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***Case No COMP/M.2044 – INTERBREW / BASS***

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

Article 9
Date: 22/08/2000

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.08.2000
SG (2000) D/ 106331

In the published version of this decision, some information has been omitted pursuant to Article 17(2) of Council Regulation (EEC) No 4064/89 concerning non-disclosure of business secrets and other confidential information. The omissions are shown thus […]. Where possible the information omitted has been replaced by ranges of figures or a general description.

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 9(4)(a) DECISION

**Decision relating to the referral of the case No COMP/M. 2044 Interbrew / Bass to the United Kingdom Competition Authorities, pursuant to Article 9 of Regulation 4064/89**

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EEC) No. 4064/89 of 21 December 1989, on the control of concentrations between undertakings[1], as amended by Council Regulation (EC) No 1310/97 of 30 June 1997[2] (together, 'the Merger Regulation'), and in particular article 9(3)(b) thereof,

Having regard to the notification made by Interbrew SA on 6 July 2000, pursuant to article 4 of the Merger Regulation,

Having regard to the request of the United Kingdom Competition Authorities of 1 August 2000,

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1 OJ L 395, 30.12.1989, p.1; corrected version OJ L 257, 21.9.1990, p.13

2 OJ L 180, 9.7.1997, p.1; corrigendum OJ L 40, 13.12.1998, p.17

Whereas:

1. On 06.07.2000 the Commission received a notification of a proposed concentration by which Interbrew SA will acquire sole control of Bass Holdings Limited and Prazske Pivovary a.s.

2. By a letter dated 01.08.2000, the United Kingdom requested the referral to the competent United Kingdom competition authorities of the proposed concentration in as far as it threatens to create or strengthen a dominant position as a result of which competition will be significantly impeded on markets in the beer sector within the UK, with a view to assessing it under United Kingdom national competition law, pursuant to article 9(2)(a) of the Merger Regulation ("the UK request"). On the same date as this decision, the Commission addressed to Interbrew a decision, in accordance with the application of Article 6(1)(b) of Council Regulation (EEC) No. 4064/89, not to oppose the notified operation in as far as it relates to markets other than those in the UK beer sector, and to declare it compatible with the common market and with the EEA Agreement.

## I THE PARTIES

3. **Interbrew SA** ("Interbrew") is principally involved in the supply of beer in the Americas, Western, Central and Eastern Europe and Asia Pacific. Interbrew's portfolio of brands includes Stella Artois, Labatt Blue and Rolling Rock. Earlier this year (25.05.2000) Interbrew acquired the UK brewing business of Whitbread PLC, the number three UK brewer. This transaction was not subject to Community merger control and is currently being investigated by the UK authorities.

4. **Bass Holdings Limited** ("BHL") is a subsidiary of Bass plc, active in the supply of beer primarily in the UK. This activity is done principally through Bass Brewers Limited. Its brand portfolio includes, inter alia, Carling, Worthington, Tennents and Caffrey's. Approximately [...]% of BHL's turnover is achieved in the UK where it is the number two brewer.

5. **Prazske Pivovary a.s.** ("Prazske) is active in the supply of beer in the Czech Republic where [...]% of its turnover is generated. Approximately [...]% of its turnover is generated in the EEA, principally in Germany. Its beer brand portfolio includes, *inter alia*, Staropramen.

## II. OPERATION

6. The notified operation is the acquisition by Interbrew (through its wholly-owned subsidiaries Interbrew UK Holdings Limited, Interbrew Central European Holding BV and Brandbrew SA) of Bass Machine Holdings Limited's shares in BHL and Prazske, and the business, assets and certain liabilities of Bass Beers Worldwide Limited ('BBW').

7. Bass Machine Holdings Limited holds 100% of the shares in BHL and approximately 80% of the shares in Prazske. The remaining shares in Prazske are widely held and are publicly traded in the Czech Republic.

## III. CONCENTRATION

8. Interbrew will acquire sole control over BHL, Prazske and BBW. The transaction is therefore a concentration within the meaning of article 3(1)(b) of the Merger Regulation.

## IV. COMMUNITY DIMENSION

9. The combined aggregate worldwide turnover of the undertakings concerned exceeds EUR 5,000 million (Interbrew 4,247 million; BHL and Prazske 1,592 million). The aggregate Community wide turnover of each party exceeds EUR 250 million (Interbrew [...] million; BHL and Prazske [...] million). BHL and Prazske achieve together more than two-thirds of their Community-wide turnover in the UK. Interbrew does not achieve more than two-thirds of its Community-wide turnover in any one Member State. The operation has therefore a Community dimension.

## V. RELEVANT MARKETS

10. Interbrew is not currently active on the retail level, either on- or off-trade and has not acquired the Bass retailing activities in the UK which stem from Bass' interests in (ownership of) hotels, pubs and restaurants and other leisure interests. It would, however, be active in production and supply of beer.

### A. <u>Relevant product markets</u>

11. In its notification, Interbrew has defined two affected markets:

- the production of beer for supply to the on-trade; and
- the production of beer for supply to the off-trade.

