

***Case No IV/M.400 -
ALLIED LYONS /
HWE-PEDRO
DOMECQ***

Only the English text is available and authentic.

**REGULATION (EEC) No 4064/89
MERGER PROCEDURE**

Article 6(1)(b) NON-OPPOSITION
Date: 28.04.1994

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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 28.04.1994

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sirs,

Subject : Case No IV/M.400 - ALLIED LYONS/HWE-PEDRO DOMEQC
Notification of 24.03.1994 pursuant to Article 4 of Council Regulation No 4064/89

- 1 The above mentioned notification concerns the proposed acquisition by Allied Lyons plc of sole control of the Hiram Walker Europa/Pedro Domecq group, currently jointly controlled by Allied Lyons plc and a Dutch holding company G. Carrizuelo Investment BV, which is in turn controlled by Mr. Mora Figueroa.
- 2 After examination of the notification, the Commission has concluded that the notified operation falls within the scope of the application of Council Regulation n° 4064/89 and does not raise serious doubts as to its compatibility with the common market.

I THE PARTIES

Allied Lyons PLC (Allied)

- 3 Allied Lyons plc is a group of companies based in the UK with interests in North America and in the whole of Europe. The principal activities of the group are food manufacturing (tea, coffee, bakery), brewing, wines and spirits and in retailing in the UK (pubs, franchises, off-licences). As far as wines and spirits are concerned, Allied owns a wide range of products, principally whisky, gin, liqueurs, cognac and fortified wines and holds a portfolio of famous brands. This spirits and wines business is managed by its subsidiary, Hiram Walker Group limited.

Hiram Walker Europa (HWE)

- 4 HWE was formed in 1968 by Hiram Walker Gooderham & Worts Limited and the Mora Figueroa family. In 1986, Allied Lyons acquired joint control of this group together with Mr Mora-Figueroa. HWE is currently jointly controlled by Allied and Grupo Carrizuelo Investment BV (Carrizuelo), which is owned by [...] ⁽¹⁾. HWE owns and distils the whisky brand Doble V and is the importer of some Allied brands into Spain.

Pedro Domecq

- 5 Controlled by HWE, Pedro Domecq is a producer and distributor of spirits and wines, and more specifically brandies, anise, sherry, whisky and light wines. As a producer, Pedro Domecq, through Destilerías y Crianza del Whisky SA, has de facto control of the DYC brand of whisky. As a distributor, Pedro Domecq distributes in Spain HWE's whisky, imports in Spain other Allied's brands and exports large volumes to Mexico. In Spain, Pedro Domecq's products are distributed by two subsidiaries : Commercial Domecq and Terry Distribuidora SA (Tedisa), previously owned by Allied and transferred to Pedro Domecq in 1992.

Mr Mora-Figueroa

- 6 As a partner of Allied in HWE, Mr Mora-Figueroa is the chairman of HWE and the managing director of Pedro Domecq. He has no other interests in the spirits and wines business except through the HWE/Pedro Domecq group.

II THE OPERATION

- 7 Under the proposed operation, Allied Lyons will obtain control of a newly formed holding company, Spain Alecq BV which will bring together the Hiram Walker Europa/Pedro Domecq group of companies. Carrizuelo, and indirectly Mr Mora-Figueroa, will retain a 27 % interest in Spain Alecq. Carrizuelo will have therefore certain minority protection rights but will not keep joint control. As a result of these transactions, Allied will obtain sole control of HWE and the Pedro Domecq group through Spain Alecq NV. Moreover, Carrizuelo will have the option to sell its retained 27 % interest in Spain Alecq to Allied for a six year period. Lastly, Allied will seek to purchase the remaining shareholdings held by minorities in the HWE/Pedro Domecq group.

(1) Deleted as a business secret

III CONCENTRATION

- 8 The notified operation constitutes a concentration within the meaning of Article 3 of Regulation n° 4064/89. The move from joint control to sole control is a concentration because it will bring about a lasting change in the nature of control held by Allied. After completion of the proposed operation, Allied will acquire sole control of the HWE/Pedro Domecq group, currently jointly controlled by Allied and Mr Mora-Figueroa.

IV COMMUNITY DIMENSION

- 9 The aggregate worldwide turnover of the parties exceeds 5,000 million ECU. The aggregate Community wide turnover of each party exceeds 250 million ECU. They do not achieve more than two-thirds of their turnover in one and the same Member State. The operation has therefore a Community dimension.

