

PROPOSED ACQUISITION BY
SERVICED DISPENSE EQUIPMENT LIMITED
OF THE TECHNICAL SERVICES FUNCTION
OF COORS BREWERS LIMITED

REFERENCE TO THE COMPETITION COMMISSION

**MAIN PARTIES' RESPONSE TO THE COMPETITION
COMMISSION'S PROVISIONAL FINDINGS REPORT
AND NOTICE OF POSSIBLE REMEDIES**

19 JANUARY 2005

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**Proposed Acquisition by Serviced Dispense Equipment Limited
of the Technical Services Function of Coors Brewers Limited**

Reference to the Competition Commission

**Main Parties' response to the Competition Commission's Provisional Findings Report
and Notice of Possible Remedies**

EXECUTIVE SUMMARY

Provisional Findings

1. The parties do not agree with the Competition Commission's provisional finding that the transaction will lead to SLCs. They nevertheless set out in this document a package of remedies which addresses the Commission's concerns. This package represents a significant liberalisation of the markets when compared with the current situation or the counterfactual identified by the Commission.

Remedies

2. The parties are prepared to offer undertakings along the lines suggested in paragraph 5 of the Commission's Notice of Possible Remedies. The parties also propose to introduce further provisions to address the concerns of the Commission and to facilitate the development of the nascent TS and TSE markets.

Restructuring of SDEL

3. Under the parties' revised proposals, SDEL will undertake to restructure itself. It will become a more substantial business. It will have a full time Managing Director. It will also have a full time Contracts Manager, to allocate, negotiate and manage sub-contracts, who will report to the Managing Director. The Managing Director will report to the SDEL Board. SDEL will employ around 150 employees and have a projected annual internal cost base of approximately £[] million.
4. SDEL will assume responsibility for key functions, including:
 - the appointment of sub-contractors for its TS work;
 - procurement of TSE;
 - negotiation of contracts with sub-contractors and high level allocation of work between TS sub-contractors;
 - day to day allocation of work to TS sub-contractors;
 - finance and administration.

Relationship with Innserve

5. SDEL will become fully independent from Innserve. Innserve and its management will have no involvement in SDEL:

- Neither Mordaunt & Foster Limited nor Hallriver Limited will remain a shareholder of SDEL Holdings Limited (the parent company of SDEL) and consequently will have no involvement in SDEL's decision-taking.
 - Mr Nicholas Bryan will no longer be a director of SDEL and will have no role in SDEL's strategy for use of TS sub-contractors or allocation of work to TS sub-contractors.
 - No Innserve employee or director will be able to influence the decisions of SDEL's Contracts Manager.
6. It is proposed that the parties undertake to cap the level of fees paid by SDEL to Innserve for TS work to the same level that Innserve was due to receive for TS work under the current status quo, thereby ensuring that Innserve does not gain any additional TS market share as a result of the merger.
7. The total expenditure placed with Innserve by SDEL will be much lower than the £ [] million originally envisaged under the proposed transaction because the level of fees for TS work will be capped and because SDEL will no longer be paying Innserve charges for the activities which have been transferred to SDEL under the new structure.
8. The parties have agreed that SDEL will adopt [].
9. SDEL and Innserve will undertake to amend the Services Sub-Contract between them so that:
- the profit-sharing arrangement between SDEL and Innserve will be removed;
 - []; and
 - []. Innserve and SDEL will negotiate a protocol which will set out rules for how the repair/replace decision is taken (bearing in mind that Innserve will not now be responsible for carrying out all of SDEL's TS business).

Quality and KPIs

10. The parties do not agree with the Commission's findings that the SDEL brewers' and Coors' service levels are unsatisfactory. The Commission's own Buyer Survey did not indicate any significant differences in levels of satisfaction between different providers of TS. Nor did the evidence already provided to the Commission by the parties. Moreover, the Commission's statement that Innserve's KPI levels will be []% is incorrect. This is the lowest (threshold) level for four-hour call outs. The threshold level for emergency servicing is []%. If the levels achieved fall below these levels, Innserve will suffer financial penalties. [].
11. However, to satisfy any residual concerns that the Commission may have, SDEL will undertake to introduce a financial incentive for Innserve to achieve the target level of KPIs. The bonus will be an amount equal to the level of penalties for failing to achieve the threshold level of KPIs.
12. SDEL will undertake to ensure that the monitoring of Innserve's and its other sub-contractors' performance is adequately funded and to employ personnel to monitor

this performance, who will be independent of the sub-contractors (including Innserve).