*Beer*

12. Interbrew argues that beer competes within a wider beverages market, notably with cider, wine, FABs, spirits, soft drinks and bottled water. It refers to the decline of beer in the UK whereas the overall consumption of other beverages and particularly cider and wine has grown. Where in 1975 64.6% of alcohol consumption in the UK was represented by beer, and 12.1% and 2.3% were represented by wine and cider respectively, beer accounted in 1997 for 53.5% of alcoholic consumption and wine and cider for 22.7% and 5.5% respectively. Nevertheless, it has provided, for the purpose of this notification, market information for the beer market.

13. The Commission's investigation has found that the vast majority of respondents support the existence of a beer market, separate from other beverages on the basis of its alcoholic properties and taste as well as, amongst other reasons, the price differences. This is in line with the Orkla/Volvo decision[3].

*Types of beer*

[3] Commission Decision of 20.9.1995 in Case IV/M.582 – Orkla/Volvo (OJ L66, 16.3.1996, p.17).

14. There are a number of conventions used to describe beers – such as those based on physical product characteristics (e.g. lager versus ale) or product positioning (standard versus premium). Interbrew argues that, despite this apparently considerable degree of product differentiation, it is appropriate to define a single market including all beers. Interbrew has argued that final consumers cannot be easily allocated into artificial categories. Rather, an increasing number of consumers frequently drink both lager and ale and their behaviour reflects the nature of the beer market as a single market.

15. Interbrew cites the conclusions of the most recent Monopolies and Mergers Commission ("MMC") Report on the issue[4] in which the MMC stated that the differences between lager and ale were less clear-cut than they may have been in the past. In particular the MMC referred to the development of beers that combine some characteristics of the two types, the so-called 'nitro-keg' ales, and the emergence of national ale brands that are developed and promoted in a similar way to lager.

16. With regard to the standard/premium distinction, Interbrew indicates that the distinction which has traditionally been drawn in the UK for both lagers and ales is on the basis of alcoholic strength (a product with over 4.2% alcohol by volume being a premium). The MMC noted in the 1997 Report that consumers' perception of what constitutes a premium lager is the combined result of a number of factors such as product quality, product innovation, branding, alcoholic strength, packaging and price.

17. Evidence has been given to the Commission that there are demand-side differences between consumers of premium products and consumers of standard products, therefore indicating the possible existence of separate markets. In particular, there are differences in drinking occasions (premium lagers tend to be drunk more by younger consumers at weekends whereas standard lagers tend to be consumed at "lower energy" occasions and by older customers in the week), and differences in prices (the average retail prices for a pint of draught premium lager being 20 pence more than standard lager, a difference of about 10%; the difference for bottled beer is 40 pence). The Commission has also received some evidence that final consumers' demand for premium products is more price inelastic than for standard products, which also indicates separate markets.

18. Retail outlets generally offer a range of beers of all types because the different products appeal to different consumer groups. A major retailer stated that "The consumer would choose another pub rather than switch to a standard lager" and that therefore it is essential for pubs to offer at least one product in each classification. Interbrew recognises that, in deciding which brands to stock, retail outlets do typically stock both premium and standard lager brands. This would indicate that, at the level of supply to the retailer, separate product markets may be appropriate.

19. Interbrew has also argued that the potential for supply-side substitution supports a single market definition on the grounds that the cylindro-conical fermenting vessels used in most modern breweries incur no more switching costs when switching between the production of lager and ale than when switching between two different brands of lager. However, this argument has not been supported by the Commission's investigation, in part because there exist distinct differences between the brewing,

[4] 1997 MMC Report on the proposed merger of the UK brewing interests of Bass PLC, Carlsberg A/S and Carlsberg-Tetley PLC ("the 1997 Report")

packaging and dispensing of cask-conditioned ale (ale undergoing fermentation in the container from which it is served; also called “real ale”) that accounts for around 15% of UK beer consumption.

20. Others have argued that it is not the physical characteristics that matter, but the costs of building and maintaining a brand image which are the major barriers to switching production and which support arguments in favour of separate markets.

21. There are a variety of factors at the production, distribution and retail level that all have a bearing on the definition of the product market and the Commission’s investigation has not produced strong evidence one way or the other. However, the Commission considers that, for the purposes of the present decision, it is not necessary to decide whether narrower relevant product markets should be defined, since on the largest possible market which includes all beer, competition concerns arise.

*On- and off-trade*

22. In previous case law of the Court of Justice[5] and the European Commission (pursuant to the Merger Regulation[6] as well as Articles 81-82 of the Treaty[7]), a distinction has been made between the market for the supply of beer for the on-trade (premises such as public houses, bars, restaurants, hotels, etc. where the beer is purchased and consumed) and off-trade premises (premises such as supermarkets and off-licenses where the beer is purchased but cannot be consumed).

