own distribution arm. To facilitate the delivery of non flour based Approved (food) Products (**Non Flour Approved Products**) to franchisees, Bakers Delight has:



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(3) investigated and monitored PFD Foodservices' adherence to [redacted] (as previously defined), compliance with regulatory regimes and observance of other standards identified in our letter to the ACCC dated 23 March 2007.

These steps ensure that the cost effectiveness of, and the integrity of Non Flour Approved Products during the delivery process is maintained.

1.8 Under Bakers Delight's current supply process:

- (1) franchisees have the option of ordering their full requirement of Non Flour Approved Products from a single distributor.

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- (2) the identity of Approved Suppliers from whom Approved Products are sourced is transparent to franchisees;
- (3) franchisees are not expressly prevented by the Franchise Agreement from:
- (a) sourcing their supply of Approved Products from a "non-approved supplier"; and or
- (b) using a "non approved" product;

provided that the franchisee can establish to Bakers Delight that the relevant manufacturer, supplier and or product meets with Bakers Delight's "supply and service" requirements (as outlined at paragraph 9.2 of our letter to the ACCC dated 23 March 2007) (as depicted in Annexure B). The majority of franchisees choose not move outside the endorsed structure due to the additional burden and cost that this entails (as explained in paragraph 9 of our letter to the ACCC dated 23 March 2007); and

- (4) after lodgement of the Notification Bakers Delight amended its Operations Manual to require franchisees to purchase their requirement of Approved Products from "Bakers Delight Distributors", being PFD Foodservices and Manildra.

1.9 As discussed at paragraphs 9.7 and 9.8 of our letter to the ACCC dated 23 March 2007, Bakers Delight permits franchisees to engage a party other than PFD Foodservices to supply Non Flour Approved Products to them. Bakers Delight has communicated to franchisees that Bakers Delight will not regard franchisees as being in breach of their Franchise Agreement if they do so. However as discussed in the letter of 23 March 2007, franchisees that do so will incur a proportionate reduction of their subsidy to attend the Bakers Delight national conference from the Conference and Development Fund (**C&DF**).

#### 1.10 Proposed supply arrangements

1.11 Bakers Delight proposes to condense the current two tiered supply arrangement into a one tier supply whereby:

- (1) Franchisees will be compelled by the Franchise Agreement to purchase specific Approved Products (referred to as **Core Products**) from **Nominated Suppliers**.
- (2) The Nominated Suppliers will be:

- (a) PFD Foodservices in relation to non flour based Core (food) Products; and
- (b) Manildra in relation to flour based Core Products.

(Please note that PFD Foodservices and Manildra will also in theory be "sub suppliers"/Approved Suppliers under the proposed supply arrangements, as explained in paragraphs 1.11(3)(a) and 1.13 below).

- (3) PFD Foodservices will be appointed as a Nominated Supplier on the condition that it fulfils franchisee orders for non flour based Core (food) Products:
    - (a) from "sub suppliers" nominated by Bakers Delight (i.e. the Approved Suppliers as described above under the current regime); and
    - (b) on terms negotiated by Bakers Delight with the relevant sub suppliers.
- 1.12 Under this single tiered supply arrangement "Approved Suppliers" will be relegated to the status of sub suppliers in regard to the supply of Core Products, as evident in Annexure B. However, the identity of the sub suppliers will be transparent to the franchisees.
- 1.13 In regard to franchisees' purchase of Approved Products other than Core Products (i.e. non food), the existing two tiered supply system will remain, and they may do so from any Approved Supplier.

## **2. Identification of suppliers**

- 2.1 You have requested clarification of the process by which potential suppliers are and will be identified by Bakers Delight. We advise that potential suppliers are identified through numerous channels, including:
- (1) recommendations from the franchise group;
  - (2) trade references;
  - (3) Bakers Delight's own inquires;
  - (4) approaches by new manufacturers directly to Bakers Delight; and
  - (5) the expansion of products manufactured by Approved Suppliers.
- 2.2 In terms of how Bakers Delight shortlists and decides between potential suppliers, we refer to the selection criteria outlined at paragraph 5.4 of our letter to the ACCC dated 23 March 2007. Where multiple suppliers can offer the supply of the same product, Bakers Delight weighs price considerations against:

- (1) surety of supply, as it is imperative that suppliers experience minimal disruptions to supply;
- (2) costing transparency, as an understanding of costing elements enables Bakers Delight to efficiently negotiate prices in the future (see paragraph 3 below); and
- (3) suppliers' manufacturing and stock management accreditations.