13. The SDEL brewers and Coors will undertake to publish the KPI service commitments that are being made by SDEL and the projected time period within which the KPI targets will be delivered.
14. SDEL, the SDEL brewers and Coors will undertake not to change SDEL's current contractual commitment to ensure that the TSE achieves the brand dispense characteristics and that all new TSE is serviceable including meeting the legislative requirements (including industry codes of practice and the FBI). The brand dispense characteristics are the specification supplied by the SDEL brewer to SDEL for the dispense of each brand.

Price

15. [] The parties will undertake not to change these price mechanisms.
16. It is intended that SDEL will only make a nominal profit. SDEL, the SDEL brewers and Coors will undertake to amend the Customer Services Agreements ("CSAs") so that[].

Relationship with Retailers

17. SDEL will undertake to commit to an Asset Access Protocol, including rules allowing TS providers access to SDEL's TSE and governing TS provision and TSE replacement arrangements.
18. As part of that Asset Access Protocol, where a retailer (or a retailer's independent TS providers or a third party leasing company) wishes to buy TSE from SDEL, SDEL will sell that TSE at a value equivalent to the higher of net book value or 20% of original cost. However, SDEL appreciates that in small estates (on the Commission's own definition, fewer than ten outlets), net book value may in certain circumstances not be equivalent to fair market value. Therefore, for small estates, where the retailer requests, SDEL will appoint an adjudicator, on the terms set out in detail below.
19. The SDEL brewers and Coors will undertake to quote to retailers an unbundled price for TS and generic TSE on request.
20. [].

Relationship with sub-contractors

21. SDEL will have no interest in manipulating the sub-contractor market to the detriment of its sub-contractors. On the contrary, SDEL has every interest in encouraging the development of a vibrant sub-contractor market so that it has plenty of available resources. However, to address any residual concerns that the Commission may have, SDEL will undertake to commit to a Code of Conduct in its dealings with third party TS providers to ensure the continuation of a healthy TS sub-contractor market.

Adjudication

22. The parties would welcome and endorse the appointment of an adjudicator in relation to issues which require adjudication, subject to certain conditions as set out in this response.

Duration

23. The parties propose that the package of remedies could be applied for five years, which would allow the nascent TS and TSE markets to develop.

Proportionality of remedies

24. The parties believe that the above set of remedies is proportionate to the SLCs identified by the Commission, in that the remedies are practicable, will not be intrusive or restrictive, will not result in heavy compliance costs and will be effective in resolving the SLCs identified by the Commission.
25. On the other hand, the parties submit that the Commission's proposed remedy, whereby SDEL would undertake not to allocate more than 50% of its TS business to Innserve, would be disproportionate, inter alia because [].
26. Similarly, the Commission's proposed remedy of prohibition would be disproportionate as the parties' proposed package of remedies addresses the Commission's concerns and facilitates the development of the nascent TS and TSE markets which, if the transaction were to be prohibited, would not be so facilitated.

Customer benefits

27. The customer benefits which result from the proposed transaction will not be significantly reduced as a result of compliance with the remedies.
28. On the contrary, many of the proposed remedies will lead to greater customer benefits, including:
- clarifying the terms of access by third party TS providers to SDEL's assets;
 - empowering the retailer to take the repair/replace decision so as to obtain the best deal for the assets in its outlets;
 - incentivising Innserve to achieve levels higher than the KPIs, so that retailers may obtain even better quality TS as a result; and
 - providing a mechanism for determining the sale price of TSE facilitating their acquisition by retailers and other third parties.

Conclusion

29. Accordingly, the parties believe that the proposed set of structural and behavioural remedies will fully meet the concerns expressed in the Commission's Provisional Findings Report and will facilitate the development of the nascent TS and TSE markets when compared with the current situation or the counterfactual identified by the Commission.