23. Interbrew has argued that distribution to the on-trade is becoming increasingly similar to distribution to the off-trade as a result of the growth of powerful independent pub companies which can exercise similar pressure on prices as that exercised by supermarkets and multiple retail groups in the off-trade. Nevertheless, many factors indicate that the on-trade and the off-trade continue to possess characteristics that are sufficiently different to justify their treatment as different markets and this has been supported by the Commission’s investigation. For example, draught beers (i.e. sold in kegs) account for approximately 85% of total consumption in the on-trade but are almost non-existent in the off-trade; the movement of draught containers requires specialised distribution facilities; and there are major differences in consumers’ buying criteria. In particular, in the on-trade, consumers’ purchases represent the purchase of a leisure service[8] whereas in the off-trade, consumers are buying a functional good.

24. The Commission therefore considers that, in accordance with previous decisions, it is appropriate to define separate markets for the on-trade and the off-trade.

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5 Judgement of 28.2.1991 in Case C-234/89, *Stergios Delimitis v. Henninger Bräu*, [1991] ECR I-977.

6 *e.g.* Orkla/Volvo, op.cit.

7 *e.g.* Commission Decisions 1999/230/EC - Whitbread of 24.2.1999 (OJ L88, 31.3.1999, p. 26) and 1999/473/EC - Bass of 16.6.1999 (OJ L186, 19.7.1999, p. 1).

8 See for example, Cases IV/36.456/F3 – *Inntrepreneur* and IV/36.492/F3 – *Spring*, OJ L 195, 29.06.2000, para 40

*Supply of beer*

25. The production (brewing) level encompasses the physical brewing and packaging processes. Brewers, or where relevant licensees or importers, also undertake the marketing and advertising in relation to the products they produce and/or import.

26. In the on-trade, beer generally passes through one or two transactions on its route to the retail outlet. Firstly, there may only be one transaction for beer sold by brewers directly to retailers, whether these are retail outlets with which the brewers hold ownership interests (27% of consumption in 1997) or other vertical links such as loan ties (<18%), or the so-called free-free retail outlets (<35%)[9]. Secondly, there are two transactions for beer sold by brewers to wholesalers who in turn sell to individual retail outlets. These wholesalers can be independent wholesalers (6%) or other brewers. There are also two transactions for beer sold by the brewers to the so-called pub management companies ("pubcos", 20%) that in turn have ownership interests in multiple individual outlets.

27. As well as passing through the different possible transactions outlined above, the beer must also be physically distributed. A distinction can be made between primary distribution and secondary distribution: primary distribution being the distribution from the breweries to central warehouses, and secondary distribution being that from central warehouses to individual outlets.

28. Whereas primary distribution is almost entirely carried out by the brewers themselves, the party which has bought the beer from the brewers has a choice about who undertakes the necessary secondary distribution. Whilst this can be done by independent logistics companies, in the large majority of cases this is still done by the brewers.

29. Brewers also market directly to retail outlets, for example through sending sales representatives to the outlets. They also provide other related services, including installation and maintenance of dispensing equipment.

30. In the off-trade, there are two routes to market. Firstly, brewers sell to independent wholesalers who supply independent retail outlets. Secondly, brewers sell to multiple retail outlet owners (i.e. supermarkets and off-licence chains). Brewers do not sell direct to individual off-trade retail outlets. Primary distribution is again done by the brewer, while secondary distribution is typically done by the independent wholesaler or the off-trader itself.

31. While it cannot be excluded that the different routes to market represent different relevant markets, for the purposes of this decision it is not necessary to define narrower markets since even on the widest possible basis, i.e. the supply of beer to the on-trade and the supply of beer to the off-trade, competition problems arise and the markets fulfil the criteria in Article 9. For the same reason it is not necessary to decide whether distribution, and in particular secondary distribution, represents a separate service market.

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[9] The consumption percentages figures indicate total consumption in such outlets. It must be noted, however, that this may involve two transactions if the brewer is selling beers to the retail outlets which it in turn has bought from other brewers.

**Product market conclusion**

32. The Commission's investigation has confirmed its findings in previous decisions that beer is on a separate product market from other beverages and that the beer on-trade and off-trade constitute separate product markets.

33. While the investigation also revealed the possible existence of separate product markets for the different types of beer, it is not necessary to decide whether narrower relevant product markets should be defined, since competition concerns arise even when analysed on the basis of the largest possible market which includes all beer.

34. The investigation has also revealed that it may be appropriate to define separate markets for the different routes to market, and for the associated distribution services. However, as shown below, serious competition concerns regardless of whether narrower markets are defined. For the purposes of this decision, it is therefore unnecessary to conclude as to whether such narrower product markets exist. Consequently, in this decision it suffices to consider the relevant product markets as follows:

- the supply of beer to the on-trade; and

- the supply of beer to the off-trade.

**B. <u>Relevant geographic market</u>**

35. Interbrew indicates that the relevant geographic market is not smaller than the United Kingdom for both the on- and the off-trades, and that the geographic market may even be wider, as a result of the relatively high level of import penetration (direct and personal imports) into the UK. However, the Commission's investigation has provided strong support for the view that the market is no wider than the UK. In previous decisions the Commission has supported national geographic markets in reference to the fact that consumer preferences still vary considerably between different Member States (e.g. the importance of ales in the UK) and the fact that there are still relatively few brands that have a significant presence in more than one Member State. Other factors in support of a UK national market referred to in the previously mentioned Commission decisions pursuant to Article 81 of the Treaty are the existence of the Beer Orders, the high consumption of draught beer, the presence of pub management companies, the existence of specific pub-licensing regulations and the variety in types of ale offered. These factors remain relevant.

