New case law on market foreclosure

Court of First Instance upholds three Commission decisions relating to beer ties

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In its judgments in the Roberts (1), Shaw (2) and Joynson (3) cases, the European Court of First Instance (‘CFI’) upheld three Commission decisions relating to exclusive purchasing agreements in the UK beer sector. The Shaw and Joynson judgments are of mainly historic interest in that they relate to decisions adopted before the entry into force of the Commission’s new rules on vertical agreements (4). On the other hand, the Roberts judgment expands the case law on foreclosure in a manner consistent with the economics-based approach of the new rules.

a) The Roberts case

In Roberts v Commission, the CFI confirmed the Commission’s view that the exclusive purchasing agreements or ‘beer ties’ of a brewer with a very small market share were not capable of contributing significantly to the foreclosure of the market and therefore did not fall within Article 85(1) (now Article 81(1)).

The judgment related to the Commission’s decision of 12 November 1998 (5) in which it rejected a complaint from Mr and Mrs Roberts, who were lessees of a pub belonging to the regional brewer Greene King. The Roberts complained that the obligation in their lease to buy all their beer from Greene King infringed Article 85(1). Greene King owned approximately 1100 pubs and had concluded loans associated with a beer purchasing obligation (‘loan ties’) with a further 1500 outlets.

First of all, the CFI held that the relevant product market was the supply of beer to all types of outlets which sell alcoholic drinks for consumption on the premises (the ‘on-trade’). Referring to the judgment of the European Court of Justice (‘ECJ’) in Delimitis (6), the CFI held that in all such outlets the product is consumed on the premises; the sale of the product is associated with the provision of services; brewers use a specific distribution system and consumer prices are higher than in the food retail sector (the ‘off-trade’). Therefore, pubs did not constitute a separate product market from other on-trade outlets such as clubs and restaurants.

Secondly, the CFI confirmed the Commission’s finding that Greene King’s share of the UK on-trade was too small to make a significant contribution to the foreclosure of the market. It should be recalled that in Delimitis the ECJ set a two-stage test for determining whether an exclusive purchasing agreement is compatible with Article 81(1): first, is access to the relevant market difficult, for example due to the presence of parallel networks of similar agreements (the foreclosure test), and, second, do the agreements of the party in question contribute significantly to that foreclosure? Greene King controlled less than 2% of on-trade outlets and its beer sales amounted to less than 2% of the on-trade total, i.e. much less than the market share of 5% or more held by each of the four national brewers.

This ruling is in line with the Commission’s Guidelines on Vertical Restraints, which state that even where a market is foreclosed by parallel networks of non-compete agreements, suppliers whose tied market share is less than 5% are not generally considered to contribute significantly to the cumulative foreclosure effect (7).

Finally, the CFI examined Greene King’s role as a wholesaler of beer for other national and regional brewers. It considered whether, for the purposes of applying Article 85(1), Greene King’s network of

(5) Case IV/36.511/F3 – Roberts/Greene King, decision available on the DG Competition website.
(6) Paragraph 142 of the Guidelines on Vertical Restraints.
beer ties, which on their own did not contribute significantly to foreclosure, should be attributed to the networks of the national brewers which supplied it and which did contribute significantly to foreclosure. It held that such an attribution was possible if two conditions were met.

First, the ‘upstream’ agreement between the supplying brewer and the wholesaling brewer should only be regarded as part of the tied network of the supplying brewer if it contains some form of purchasing obligation (minimum purchase volumes, non-compete clause, etc.). Second, in order for the ‘downstream’ agreements between the wholesaling brewer and its on-trade outlets also to be attributed to the supplying brewer’s network, the upstream agreements must be so restrictive that they make it impossible, or at least very difficult, for other brewers to gain access to the wholesaling brewer’s network of downstream agreements. On the other hand, if the restrictive effect of the upstream agreements is limited, other brewers can gain access to the wholesaling brewer’s tied network via a single supply agreement, in which case the downstream network may promote market penetration.

In the case of Greene King, the CFI confirmed the Commission’s view that Greene King’s beer ties could not be attributed to the networks of agreements of the national brewers from whom it purchased, because less than 20% of Greene King’s purchases from other brewers were subject to a restrictive purchasing obligation.

b) The Shaw and Joynson cases

In Shaw and Falla v Commission and Joynson v Commission, the CFI upheld the Commission’s 1999 decisions (1) granting an individual exemption under Article 81(3) to the standard leases of the UK brewers Whitbread and Bass respectively. Each brewer owned over 4000 pubs and leased a large number of these on long-term leases containing exclusive purchasing and non-compete obligations. The Commission concluded that the tied market share of each brewer contributed significantly to the foreclosure of the UK on-trade market and therefore the leases fell within Article 81(1). The leases did not comply with the exclusive purchasing block exemption then in force (2) for the technical reason that the exclusive purchasing obligation was by reference to types of beer (e.g. ales, lagers, etc.), rather than brands of beer specified in the lease. It was therefore necessary to assess their eligibility for individual exemption under Article 81(3).

In line with the rationale of the exclusive purchasing block exemption then in force, the two decisions began from the assumption that exclusive beer supply agreements generally lead to an improvement in distribution, but stated that such improvements might not arise where the purchaser (the pub lessee) faced unjustified price discrimination. The Commission therefore investigated whether the tied lessees of Whitbread and Bass did face such discrimination. It concluded that the two brewers charged higher beer prices to their tied lessees than to equivalent free trade customers, but that the price differential was compensated by certain countervailing benefits granted to the tied lessees, including lower rents, professional services, procurement services and capital expenditure.

First of all, the CFI upheld in both judgments the method used by the Commission to calculate the price differential, even referring in the Shaw judgment to the Commission’s ‘painstaking investigation’. The Commission had compared the average prices charged by the brewer to its tied lessees with those it charged to individual free house operators. The CFI confirmed that the Commission had been correct to exclude from the comparison prices charged to customers at other levels of the distribution chain, such as wholesalers or pub chains.

Second, it upheld the Commission’s evaluation of the above-mentioned countervailing benefits. It held that the Commission was entitled to rely on Whitbread’s internal figures relating to beer sales, pub rents, etc. when evaluating the benefits, the correctness of such figures not being prima facie open to challenge, absent any allegation of fraud.

Third, the CFI held that the Commission was right to assess the situation of Whitbread’s tied lessees as a whole rather than that of each individual lessee. It was immaterial that the countervailing benefits might not entirely compensate for the price differential in the case of particular Whitbread lessees, provided that the average lessee did enjoy such compensation. This was because the starting point for the Article 81(3) assessment was the finding that Whitbread’s network of leases, taken as a whole, made a

substantial contribution to foreclosure of the market.

Fourth, it held that the Commission had correctly focussed on whether Bass’s tied lessees faced significant, long-term price discrimination and not whether the profitability of Bass tied pubs was equivalent to that of their competitors.

Finally, the CFI held that the Commission was entitled to exempt Whitbread’s leases for their entire duration, despite the fact that the countervailing benefits did not completely compensate for the price differential during the first three years of the majority of the leases. In this respect, it endorsed the Commission’s conclusion that price discrimination by a brewer would only affect the competitiveness of its tied lessees appreciably if it were significant and long-lasting. This was not the case where the remaining price differential in the first three years amounted to only 1% to 3% of the beer price and where Whitbread’s tied lessees enjoyed other ‘unquantifiable’ benefits, including different commercial risks compared to independent operators.