**Proposed Acquisition by Serviced Dispense Equipment Limited
of the Technical Services Function of Coors Brewers Limited**

Reference to the Competition Commission

**Main Parties' response to the Competition Commission's Provisional Findings Report
and Notice of Possible Remedies**

1. INTRODUCTION

- 1.1 This response reflects the views of SDEL, Scotco, Carlsberg UK, Coors and Innserve (together "the parties").
- 1.2 The parties do not believe that the transaction would lead to any SLC in any market. On the contrary, the parties believe that the transaction, operated as the parties propose, would tend to facilitate the development of nascent markets for TS and TSE.
- 1.3 But on the basis of the Commission's Provisional Findings Report the parties set out below a package of remedies which responds to the SLCs identified by the Commission in the Provisional Findings Report and which further facilitates the development of the nascent TS and TSE markets.
- 1.4 Annex 1 sets out the parties' response to the issues raised in the Provisional Findings Report on a paragraph by paragraph basis.
- 1.5 In Annex 2 the parties explain why the package of remedies below is proportionate, and why the remedy postulated by the Commission, under which SDEL would be allowed to sub-contract only 50% of its TS business to Innserve, and the alternative remedy of outright prohibition are disproportionate.
- 1.6 The Commission has further asked for the parties' representations on the customer benefits to be derived from the transaction. These are set out in Annex 3.
- 1.7 Annex 4 contains a diagram illustrating the proposed restructuring of SDEL.

2. PROPOSED UNDERTAKINGS

2.1 The Market Power Of Innserve

Commission's suggested undertaking

'a requirement that SDEL place no more than, say, 50 per cent of its TS business with Innserve, coupled with a requirement not to place more than 20 per cent of its business with any other TS provider'.

Parties' comments

- 2.1.1 The Commission expresses on a number of occasions the concerns that the proposed transaction will reduce the scope for entry into TS. These concerns relate inter alia to the scale of a new entrant and to the availability of an entry platform.
- 2.1.2 The Commission has stated there is a loss of a platform for entry, but it is unclear what they mean by that. It could be that the Commission has in mind a new entrant which could grow to sufficient scale by purchasing the TS business of Coors. This, however, is ruled out in the counterfactual. The parties understand that the Commission has in mind the possibility of Coors subcontracting large amounts of the TS that it is committed to provide as part of a bundled service.
- 2.1.3 However, the undertaking on the part of SDEL to outsource a proportion of its TS work, of the size of Coors's TS business, should deal fully with this issue i.e. SDEL would, post transaction, provide a platform similar in size and nature to that presently provided by Coors.
- 2.1.4 The parties submit that, at the present time, options for entry do exist and, as explained in the parties' response, will be increased by the proposed undertakings which the parties have proposed. Contrary to the Commission's comments in paragraph 5.54 of its Provisional Findings Report, it is not correct that pubcos do not have sufficient scale or infrastructure to provide a valid platform for entry. For example the large pubcos own more outlets than the regional brewers, which have their own TS operations. In addition, some pubcos have a call centre.
- 2.1.5 Furthermore, the parties do not agree with the comments in paragraph 5.54 that a successful business could not be created by providing TS to a network of independent retailers, to regional brewers or to pubcos, as they believe that these do provide a sufficiently large entry platform to gain the synergies required. There is already evidence in the market to support this. For example, each of the regional brewers generally provides TS and generic TSE to the on-trade outlets which it owns or for which it is the main beer supplier. [].
- 2.1.6 The Commission also suggests that Innserve will have a significant market share of 50% or more of the supply of TS in Great Britain. The Commission suggests that market power could be exercised against TS sub-contractors. In particular, the Commission expresses a concern that Innserve will have buyer power in the TS market, allowing it to hinder the development of any alternative TS provider and impose unfair terms on its sub-contractors.

2.1.7 The parties note the Commission's suggestion that Innserve be limited to a maximum of 50% of SDEL's total requirements. []. On the basis of the Commission's decision in *Knauf Insulation Limited and Superglass Insulation Limited (November 2004)*, as set out in Annex 2, such a requirement would be disproportionate, [].

Parties' suggested undertaking

2.1.8 SDEL proposes a significant restructuring remedy, whereby SDEL will retain responsibility for the management and allocation of the sub-contracting of its TS work. To enable this, SDEL will become a more substantial business, with appropriate resources, carrying out the following key functions:

2.1.8.1 supply chain, including stores and distribution;

2.1.8.2 negotiation of contracts with sub-contractors and high level allocation of work between TS sub-contractors;

2.1.8.3 day to day allocation of work to TS sub-contractors;

2.1.8.4 procurement;

2.1.8.5 asset control;

2.1.8.6 generic TSE development and innovation;

2.1.8.7 finance and administration;

2.1.8.8 systems;

2.1.8.9 billing to brewer customers;

2.1.8.10 customer service; and

2.1.8.11 contract management (e.g. managing performance of TS sub-contractors and ensuring compliance by SDEL with the Code of Conduct for sub-contractors).