36. Some respondents have argued in favour of separate markets within the UK, in particular that Northern Ireland could be regarded as a separate market for both the on- and off-trade due to the specific licensing system (with supermarkets requiring separate tills and entrances for alcohol sales); the limited number of property tied houses; the larger consumption in the off-trade and the higher consumption of lager and stout than in the rest of the UK. The market structure is also different with [85-95]% of beer sold in the on-trade being supplied by Guinness (60%) and Bass ([25-35]%). Since Interbrew currently makes no significant sales into Northern Ireland, the operation would not materially change the competitive situation on any separate market. Also, given that consumption of beer in Northern Ireland accounts for only 2% of consumption in the UK, the outcome of the assessment would not be materially different whether the UK or Great Britain is considered to be the relevant market. It is therefore not necessary for the purpose of this procedure to define whether or not Northern Ireland constitutes a separate market.

37. Some respondents have argued that Scotland and the different "ITV television advertising franchises" within England and Wales constitute separate geographic markets. The arguments presented relate to the different strength of particular brands and/or types of beer in the respective regions. For instance, Scottish consumers prefer brands with a Scottish heritage such as Tennent's or McEwans; mild is a type of beer particularly strong in the Midlands (the "Central" ITV franchise); and other regional brewers are particularly strong in particular regions (e.g. Greene King in East Anglia). Although there are regional preferences, both with respect to types of beer and to particular brands, there are, at this stage of the procedure, no convincing indications that these preferences lead to the conditions of competition being appreciably different in those areas. In this respect, reference is made to the fact that the largest brewers, the so-called "national brewers" have national, not regional wholesaling and distribution operations. In addition, beers are mainly marketed at a national level; there appear to be no significant differences in wholesale prices across the UK and the level of discounts is generally negotiated at a national level.

38. In the light of the above, the Commission has concluded that the relevant geographic markets for the supply to both the on-trade and the off-trade are no wider than the UK and therefore that the UK presents all the characteristics of a distinct market, thereby satisfying the geographic criteria for referral to the competent UK authorities under article 9(2)(a) of the Merger Regulation. The question of whether the relevant geographic market covers the whole of the UK, excludes Northern Ireland or other regions which should be considered as relevant geographic markets can be left open, as the analysis would not be materially changed.

## VI. ASSESSMENT

### 1. <u>The UK market for the supply of beer to the on-trade</u>

39. Information provided by the parties on their market shares for the supply of beer and lager to the on-trade is summarised in Table 1. As mentioned above, lager sales now represent 60% of consumption in the on-trade. These data include beer produced under licence, but exclude factored sales[10].

40. On the basis of 1999 data, after the concentration, brands controlled by Interbrew would represent [30-40]% of the on-trade beer market in Great Britain. Interbrew would become the new market leader. Scottish and Newcastle ("S&N") would hold 26.3%, followed by Carlsberg-Tetley with 12.9%. Interbrew and S&N would together hold around 60% of the overall market. On the basis of the information in the notification, Interbrew's share of sales is between [35-45]% and [35-45]%[11] when factored sales are taken into account, depending on how Heineken and Murphy's volumes are treated. The parties highlight that these levels of concentration are low in comparison to most other European countries. However, straight comparisons of this type have not been taken as a basis of proof that the UK beer markets are competitive. This is because historical developments have led to significantly different patterns of competition in different countries' beer markets. In addition, as the UK highlighted in

10 Sales of other brewers' beers wholesaled by the parties.

11 Table 21, sales by volume

its Article 9 request, most other European beer markets are smaller than that in the UK, and it is therefore to be expected that the markets would be more concentrated.

**Table 1 GB On-trade market shares**

| | All beer | | | Lager | | |
|---|---|---|---|---|---|---|
| | **'97** | **'98** | **'99** | **'97** | **'98** | **'99** |
| BHL | [20-30]% | [20-30]% | [20-30]% | [20-30]% | [20-30]% | [20-30]% |
| Interbrew* | [5-15]% | [5-15]% | [5-15]% | [5-15]% | [5-15]% | [5-15]% |
| **BHL & Interbrew*** | **[25-35]%** | **[25-35]%** | **[25-35]%** | **[30-40]%** | **[30-40]%** | **[30-40]%** |
| S&N | [20-30]% | [20-30]% | [20-30]% | [20-30]% | [20-30]% | [20-30]% |
| C-T | [10-20]% | [10-20]% | [10-20]% | [10-20]% | [10-20]% | [10-20]% |
| Anheuser-Busch | [0-5]% | [0-5]% | [0-5]% | [0-5]% | [0-5]% | [0-5]% |
| Guinness | [5-10]% | [5-10]% | [5-10]% | [0-5]% | [0-5]% | [0-5]% |
| W&D | [0-5]% | [0-5]% | [0-5]% | [0-5]% | [0-5]% | [0-5]% |
| Greene King | [0-5]% | [0-5]% | [0-5]% | [0-5]% | [0-5]% | [0-5]% |
| Others | [10-20]% | [10-20]% | [10-20]% | [10-20]% | [10-20]% | [10-20]% |
| Heineken+Murphy's | [0-5]% | [0-5]% | [0-5]% | [5-10]% | [5-10]% | [5-10]% |