### 3. Documentation relating to the approval and selection process

3.1 The ACCC has requested copies of all documentation relating to the selection of suppliers, including tender and proposal documentation.

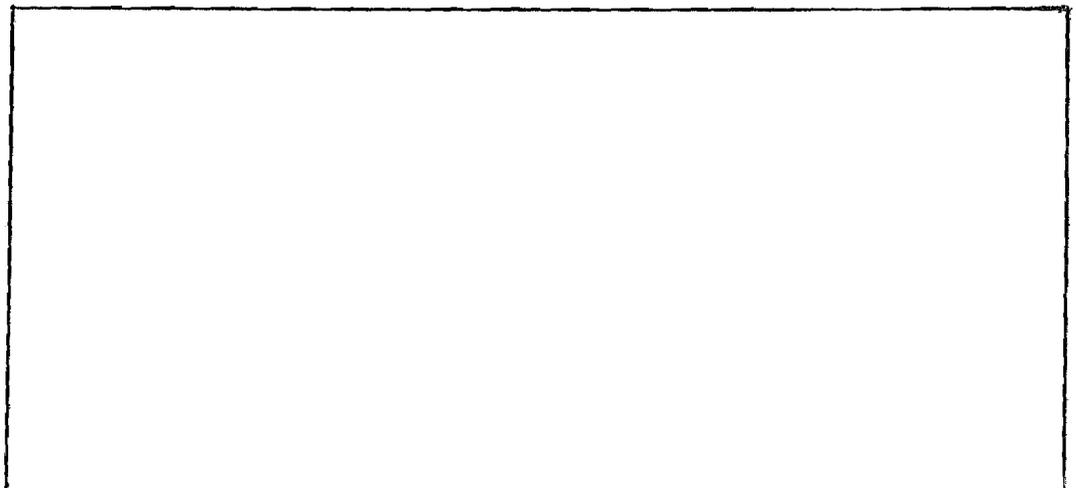
3.2 We advise that Bakers Delight does not conduct tenders as such, but rather conducts pricing reviews with incumbent suppliers as part of its ongoing supplier management process.

3.3 Where a cost change is sought by a supplier, it is reviewed by Bakers Delight against industry information obtained from:

- (1) other supply partners (for example, PFD Foodservices might distribute a similar but competing product through their system which can be used by as a benchmark);
- (2) international and local market reports; and
- (3) trade magazines and bulletins.

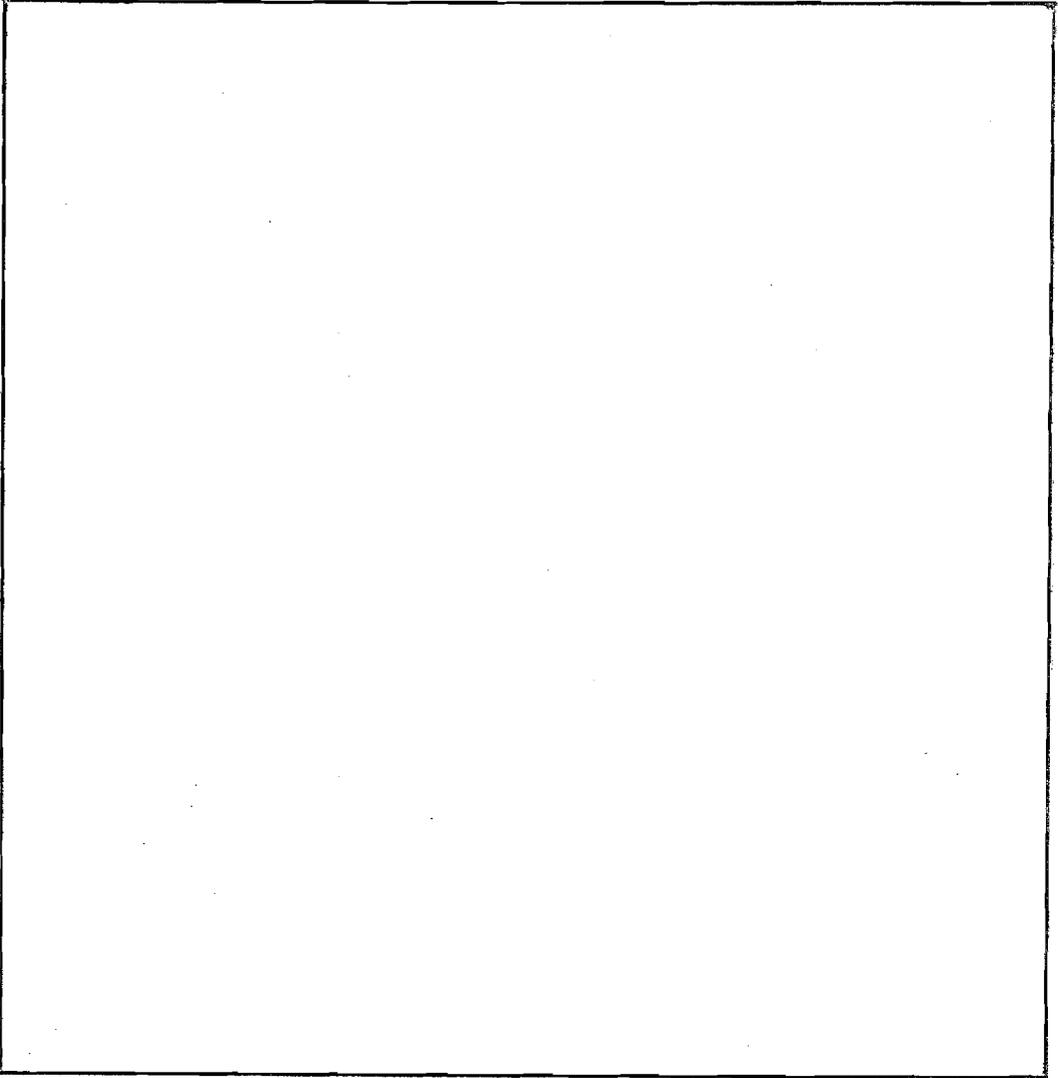
The price review process also occurs on the expiry of Bakers Delights' supply arrangements, and is discussed in detail at paragraph 6 of our letter to the ACCC dated 23 March 2007.