2.1.9 SDEL will have a full time Managing Director, who will report to the SDEL Board.

2.1.10 SDEL will employ around 150 employees. These will comprise []. SDEL will have a projected annual internal cost base of around £[] million.

2.1.11 The SDEL Board will determine sub-contracting strategy. SDEL will employ a full time Contracts Manager who will be responsible for allocating, negotiating and managing contracts with sub-contractors. The Contracts Manager will report to the Managing Director.

2.1.12 The Contracts Manager will be assisted by SDEL employees who will allocate work to TS sub-contractors and monitor its quality.

2.1.13 A diagram showing the administrative structure of SDEL and Innserve under the revised proposals appears in Annex Four.

- 2.1.14 SDEL will become fully independent from Innserve. Innserve and its management will have no involvement in SDEL:
- 2.1.14.1 Neither Mordaunt & Foster Limited nor Hallriver Limited will remain a shareholder of SDE Holdings Limited (the parent company of SDEL) and consequently will have no veto over SDEL's decision-taking.
 - 2.1.14.2 Mr Nicholas Bryan will no longer be a director of SDEL and will have no role in SDEL's strategy for use of TS sub-contractors or allocation of work to TS sub-contractors.
 - 2.1.14.3 No Innserve employee or director will be able to influence the decisions of SDEL's Contracts Manager.
- 2.1.15 It is proposed that the parties undertake to cap the level of fees paid by SDEL to Innserve for TS work to the same level that Innserve was due to receive for TS work under the current status quo, thereby ensuring that Innserve does not gain any additional TS market share as a result of the merger.
- 2.1.16 The total expenditure placed with Innserve by SDEL will be much lower than the £[] million originally envisaged under the proposed transaction because the level of fees for TS work will be capped and because SDEL will no longer be paying Innserve charges for the activities which have been transferred to SDEL under the new structure.
- 2.1.17 The parties have agreed that SDEL will adopt [].
- 2.1.18 SDEL and Innserve will undertake to amend the Services Sub-Contract between them so that:
- 2.1.18.1 the profit-sharing arrangement between SDEL and Innserve will be removed;
 - 2.1.18.2 []; and
 - 2.1.18.3 []. Innserve and SDEL will negotiate a protocol which will set out rules for how the repair/replace decision is taken (bearing in mind that Innserve will not now be responsible for carrying out all of SDEL's TS business).
- 2.1.19 For the whole of the balance of SDEL's TS sub-contracting not allocated to Innserve, SDEL would directly, through its own independent staff as described above, let sub-contracts to independent sub-contractors. Innserve would have no influence over this activity.
- 2.1.20 The Commission's proposal that not more than 20% of SDEL's TS business should be placed with any one TS provider (other than Innserve) would be accepted by SDEL if the Commission ultimately decides that this is an appropriate remedy. However, the parties note that this may restrict at least in the short term the creation of a TS provider similar in size to Innserve.
- 2.1.21 []

Effect of undertaking

NON-CONFIDENTIAL VERSION

- 2.1.22 In its Provisional Findings Report, the Commission stated that the proposed transaction will remove Coors as a potential platform for entry into TS.
- 2.1.23 The proposed undertaking on the part of SDEL to allocate the balance of its TS business to sub-contractors other than Innserve deals fully with this issue. Given that the amount to be allocated to Innserve will not increase under the proposed transaction (as modified), the amount to be allocated to other sub-contractors will be in line with the size of Coors' TS business. Therefore SDEL would, post transaction, provide a platform for other TS providers identical in size to that currently provided by Coors.
- 2.1.24 As a result of the restructuring, Innserve will not have any buyer power in the market for TS sub-contracting. SDEL, which will assume a sub-contracting role, will have no incentive to manipulate its relations with sub-contractors. However, to satisfy any residual concerns of the Commission, SDEL will undertake to be bound by the proposed Code of Conduct regulating its interactions with TS sub-contractors (see further below).
- 2.1.25 The proposed arrangement will ensure that Innserve would not be in a position substantially to impede the growth of independent sub-contractors and that the majority of the market remained available for new entrants or existing TS providers.