* i.e. the Whitbread brewing business acquired by Interbrew earlier this year, excluding Heineken and Murphy's brands

Source: Form CO and AC Nielsen

41. The Commission has received indications that [25-35]% is an under-estimate of Interbrew's market share since it does not take into account the impact of the relationships between Interbrew, Whitbread and Heineken in relation to the Heineken and Murphy's brands.

42. Part of the Whitbread brewing business was not acquired by Interbrew. This part currently holds a license to brew and distribute the Heineken and Murphy brands. Heineken is the number eight brand in the UK. In order to fulfil this agreement, Whitbread will lease the Samlesbury brewery from Interbrew. Interbrew and Whitbread will also have an agreement according to which Interbrew will distribute these products. The agreement between Whitbread and Interbrew gives Interbrew control over the pricing of Heineken products. It has been put to the Commission that in the light of the agreement between Whitbread and Interbrew, as a result of which Heineken will be almost entirely dependent on Interbrew for its wholesaling and distribution to the on-trade, Heineken's market shares should be included with Interbrew's. This would increase the parties' combined share to [30-40]% of all beer sold in the on-trade. In response, Interbrew has argued that "Interbrew has no control over the production, packaging and positioning or brand development of Heineken's products in the UK, whilst it is the market that sets the overall price for the products". In addition, Interbrew argues that the arrangements between it and Whitbread contractually oblige Interbrew to price Heineken products "competitively".

43. The Commission notes that Interbrew will not have control over the marketing of the Heineken and Murphy's brands, nevertheless, since Heineken will be reliant on Interbrew to determine the price at which Heineken is sold, the competitive threat that Heineken could otherwise have provided to Interbrew will be significantly reduced for the period the arrangements exist in their proposed form.

*Brand ownership*

44. The parties argue that the product ranges of Interbrew and Bass are largely complementary and that the acquisition will produce competitive benefits by enabling them to offer their customers a broader range of products. Interbrew's and S&N's brand portfolios are summarised in table 2.

**Table 2: Interbrew & S&N brand portfolios (on-trade)**

| Product sector | Interbrew | Scottish & Newcastle |
|---|---|---|
| Standard lager | Carling (1) | Fosters (2) |
| Premium lager | Stella (1) | Kronenbourg (2) |
| Standard bitter | Worthington (3)<br>Boddingtons (4) | John Smith's (1) |
| Premium bitter | Caffrey's (1)<br>Bass Draught (2) | McEwans Export (6) |

* Numbers in brackets represent brand position.

45. Overall, Interbrew will own three of the top ten brands on the UK market (Carling, Stella and Tennents) and will distribute the 8th brand, Heineken. S&N and Carlsberg-Tetley each own two brands in the top ten, while Guinness and Anheuser-Busch (with Budweiser) each own one.

46. It results from the Commission market investigation that consumer demand is increasingly shifting towards the top brands. This is illustrated by the rise in the market shares taken by the top brands. In 1995 the top 10 brands held 39% share of volume. By 1999 this had risen to 55%. In 1999 the top three beer brands alone accounted for 22% of the total market. This reflects the increasing amounts of money that brewers are spending on their major brands to the detriment of some of their more minor brands. Several respondents have indicated that this tendency will continue and that brewers will have increased incentives to focus their marketing expenditure on a small number of brands in order to achieve greater economies of scale and that this trend will be exacerbated by the concentration.

47. It has been put to the Commission that as the ownership of the top brands concentrates, and the brewers' marketing expenditure becomes concentrated on fewer brands, retailers and wholesalers will be obliged to stock those top brands, or else their sales will suffer. Furthermore, it has been put to the Commission that this might lead certain of those customers who currently source their supplies from more than one brewer or wholesaler to be persuaded to sign exclusive agreements with either Interbrew or S&N which in turn would raise barriers to entry and expansion against other brewers, thereby reducing the competitive threat that they currently offer. As an example, prior to the concentration, Bass did not possess one of the top brands of premium lager and therefore had incentives to wholesale and distribute other brewers' premium lagers.

Post concentration, these incentives will be removed, as the merged entity will own the number one brand of premium lager, Stella Artois.

48. In its notification, Interbrew has also argued that there is a considerably greater degree of brand fragmentation in the UK compared to other countries and that the market position of individual brands is inherently less stable than in other Member States. However, such direct comparisons across countries have not been accepted as evidence of the strength of competition.