V COMPATIBILITY WITH THE COMMON MARKET

A MARKET DEFINITION

a) RELEVANT PRODUCT MARKETS

- 10 Although Allied Lyons has a wider portfolio of spirits and wines (including gin, rum, port and table wine), the only product categories where both Allied Lyons and HWE/Pedro Domecq are present in the European Community are the following : whisky, sherry and brandy. With respect to brandy, the overlapping activities of the parties are marginal. The Commission will therefore focus on the effects of the transaction on the whisky and sherry sectors.

Whisky

- 11 Whisky is usually distilled from maize, barley or rye. The most important types of whisky (Scotch, Irish, Bourbon and Canadian) vary in certain respects but have in common a cereal as primary product and the very typical flavour, irrespective of all differences arising from the type, specialities of the brands and the age of the whisky⁽¹⁾. As a result, consumers usually regard whisky as distinct from other spirits.
- 12 Although a further segmentation within the whisky market can also be made mainly on the basis of origin (Scotch, Irish, Bourbon and Canadian), a certain degree of substitutability can be found to exist between these types. In any event, a more precise definition of the market is not required in this case as most of the whisky traded in the geographic area affected by this operation is Scotch or Scotch-based.

⁽²⁾ See Commission decision of 13.12.1985 on the case IV/30.570 - sole distribution agreements for whisky and gin.

Sherry

- 13 Sherry is a special type of fortified wine which is strictly defined by the area in which it is produced, namely the Jerez region of Spain. There are, however, wines of a style similar to sherry which are considered as sherry-style wines and which are produced in other countries (UK, Cyprus, Australia and South Africa), usually known as British sherry, Cyprus sherry, etc... and elsewhere in Spain (such as "montilla", produced in Montilla, near Córdoba).
- 14 Numerous factors enable to distinguish Jerez sherry from sherry-style wines. First of all, "sherry", which is the English name for Jerez, refers to a fortified wine produced in the Jerez region of Spain. Similar wines from Spain outside the Jerez region are prevented by the Spanish authorities from making any reference to sherry. With respect to other sherry-style wines, produced outside Spain, the term sherry cannot be used in the EC without the designation British or Cyprus. Nonetheless, the issue of the use of the word sherry will be reviewed in 1996, at which time it is possible that the terms British sherry and Cyprus sherry will be prohibited in the EC. The origin is therefore an important factor of distinction between the different products.
- 15 Secondly, there is a considerable price gap between the Jerez sherry and sherry-style wines. Prices vary according to quality and reputation. Premium brands, namely the Jerez brands, are much more expensive than the British sherry brands. In particular, in the two countries that will be subject to examination, the UK and Ireland, prices range from £ 5 for a bottle of Jerez to £ 3 for British sherry, and from IR£ 6.5 to IR£ 3.5 respectively.
- 16 Thirdly, consumers habits confirm the distinction between the Jerez sherry and sherry-style wines. In the UK and the Republic of Ireland, which will be defined below as the geographic affected markets, expensive sherries, namely Jerez, are often used for special occasions (mainly Christmas) while cheap sherries, namely British, are bought for everyday use. Moreover, over the last ten years the sales of sherry in the UK and in Ireland have been decreasing regularly whereas the sales of British sherry have remained relatively steady. The parties state that this shows that British sherry has been gaining in market share at the expense of Jerez sherry. This could be true if all sherries were substitutable. However, this could also mean that these two products are subject to different consumer demand trends. In this respect, the Jerez sherry has suffered from having a less fashionable image and from failing to attract young drinkers although it has kept a loyal customer base who would not easily switch to British sherry.
- 17 Origin, prices, demand trends, consumer habits in the UK and in Ireland are several factors which seem to distinguish Jerez sherry from sherry-style wines. Nonetheless, the question whether they constitute two distinct product markets can be left open because the operation does not lead to the creation or the strengthening of a dominant position, even in the narrowest market of Jerez sherry.

b) GEOGRAPHIC REFERENCE MARKETS

Whisky

- 18 Allied Lyons produces Scotch whisky under its own brands in Scotland and sells it worldwide. HWE/Pedro Domecq distils grain spirit in Spain and blends it with Scottish malt whisky bought in bulk from Allied's plants in Scotland.

Although markets for spirits are undergoing a process of internationalisation, they have traditionally been and in some cases remain mainly national, in particular because of the different consumer preferences and distribution networks. This seems to be particularly true in Spain, where traditionally legal requirements and import restrictions operated as a strong barrier and resulted in imported whisky being sold at a price that was usually double the price of Spanish products.