2.2 Code of conduct for fair treatment of sub-contractors

Commission's suggested undertaking

'A code of conduct for SDEL in its dealings with third party TS providers to ensure the continuation of a healthy TS sub-contractor market'.

Parties' comments

2.2.1 Under the proposals set out above, SDEL will be responsible for sub-contracted work. Whilst SDEL will be keen to secure the best available prices for sub-contract work, it will have no incentive to damage the sub-contracting base, and will want to ensure that sub-contractors can operate on a sufficient scale to provide the services that SDEL will require. Innserve itself will no longer be responsible for sufficient sub-contracted work to be able to influence the development of sub-contractors. The parties submit, therefore, that there is no need for any Code of Conduct to protect sub-contractors.

Parties' suggested undertaking

2.2.2 However, to satisfy any residual concerns of the Commission, SDEL would subscribe to a Code of Conduct with the objective of maintaining a healthy TS sub-contractor market covering:

2.2.2.1 the requirement that SDEL does not impose any restriction on its sub-contractors working freely for any other customer;

2.2.2.2 the requirement that SDEL does not impede or penalise a sub-contractor who contracts directly with a retailer or bids to do so;

2.2.3 The parties do not rule out the possibility of some form of adjudication in cases where sub-contractors believe that the code of conduct has not been adhered to. They submit, however, that this would not be necessary, given the fact that SDEL has no conceivable incentive to restrict the development of sub-contractors.

Effect of undertaking

2.2.4 The undertaking would be added protection for the continuation of a healthy TS sub-contractor market. This is also ensured by the proposed restriction on the extent of sub-contracting by SDEL to Innserve and by SDEL's proposed Asset Access Protocol.

2.2.5 The parties submit that the proposed undertakings remove any concerns that Innserve would be in a position to exercise any market power to the detriment of sub-contractors.

2.3 Access to TSE

Commission's suggested undertaking

'A detailed set of rules that would allow third party TS providers access to SDEL's TSE and govern TS provision and TSE replacement arrangements:'

Parties' comments

2.3.1 The Commission rightly identifies access to TSE as a necessary aspect of the provision of TS by a party that does not own the TSE.

2.3.2 The Provisional Findings Report dwells on the City/Punch example as demonstrating that access to assets may be problematic for third party TS providers. This fails to take account of other examples presented to the Commission by the parties of situations which have worked (or are working) satisfactorily, for example the City/Spirit contract and the Coors/InnSpired contract.

Parties' suggested undertaking

2.3.3 The parties have already proposed that SDEL will undertake to be bound by an Asset Access Protocol, whereby the sub-contractors appointed by the retailers would be allowed access to SDEL's TSE assets. A detailed set of rules is now being drawn up.

2.3.4 The Asset Access Protocol will now envisage that:

2.3.4.1 SDEL will own the TSE.

2.3.4.2 SDEL will employ the staff directly who will operate its warehouses and supply chain.

2.3.4.3 Where SDEL owns the TSE but does not provide the TS, a retailer who has appointed a third party TS provider will be put in a position where he is able to decide whether to repair or replace the assets in his outlet, to avoid a conflict between SDEL and the TS provider. To facilitate this, the retailer will be able to call off TSE from SDEL's warehouses up to 10% per annum of the gross book value of the generic equipment owned by SDEL in the relevant outlets.

Effect of undertaking

2.3.5 This will ensure that the "repair/renewal" decision will rest with the retailer.

2.3.6 This Asset Access Protocol represents a significant liberalisation of the current situation, in that the basis on which independent TS sub-contractors can access SDEL's assets is clear and binding on SDEL. This is a significant improvement on the current position as the Protocol will avoid the need for negotiation of specific terms of access by the third party provider with each of the SDEL brewers and Coors.

2.4 Sale of equipment to retailers or independent TS providers or third party leasing companies

Commission's suggested undertaking

'A set of rules that would allow the sale of SDEL's TSE at a 'fair market value' (with regard to the age and condition of the TSE) to the retailers, the retailer's independent TSE /TS providers or to other third parties.'

Parties' comments

2.4.1 Although the parties' proposed Asset Access Protocol means that a TS provider no longer needs to purchase TSE in order to be able to carry out its TS activities, the parties recognise that certain entities may wish to purchase TSE in any event.