49. The evidence provided by Interbrew to support a hypothesis that brands are unstable is a list of the top ten brands in 1992 and in 1999. From this list, it appears that seven of the top ten brands in 1992 remained in the top ten in 1999. This therefore does not indicate significant fluctuation in fortunes and there is further evidence that points to relative stability and increasing strength for the top brands. In the last five years, no brewer has realised an increase of five percentage points in their market share in the on-trade market for beer. If narrower product markets are considered, only Stella Artois has achieved an increase of more than five percentage points. Given the apparent strength of the global players that are present in the UK market, for example, Anheuser-Busch with their Budweiser brand, such stability in market shares is an indication that there may exist barriers to entry and/or expansion. This stability is particularly surprising given that the top ten brands have been gaining share at the expense of weaker brands.

*Distribution*

50. Prior to the merger, four brewers had nation-wide distribution facilities. Post-merger, this will be reduced to three, Interbrew, S&N and Carlsberg-Tetley. The position of these so-called national brewers in distribution is stronger than their production market shares described in table 1. In part, this is because they distribute other brewers' products and in particular those without their own secondary distribution network. One respondent has estimated that for the distribution of bulk beer into the UK on-trade, Interbrew accounts for 44.6%, S&N 31.8% and Carlsberg-Tetley 15.6%. The estimate for Interbrew includes the distribution of Heineken and Murphy's.

51. It results from the Commission's investigation that there are significant economies of scale in distribution, and that, after the merger, the distribution networks owned by Interbrew and S&N will have large cost advantages over the other distributors, including Carlsberg-Tetley. It has also been put to the Commission that it would not be economically justifiable to invest the costs and time needed to establish a distribution system with the scale, scope and cost efficiencies comparable to those of Interbrew and S&N until a brewer achieves a very substantial market share. In addition, one major pubco indicated in its response that the on-premises services provided by the brewer/distributor are an essential part of the service and could not easily be replicated by an independent distributor. These "cellar technical services" include in particular the maintenance of on-premises equipment such as pipes and taps which generally belong to the brewer/distributor. It should be noted that the four national brewer/distributors and two cider manufacturers have an arrangement whereby they allow each other reciprocal use of this equipment, thus making it possible for retailers to switch between them. The regional brewers have so far declined to participate in the scheme and it has been put to the Commission that the market is effectively not open to independent distributors.

52. As indicated above, following the merger Interbrew will have incentives to replace other brewers' brands which it currently distributes with brands that it owns or licenses. This would not be a problem for these other brewers if there were no barriers to establishing their own distribution network. However, as outlined above, the Commission has received evidence that there are substantial barriers to establishing a national distribution network that would be equivalent to those of Interbrew and S&N, therefore this reduces the competitive threat that brewers who rely on Interbrew and S&N to distribute their products are able to offer.

53. This conclusion supports that reached by the MMC in their 1997 Report: "New entrants have not set up their own distribution networks and smaller brewers are, by and large, reliant on the wholesaling activities of national brewers and the existing independent wholesalers for the sale of their beers to retail outlets. This relationship implies that the threat of entry is unlikely to act as a fully effective restraint on major brewers' activities."

54. Interbrew argues that pubcos have every possibility to contract for secondary distribution with brewers or logistics companies independently of their beer supply negotiations, and that therefore the merged entity's share of distribution does not give it market power since the pubco is increasingly taking control of the supply chain. However, this option would only be economical for the largest pubcos, and as outlined above, they have indicated that they face restrictions on their ability to switch distributors.

55. In addition pubcos have indicated to the Commission that the integrated brewers/distributors are already able to discriminate in their distribution charging policy by imposing higher charges for the carriage of beers produced by brewing companies other than their own.

56. In relation to independent wholesalers, it was recognised in the MMC's 1997 report that the role of independent wholesalers in maintaining and promoting competition was important, in particular by lowering barriers to entry. It appears that the independent sector's ability to compete may be significantly weakened as a result of the merger. In particular, responses to the questionnaire indicate that, while the independent (nationally operating) wholesalers have had a good relationship with Whitbread, in general Bass' policies have sometimes led to some pub companies being given better terms than the free-trade sector supplied by the independent wholesalers even though the independent wholesalers purchased considerably higher volumes. Post-merger, Interbrew will have reduced incentives to sell via the independent wholesaling sector and as a result will be likely to reduce the volumes it currently sells via independent wholesalers. Potentially, this could threaten the continued viability of the independent wholesaling sector and thereby reduce the competitive threat that it represents.

57. It is general practice in the industry for agreements between wholesalers and brewers to entitle the brewer to receive information about the wholesaler's customers, including who they are, and what price and discounts they have been offered by the wholesaler. Such arrangements clearly enable the national brewers to target promotions at those customers they wish to obtain, thereby limiting the independent wholesalers' ability to offer a significant competition. Post-merger, the combined entity may have greater incentives to undertake such 'cherry-picking' activities.