- 19 The situation seems to have changed significantly in recent years. Legal restrictions to imports have disappeared and excise duties and VAT rates have been reduced and, although demand for whisky in Spain has increased as a whole, sales of Spanish whisky have doubled since 1983 but total sales of Scotch have multiplied by four. However, the fact that consumer preferences in Spain are different from those observed in other countries together with the fact that the two Spanish brands of whisky (Doble V from HWE and DYC from Pedro Domecq) are still very successful in Spain lead to the conclusion that for the purposes of this transaction it is the Spanish market for whisky that should be analysed. Nevertheless, the question whether Spain constitutes a distinct geographic market can be left open since the operation does not lead, in any event, to the creation or strengthening of a dominant position in this market.

Sherry

- 20 Sherry from Jerez is only produced in Spain and then exported worldwide. However, different factors tend to show that very often sherry markets remain mainly national. In particular, the fact that sherry producers appoint one distributor per country on the basis of exclusive distribution arrangements and that consumer preferences vary from country to country. In addition, trade for sherry seems to be only one-way (from the source to the final destination) since inter-state trade of sherry does not seem to be very frequent.
- 21 As a result of the above, the effects of the present transaction in the sherry market will be analysed at national level mainly in the UK and in the Republic of Ireland. However, the question whether they constitute two distinct geographic markets can be left open since the operation does not lead to the creation or strengthening of a dominant position in any of them.

B ASSESSMENT OF DOMINANCE

a) INTEGRATION OF ALLIED LYONS/HWE/PEDRO DOMECCQ GROUP

- 22 Before the completion of the proposed concentration, the parties are to a considerable extent vertically integrated

- 23 On the one hand, Allied Lyons uses HWE/Pedro Domecq as its distributor in the countries where Pedro Domecq is active as a distributor, namely Spain and Mexico, where Allied Lyons has no activity as a spirits and wines distributor. Long John, Allied Lyons' less important whisky brand in terms of market share (0.6 % of the Spanish market) is currently distributed in Spain by Larios. [...] ⁽¹⁾.
On the other hand, HWE/Pedro Domecq's brands are distributed by Allied Lyons through its own vertically-integrated distribution structure in certain countries where Pedro Domecq does not have its own distribution network. This is the case in Italy, the UK, the Netherlands, Argentina, Portugal, Denmark and Brazil.
- 24 As far as sherry is concerned, Allied Lyons distributes Pedro Domecq's brands in the UK. In the Republic of Ireland, Pedro Domecq's sherry brands are distributed by a third party, Fitzgerald, owned by Pernod-Ricard.
- 25 As a result of the above, despite marginal exceptions (Long John or sherry in Eire), most of Allied Lyons' brands are distributed by Pedro Domecq and vice versa. After the operation, there will not be any substantial change in this vertical integration.
- 26 Besides, HWE and DYC already rely on Allied Lyons for the production of their brands Doble V and DYC. As a matter of fact, these two "Spanish whiskies" are produced from a blend of bulk Scotch whisky source from Allied Lyons and a locally distilled grain spirit.

b) DOMINANCE

- 27 Taking into account the market definitions given above, the only markets where the combination of the activities of the parties will lead to a significant increase of their market presence after completion of the operation are as follows :

Affected Country + Product	Allied Lyons (92)		HWE/Pedro Domecq (92)		Total	
	Vol.	Val.	Vol.	Val.	Vol.	Val.
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Spain (whisky)	16%	[..] ⁽¹⁾	30.8%	[..] ⁽¹⁾	46.8%	[..] ⁽¹⁾
UK (Jerez sherry)	26.9%	[..] ⁽¹⁾	2.2%	[..] ⁽¹⁾	29.1%	[..] ⁽¹⁾
Ireland (Jerez sherry)	47.3%	[..] ⁽¹⁾	10.8%	[..] ⁽¹⁾	58.1%	[..] ⁽¹⁾

(NB: Market shares are of retail sales. Consequently, they should be regarded as estimates of "intermediate" sales.)

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⁽⁴⁾ Between 15% and 20%.

⁽⁵⁾ Between 20% and 25%.

⁽⁶⁾ Between 35% and 40%.

⁽⁷⁾ Between 25% and 30%.

⁽⁸⁾ Less than 5%.

⁽⁹⁾ Between 30% and 35%.

⁽¹⁰⁾ Between 50% and 55%.

⁽¹¹⁾ Between 5% and 10%.

⁽¹²⁾ Between 60% and 65%.

All figures have been deleted for business secret reasons and replaced by ranges.

The market shares in those markets characterised by the existence of heterogeneous products due to brand image, etc, are better represented by value data, and not volume. This is particularly true for whisky in Spain.