2.4.2 The Commission appears to be sceptical of using SDEL's proposed formula of selling generic TSE at the higher of its net book value ("NBV") or 20% of its original capital value. Under SDEL's accounting policy, NBV is calculated as []. We make the following comments:

2.4.2.1 First, SDEL has adopted the most conservative asset valuation policy of the three brewers:

(i) [];

(ii) [];

(iii) Coors' previous accounting policy of [] depreciation is broadly equivalent to the SDEL accounting policy of [].

2.4.2.2 Second, in most estates the law of large numbers will ensure that the actual asset valuation will tend towards the asset value given by the average net book value. While some outlets are likely to have well maintained equipment, some outlets are likely to have equipment that has been less well maintained. This will balance out in an estate with a sufficient number of outlets, and the actual variation is very unlikely to diverge from the asset valuation given by NBV.

2.4.2.3 Third, the cost of moving away from a formula relating to average net book value to a valuation of individual assets by inspection would be large and would constitute a large and disproportionate expense across the market as a whole.

2.4.2.4 Fourth, there is no reason to believe that certain types or groups of outlets are likely to have worse maintained equipment than others, such that average NBV would overestimate the value of the assets in those outlets. For example, there is no significant difference between the condition of equipment in tenanted and managed estates.

2.4.2.5 Fifth, retailers employing third party TS providers would be free to continue to use the SDEL assets and, under the terms of the Asset Access Protocol (using the 10% gross book value replacement

allowance) replace defective or poor quality TSE with new equipment.

2.4.2.6 Finally, the retailer would retain the option of changing principal supplier to another member of the FBI and negotiating a price for the TSE with this brewer.

2.4.3 For the reasons set out in the second bullet above, adjudication should be unnecessary where the TSE in a sufficient number of outlets is being sold. In most portfolios of assets it would be unlikely that the condition of the assets would not reflect the average of SDEL's portfolio, i.e. SDEL's proposed formula should represent an accurate valuation of the assets. Adjudication of the value of TSE in a substantial number of on-trade outlets would be impractical and could lead to cherry picking in that retailers could seek adjudication where market value is less than NBV but not where it exceeds it.

Parties' suggested undertaking

2.4.4 The parties therefore propose to undertake to adhere to appropriate rules on the acquisition by retailers, retailers' independent TS providers and third party leasing companies of TSE owned by SDEL. These rules would be based on the proposals already made by the parties.

2.4.5 The parties are willing to accept individual valuations of assets and pay for an adjudicator for those small retail estates where there is a dispute over value, as it is recognised that the averaging effect across outlets may not hold in small estates. Adopting the Commission's definition of small retail estates being those with less than ten outlets, where a price cannot be agreed with SDEL (or, if the sale is in connection with a beer supply contract, the brewer), the retailer could, if he so requests, have access to an independent adjudicator, whose remuneration would be paid by SDEL. To avoid a situation where purchasers always elected for independent valuation to attempt to secure a lower price with no disadvantages attached, or simply to use the threatened cost of a valuation as a means of trying to secure a lower price, the adjudication should be subject to three conditions:

2.4.5.1 The number of requests for adjudication of a particular set of assets that a retailer would be entitled to make in any one year would be limited to two;

2.4.5.2 The request for adjudication should be subject to a "reasonableness" test (in the administrative law sense), so that if, in the opinion of the adjudicator, a request has been made unreasonably, the party which made the request will bear the full costs of having made it;

2.4.5.3 In any event, all costs other than the adjudicator's remuneration will be borne by the party against whom the adjudicator makes a finding.

Effect of suggested undertaking

- 2.4.6 The parties note that given the switching costs identified by the Commission, the Commission's view is that the TSE market could not develop in current circumstances. These purchase rules therefore represent a significant liberalising advance on the current situation.

2.5 Lack Of Price Transparency

Commission's suggested undertaking

"A set of rules regarding the transparency of the cost for TS and TSE to retailers"

Parties' Comments

- 2.5.1 The Commission notes a potential difficulty in relation to the quotation of unbundled pricing. Paragraph 5.55 of its Provisional Findings Report suggests that the Commission's concern focuses on new entrants.
- 2.5.2 This issue arises from the fact that under their contracts with SDEL, brewers will save £[] per annum indexed for every line in which they do not provide TS. £[] per annum was an estimation of the avoidable costs of a typical line as serviced by Innserve. The Commission expresses its view that £[] translated into a discount per barrel might not produce sufficient savings for a retailer to be in a position to fund the services of a new third party TS provider entering the market.
- 2.5.3 It is intended that SDEL will only make a nominal profit. The Customer Services Agreements will be amended so that[]. In view of the fact that SDEL will be subcontracting a substantial amount of work to contractors other than Innserve, SDEL's avoided costs where TS is not provided may be greater than £[]. The discount itself is a matter for each brewer individually to decide.