58. Interbrew has also argued that the effects of the merger will be to increase access to the market as the vertical disintegration between the brewing and retail assets opens up a large section of the retail outlets to areas which have not been open to brewers other than Bass before. While this separation of ownership links between brewing and retailing could potentially reduce barriers to small brewers and new entrants, this effect cannot be viewed in isolation from the supply agreements described below between Interbrew and Bass and the relationship between Interbrew as a producer/wholesaler and the independent wholesalers.

*Supply agreements*

59. Interbrew has entered into a five year agreement for the supply of beer to the Bass pub estate. Under the terms of these agreements, Interbrew will supply a minimum of [...]% of the Bass pub estate's beer requirements in year 1, falling to less than [...]% in years 4 and 5. The Commission understands that an agreement between Interbrew and Whitbread's pub business gives Interbrew the right to supply [...]% of the volumes sold through Whitbread's pub estate. However, Interbrew considers that these supply agreements do not replicate the vertical relationships that have existed between the brewing and retailing operations of Whitbread and Bass. It argues that the 5 year term of the agreement is relatively short, and that it has been put in place to provide a transition to the new commercial situation.

60. At the very minimum, the supply agreements with the Bass estate (and with the Whitbread estate) significantly limit the number of retail outlets that are genuinely released onto the free market and reduces the extent to which these outlets should be considered as independent.

*Buyer power and the independent pub companies*

61. The parties have argued that the growth of the independent pubcos has had a significant pro-competitive effect on the beer market in the UK; pubcos purchase beers from a wide range of brewers, national, regional and local; their growth has reduced barriers to entry and they are able to exert significant buyer power upon the parties. In addition, they argue that this significant buyer power has been reflected in the decline in real wholesale prices as a result of the large discounts that the brewers have offered these pubcos. However, the responses from these companies to the Commission's investigation indicate that the concentration may significantly and adversely affect their position. For example, one pubco argued that their negotiating strength would be reduced as a consequence of the above described strength of Interbrew's and S&N's brand portfolio and their strength in distribution.

*Collective dominance*

62. In its request for referral, the UK has identified a number of characteristics that indicate that the market may be susceptible to a situation of duopolistic collective dominance. The physical products are relatively homogeneous; market shares are high and stable (c.60% for all beers, c.70% for lagers); demand is stable and inelastic; the market is not growing; Interbrew and S&N will have broadly symmetrical market shares and cost structures; there has been no recent entry into national brewing and distribution other than through acquisition; the leading players would have a similar range of products and significantly, these product ranges include the strongest two brands in most of the product categories; current levels of excess capacity would deter cheating on a collusive outcome; and finally, the market is very transparent, brewers

have contacts with each other at many different levels of the supply chain, and all competitors appear to know to whom they have lost contracts and the reasons why they lost them.

63. The threat that the proposed concentration may create a duopolistic structure has been raised by many of the respondents to the Commission's investigation, including both competitors and customers in the on- and off-trades. Their arguments have focused on the strength of the two companies' brand portfolios, and the control that together Interbrew and S&N will hold over the routes to market.

64. Interbrew has argued that the characteristics of the UK beer market do not support the proposition that co-ordinated behaviour between two or more suppliers would be a viable or attainable strategy. It argues that differences between S&N and Interbrew result from S&N's ownership of retail outlets, and that as a result of owning retail outlets, S&N's commercial strategy will be significantly different to that of Interbrew and that there is a clear lack of symmetry between the companies. Secondly, the combined share of S&N and Interbrew will be less than 60%, and that the levels of concentration are less than in other European countries. Four of the world's largest brewers (Anheuser-Busch, Heineken, Carlsberg and Guinness) all compete in the UK, between them owning five of the UK's top ten brands. The regional brewers provide strong competition and have secure, tied estates from which to anchor their operations. The vertical separation between brewing and retailing brought about by the concentration introduces new opportunities to the market; there is a high level of imports into the UK market and discounts offered to customers are secret and not known to competitors. In addition, barriers to entry are falling rapidly; beer brands are weak in the UK, compared to other European markets. There are a significant number of companies able to wholesale effectively and offer competition to Interbrew and S&N. Excess capacity prevents anyone from attempting to collude implicitly in order to raise wholesale prices, and there is substantial purchasing power, and finally supply agreements are short.

65. However, as has been highlighted above, many of these factors have not been supported by the Commission's investigation. For example, much of the security resulting from vertical integration can be duplicated through vertical agreements. It is therefore not necessarily the case, as Interbrew argues, that this structural difference between the two companies inherently undermines their incentives to behave in a parallel manner. In relation to Interbrew's argument that the two companies' combined market shares will be relatively low at 60%, the Commission notes that when measured by the Herfindahl-Hirschman Index (HHI), the market structure will change from where it can be described as 'moderately concentrated' to a position where not only can the sector be described as highly concentrated, but the increment in concentration is large as well[12]. In addition, there has been a significant organic growth in the share of the top brands. Even without the proposed concentration, this pattern appears likely to continue; with the merger, this pattern is very likely to be exacerbated, in which case the parties' combined share will also rise and may even rise rapidly.