- 28 Furthermore, these market shares are to be considered with respect to the total volume and/or value of each affected market.

Affected market		Year 1992	
Country	Product	Volume (1)	Value (2)
Spain	Whisky	9312	[...] ⁽¹⁾
UK	Sherry	2880	[...]
Ireland	Sherry	74	[...]

(1) Thousands of 9 litre cases

(2) Million ECU

(sources : International Wine and Spirit Record for volumes; Allied estimates for values)

- 29 These figures show the small value of the Jerez sherry market in Ireland in volume or value terms, whereas the sherry market in the UK and the whisky market in Spain are of greater significance. As a matter of fact, within the EU, Spain holds, in terms of volumes, the second rank for sales of whisky, just behind the UK.
- 30 The market trends for these two products should also be taken into account. Whisky consumption in Spain has increased more than three-fold over a 10-year period. The dynamic growth of whisky in Spain is expected to continue although at a lower rate (3 to 5 % per annum). On the contrary, sherry consumption has declined by 30 % in the UK and Ireland over the last 10 years.
- 31 Despite strong positions in the affected markets, the parties will not hold a dominant position in these markets because of the absence of high barriers to entry and the presence of strong competitors and powerful purchasers.

Low barriers to entry

- 32 Concerning whisky, any supplier can source bulk whisky (malt or blended) directly from one of the many blenders in Scotland, Ireland or even America. Furthermore, stocks of mature whisky are currently available on the market.
- Concerning sherry, the product is to be produced and delivered from the Jerez region in Spain. This does not constitute a barrier to access to supplies because there are many producers of sherry in this area from whom a wholesaler/retailer can purchase sherry. Besides, excess stocks of sherry are currently available on the market.

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The access to the products is therefore possible for any wholesaler/retailer who would like to enter the market or to increase his sales in Spain or in the UK and Ireland.

- 33 Material aspects such as Member States' requirements for labelling, for using national language or bottling (bottle sizes for spirits are harmonised throughout the EC) do not constitute significant barriers to entry.

- 34 With respect to transport costs, their significance varies, as to the product and the area where it is shipped.

Transport costs from Scotland to Spain for Scotch whisky are not significant. The total cost of transport from a bonded warehouse located in Scotland of one case of 12 x 70 cl bottles of whisky represents some 3 % of the price to retailers in Spain. Because of the relatively high level of prices of whisky, transport costs do not constitute a barrier to entry.

On the contrary, transport costs for Jerez sherry shipped from the Jerez region of Spain to the UK and Ireland are more significant. From Spain to the UK, the transport costs of one case of 12 x 75 cl bottles of sherry represents on average 8% of the price to retailers. From Spain to Ireland, it reaches on average 12%. Nonetheless, it has to be taken into account that the most important share of this transport cost is generated not from the shipping from Spain to Ireland but from the delivery from the distributor to the wholesaler/retailer.

The breakdown of the transport costs is on average as follows :

	From Spain to distributor	From distributor to wholesaler/retailer
To the UK	4,2 % *	4,0 % **
To Ireland	5,3 % *	7,5 % **

* of the price to distributors

** of the price to wholesalers/retailers

Taking into account this breakdown, the level of transport costs from Spain, the only area where Jerez sherry is available, to the UK or Ireland is not a real barrier to entry. On the contrary, the level of transport costs in Ireland for the delivery of products from the distributor to the wholesaler/retailer is relatively high. The relevant level of trade to enter this market is however the first one, namely, from Spain to Ireland. In this respect, the fact that Jerez sherry is only produced in Spain implies that all producers selling in Ireland will have to bear the same costs. Consequently, as far as producers are concerned, transport costs do not constitute a barrier to entry.

- 35 The parties are producers and distributors to wholesalers and retailers. At this level of trade, duties and VAT do not constitute a barrier to entry because they are paid only when the goods are released for consumption in a domestic market. The EC system of registered "bonded" warehouses enables producers to supply spirits and wines free of tax from their own bonded warehouse to others. At the same time, wholesalers and large retailers may decide to purchase abroad when the national distributor's prices are higher. In particular, some Spanish suppliers

have acquired whisky from a distributor in The Netherlands. [...] ⁽¹⁾. The tax is payable by the retailer where the goods leave the bonded warehouse for the supermarket/shop shelves. At this level of trade, duties and taxes do not therefore constitute a barrier to entry.