3.4 Where Bakers Delight considers that a price change is not justified, it will investigate alternative supply arrangements, as illustrated by the below examples.



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- 3.5 Whilst the above examples illustrate recent cost reductions, there are occasions when the cost of ingredients will unavoidably increase. In such instances that same interrogation and auditing of submitted costs is conducted by Bakers Delight in order to ensure that increases are both justified and minimised.
- 3.6 In regard to Bakers Delight's documentation of the price review process, we are informed that it consists of a series of individual emails, letters, reports, research and alike, which are both cumbersome (consisting of physical files) and difficult to make sense of without explanation. Bakers Delight suggests that the most efficient and informative way to convey the relevant information would be during a face to face meeting, where the responsible Bakers Delight executive could:
- (1) provide context to the documentation;
  - (2) impart his "know how" regarding the process;
  - (3) answer any questions of the ACCC; and
  - (4) work through "live examples".

If this approach is not acceptable to the ACCC, please let us know and we can arrange for copies of examples of the relevant files to be posted to you.

**4. Complaints**

- 4.1 Please find attached as Annexure C, a list of all complaints received by Bakers Delight in relation to Approved Suppliers since 23 June 2006. If the ACCC would like any further information in relation to this list, please let us know.

**5. Costs**

- 5.1 The ACCC has requested an approximation of the proportion of a franchisee's overall costs constituted by the purchase of products from Approved Suppliers. Bakers Delight considers the relevant proportions to be:

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**6. Purchase of non-food products**

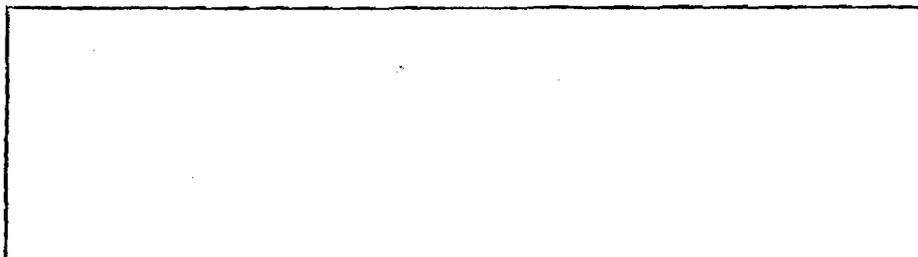
- 6.1 Bakers Delight does not require its franchisees to purchase non food products from specific third party suppliers, but does require that franchisees:

- (1) keep Bakery Premises equipped in accordance the Bakers Delight System;
- (2) use raw materials, ingredients, packaging and uniforms that meet Bakers Delight's standards; and
- (3) install and use at the bakery point of sale equipment that meets Bakers Delight's requirements, from suppliers that meet Bakers Delight's requirements;