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12 One respondent estimated that the HHI would increase from 1914 to 2664. Although the starting point is higher than that estimated by the Commission in *Inntrepreneur* (1678), an increment of 750 points would still enable the sector to be described as highly concentrated.

66. In relation to competition provided by the other brewers it should be noted that Anheuser-Busch and Guinness are essentially one brand operations, thereby catering only for a limited demand of, respectively, premium lager and stout and they are dependent on the other brewers for their distribution. In the short run, the competitive threat that Heineken can offer will be restricted by its reliance on Interbrew as indicated above. In the longer term, if it wishes to remain a viable competitor independent from Interbrew, it will have to reconsider its options. While Carlsberg-Tetley will hold a significant share of the market, and has shown through recent contracts with Punch that it can gain business through offering large discounts, a number of respondents have cast doubt on its ability to compete with two significantly larger and more profitable operations.

67. In relation to competition provided by imports, such imports lack the advertising and marketing support that is increasingly required in order to compete effectively. In addition, imports will face the barriers to distribution that are faced by incumbent operators. The Commission therefore does not consider that such imports reduce the likelihood that a duopolistic outcome will result.

***Conclusion – on-trade***

68. In the light of the above, the Commission considers that the concentration threatens to create a collectively dominant position as a result of which effective competition will be significantly weakened in the market for the supply of beer to the on-trade in the UK.

**2. The UK market for the supply of beer to the off-trade**

69. Sales to the off-trade represent a growing proportion of sales. At the time of the 1997 MMC investigation, the MMC considered that the off-trade enjoyed countervailing buyer power against the merging parties. In its request, the UK has argued that the proposed concentration raises significant issues in the off-trade.

70. Lager sales represent 82.2% of off-trade beer sales[13]. Post merger, Interbrew would hold four of the top ten lager brands, and together S&N and Interbrew would hold eight out of ten. Branded lagers are a significant and growing feature of off-trade sales, and as a result of the concentration of brands brought about by the merger, the negotiating position of the off-trade may be weakened with the result that competition would be reduced, prices would rise and the range of brands available would diminish.

71. The UK request highlights that Interbrew will control 14 of the top 40 brands (including Heineken and Murphy's), including the number one standard and premium lagers, the leading "Scottish beer", Tennents and the leading ale, Boddingtons. Between them, Interbrew and S&N will own 30 of the top 40 brands. Interbrew has argued that even looking at a top 40 indicates the degree of fragmentation and competition in the market. Nevertheless, the Commission has gathered evidence that the multiple grocers' sales of beer are largely dependent on the brands controlled by Interbrew and S&N, and that the concentration generates a significant risk that competition will be significantly reduced between the top brewers. In addition, if current trends towards greater concentration in a few national brands are, as appears

13 Key Note Market report 2000 "Breweries and the Beer Market"

possible, exacerbated by the merger, such concentration of brands may make it more difficult for regional brewers to compete effectively, due to the large sums of money that are needed in order to market their products and the greater economies of scale that the nationals can obtain in this regard.

72. It has been put to the Commission that, as in the on-trade, the entire off-trade does not consist of large multiple retailers and that there exists a significant independent wholesaling sector which plays an important role in maintaining competition in the off-trade. The Commission considers that, as with the on-trade, the concentration increases the risks that the independent wholesalers could be subject to discriminatory behaviour, therefore weakening the extent of competition they are able to offer, and potentially forcing customers to deal directly with the brewers rather than enabling them to source their supplies from others.

*Off-trade conclusion*

73. Taken together, these factors suggest that as with the on-trade the concentration threatens to create a collectively dominant position as a result of which effective competition will be significantly weakened on the market for the supply of beer to the off-trade.

## VII. ANCILLARY RESTRICTIONS

74. The parties have asked for a two-year non-competition clause between Bass and Interbrew to be treated as ancillary. Given that the conditions for referral of the deal to the UK authorities appear to be met, there will be no need to reach any conclusions about whether or not these agreements can be treated as ancillary.

## VIII. CONCLUSION

75. From the above it follows that the conditions to request a referral under article 9(2)(a) are met. It should also be noted as a relevant fact that the completed acquisition of Whitbread's brewing business by Interbrew is currently being investigated by the UK authorities and that parallel examination of the cases could potentially create difficulties. In addition, the UK authorities have the benefit of the knowledge of a number of recent investigations into competition concerns particular to the UK beer industry. Most recently, the OFT has been carrying out a detailed review of the Beer Orders.

76. The Commission therefore considers that it is appropriate for the Commission to exercise its discretion under article 9(3)(b) so as to grant the referral of that part of the concentration which relates to the supply of beer in the UK.

77. Accordingly, the Commission has adopted this decision :

### Article 1

The notified concentration resulting in the acquisition of control of Bass Machine Holdings Limited’s shares in BHL and Prazske, and the business, assets and certain liabilities of Bass Beers Worldwide Limited by Interbrew in as far as it threatens to create a dominant position on markets for the supply of beer in the UK is referred to the United Kingdom competition authorities.

## Article 2

This decision is addressed to the United Kingdom.

Done at Brussels 22.08.2000 For the Commission,