- 36 Although most of the commercial relationships between distributors and producers are based on exclusive distribution arrangements on a national basis covered under the EC Commission Regulation for exclusive distribution n° 1983/83, distributors are free to sell goods elsewhere on request. Any wholesaler/retailer who would intend to enter the market or increase his sales would not be therefore prevented to do so by these agreements. As it was stated above, retailers do source outside their own country from foreign distributors. From a demand point of view, exclusive distribution arrangements between producers and distributors do not therefore constitute significant barriers to entry.

With respect to new producers, exclusive distribution arrangements do not constitute a high barrier to entry because a lot of independent distribution companies are available both in Spain in the UK and Ireland.

- 37 In such markets where brands play a major role, the impact of advertising on the market is proportionally greater. With respect to the effects of advertising expenditure on sales, the following facts are to be taken into account.

As far as sherry in the UK and Ireland is concerned, the decline in sherry drinking is partly due to a low level of marketing investment which has probably contributed to maintain the less fashionable image of sherry. This shows that an appropriate advertising campaign by a competitor would enable it to revive the image of sherry and to gain market share, in particular amongst young consumers.

In Spain, a significant correlation has been found between the advertising expenditure and sales each year for three standard trade marks of Scotch whisky (Ballantine's, J&B and Johnnie Walker Red Label), which would tend to show that, at least in this expansion period, any brand could be introduced in the Spanish market, provided that an adequate advertising campaign is carried out. Within these three brands, the Johnnie Walker Red Label evolution is the most interesting. In a period of five years, the owner of the brand, thanks to a significant advertising expenditure, was able to stop the decline of sales and to regain market shares.

Through the correlation found, it can be calculated that in order to achieve [...] ⁽¹⁾ cases of 9 litres of yearly sales (more than any of the existing brands), it would be necessary to spend [...] ⁽⁷⁾ in advertising. Some of the main competitors of the parties have sufficient resources to enable them to spend these amounts, and they would then be able to sell into the Spanish market if prices rose. Advertising cannot therefore be considered as a possible barrier to trade even in a special market as Spain.

Presence of competitors on the market

- 38 From a demand point of view i.e. wholesaler/retailer trade level, there are many alternatives in

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the market were Allied Lyons would try to use its new position after the operation to increase prices or reduce discounts.

As a matter of fact, several producers with famous brands, wide portfolios and a similar distribution organisation are active in the affected markets :

In Spain, the future Allied Lyons/HWE-Pedro Domecq group will face competition from strong international producers such as IDV, United Distillers or Seagram which have respectively a market share by volume for whisky of around 24 %, 10 % and 7 %. Moreover, these competitors own famous brands such as J & B, Johnnie Walker or Chivas.

In the UK, the main competitors in the sherry market are IDV (19 %) and González Byass (11%).

In Ireland, the main competitors for sherry are Williams and Humbert (15 %), González Byass (8 %), Seagram (8 %) and IDV (5 %).

Strength of purchasers

- 39 The main purchasers of both whisky and sherry are powerful wholesalers or retailers such as Continente or Pryca in Spain; Sainsbury or Tesco in the UK and Quinnsworth or Dunnes Stores in the Republic of Ireland. These purchasers have considerable bargaining power especially with respect to prices and discounts, given their possibilities to obtain supplies from alternative sources (see point 38 above).

Conclusion

- 40 Having regard to the degree of integration attained by the parties prior to the concentration, the combined effect of low barriers to entry and the existing activity of strong competitors and powerful purchasers in the affected markets leads to the conclusion that the proposed operation will not lead to a situation of dominance.

VI ANCILLARY RESTRAINTS

- 41 The deed of warranty, undertaking and covenant signed by the parties provides that, during a period of three years after the completion of the operation and a period of three years after completion of the sale - if applicable - by Carrizuelo of shares in Spain Alecq BV :
1. the seller will not directly or indirectly carry on any business in the same sector as Spain Alecq BV
 2. the seller will not canvass the custom of any person, firm or company who has within one year prior to completion been a frequent customer of any member of the HWE/Pedro Domecq Group.

3. the seller will not induce any present employee of any member of the HWE/Pedro Domecq Group to become one of his employees.
4. the seller shall not adopt, use or carry on business in the spirit and wine sector under any name incorporating the trade marks or any name substantially of confusingly similar to any of the marks owned by the HWE/Pedro Domecq Group.

These agreements are directly related and necessary to the implementation of the concentration and are therefore, ancillary within the meaning of the Regulation.

- 42 For the above reasons, the Commission has decided not to oppose the notified operation and to declare it compatible with the common market. This decision is adopted in application of Article 6(1)(b) of Council Regulation No 4064/89.

For the Commission,