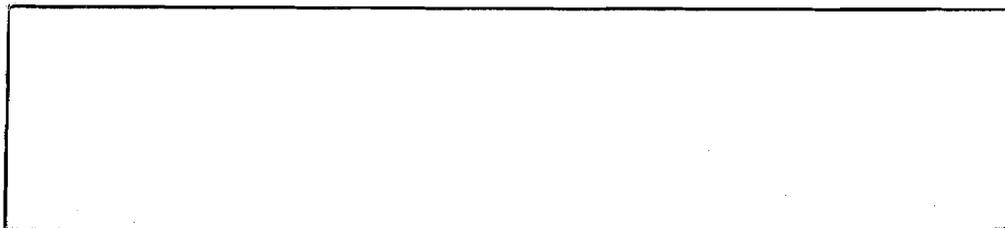
(refer to clauses 3 and 37 of the current Franchise Agreement).

- 6.2 Bakers Delight has established supply arrangements with:

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## 7. **Meaning of "System Suppliers"**

- 7.1 In our letter of 23 March 2007, "system suppliers" was used to refer to all suppliers that contributed to Bakers Delight's C&DF. "System suppliers" can more accurately be defined as Approved Suppliers (or "sub suppliers" under the proposed arrangement) including the suppliers of non food products referred to in paragraph 6.1 above (i.e. bakery equipment, packaging etc. but excluding the point of sale system).
- 7.2 All contributions and rebates received from these suppliers form part of the C&DF, which is returned by Bakers Delight to bakeries (including company owned bakeries) via various initiatives including the funding of the Bakers Delight national conference, which is generally held every second year. Bakers Delight is happy to provide the C&DF's audited financial statements, as well as guidelines for the distribution of the C&DF on request.
- 7.3 **Other benefits received from suppliers**
- 7.4 Other than the benefit received by company owned bakeries (in proportion to the benefit received by independent franchises) via the distribution of the C&DF, Bakers Delight does not receive any financial benefit from suppliers.
- 7.5 Suppliers of yeast products however do contribute to an "Ullage Account" for the benefit of the network. A description of the Ullage Account and guidelines for its use are attached as Annexure D. The funds comprising the Ullage Account flow from a small margin built into the supply and distribution costs of yeast to the network.
- 7.6 Often Bakers Delight will need to guarantee supply of a certain volume of "one-off" perishables or seasonal products to the network (e.g. the ingredients for new product initiatives). To secure supply volumes with the relevant suppliers, the suppliers may apply to Bakers Delight to be reimbursed for their costs of disposing of, storing and/or selling outside the network all unused goods. The Ullage Account is a system management tool that ensures the efficient and constant supply of "irregular" products to the network.

## 8. **Funding of the C&DF**

- 8.1 The ACCC has queried why Bakers Delight has chosen to fund the C&DF via contributions from suppliers rather than franchisees.

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- 8.2 We advise that the funding arrangement of the C&DF was implemented in 2003 following a major restructure of Baker's Delight's supply chain (Weston Milling was replaced with a "two-stop" flour and food product supply arrangement between Manildra and PFD Foodservices). Bakers Delight took the opportunity upon the change of suppliers to supplant the ad-hoc contributions with a formal protocol, being the current 2% contribution scheme. Prior to this time Bakers Delight's national conference (being the primary expenditure and purpose of the C&DF) was funded to a large extent by ad-hoc contributions by ingredient, packaging and equipment suppliers. The implementation of the 2% contribution scheme provided Bakers Delight, franchisees and suppliers with more certainty as to the funding of the conference, as well as equity between suppliers' contributions. The timing of the protocol's implementation minimised any risk that suppliers' prices would be increased to accommodate the contribution.
- 8.3 As you are aware, franchisees are already required to contribute 2.2% of their Gross Sales to the Marketing Fund pursuant to clause 31(d) of the Franchise Agreement. Bakers Delight considered that any requirement for franchisees to contribute to the C&DF in addition would be a duplication.

We look forward to meeting with the ACCC in the near future. If we can be of any further assistance in the meantime, please don't hesitate to contact us.

Yours faithfully



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Enclosures: Annexure A: Current list of Approved Suppliers (food products)  
Annexure B: Diagram of Bakers Delight Supply Chain  
Annexure C: List of complaints  
Annexure D: Ullage Guidelines

**ATTACHED ANNEXURES A - D**  
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