Parties' suggested undertaking

- 2.5.4 The SDEL brewers and Coors will undertake to quote to retailers an unbundled price for TS and generic TSE on request.

Effect of undertaking

- 2.5.5 The parties submit that this undertaking would represent a significant step towards the development of the new markets when compared with the current situation or the counterfactual identified by the Commission.
- 2.5.6 Furthermore, the undertaking regarding the division of subcontracting work will ensure that there is a base of TS subcontractors achieving economies of scale and density in line with those of Innserve.

2.6 Price and quality of TS and TSE

Commission's suggested undertaking

"Commitments from the parties to the merger on the price and quality of its TS and TSE"

Parties' comments: price

2.6.1 [].

2.6.2 Furthermore, the new structure will improve the ability of SDEL to employ benchmarking techniques, further ensuring that Innserve remains competitive with other TS providers. SDEL's ability to employ benchmarking techniques will be improved because the proposed undertakings on allocation of work to TS providers other than Innserve, the Asset Access Protocol, and the Code of Conduct for sub-contractors, will ensure that there is a vibrant sub-contractor market. This will mean that there are more independent TS providers against whom SDEL can benchmark Innserve.

2.6.3 Additionally, the restructuring of SDEL will include the employment by SDEL of personnel to monitor the performance of Innserve as compared with other TS providers in the market.

2.6.4 On TSE, since SDEL will not make more than a nominal profit, there can be no concerns that SDEL will have an incentive to increase prices. Therefore the only potential concern is that prices will increase due to a failure by SDEL to control costs. However, a mechanism will be put in place whereby SDEL will approve capital expenditure by Innserve, subject to agreed criteria. []. Therefore there is no reason to expect that TSE expenditure will rise and feed through into higher beer prices.

Parties' proposed undertaking on price

2.6.5 The parties are willing to give an undertaking not to change the price provisions of the SDEL/Innserve contract.

2.6.6 As it is intended that SDEL will only make a nominal profit, the Customer Services Agreements ("CSAs") will be amended so that, [].

Parties' comments: quality of TS

2.6.7 The parties do not agree with the Commission's findings that the SDEL brewers' and Coors' service levels are unsatisfactory. The Commission's own Buyer Survey did not indicate any significant differences in levels of satisfaction between different providers of TS. Nor did the evidence already provided to the Commission by the parties. Moreover, the Commission's statement that Innserve's KPI levels will be []% is incorrect. This is the lowest (threshold) level for four-hour call outs. The threshold level for emergency servicing is []%. If the levels achieved fall below these levels, Innserve will suffer financial penalties. [].

2.6.8 The Commission has misunderstood the effect that a reduction in the quality of TS will have, and therefore the importance to the SDEL brewers and to Coors of maintaining high levels of TS quality. The Commission has stated that low

quality TS will lead customers to change outlet rather than to change beer brand. In paragraph 5.85 of its Provisional Findings Report, the Commission stated that "We believed that, despite the parties' argument that quality was fundamental to ensuring brand success, it was more likely that the first reaction of consumers would be to switch outlet rather than to switch brand in response to a poor quality product delivered through poorly serviced TSE."

- 2.6.9 However, if this were the case, retailers would show a much greater degree of interest in the levels of TS they are receiving (and may well also show more interest in purchasing the TSE in their outlets). The fact that retailers are prepared to leave TS in the hands of third parties (whether brewers or independent TS providers) indicates that this is not the case.
- 2.6.10 In fact, the retailer does not suffer to the same extent as brewers if the levels of TS drop. If a fault develops on a line, this usually results in non-dispense of the beer, rather than a poor quality pint of beer. In this case, a low standard of TS would imply an extended period between the publican reporting the fault and the technician fixing the problem. During this period, the brand concerned will not be available in the outlet. Therefore that brand will lose sales to another brand in the same outlet as customers will almost always select an alternative brand (rather than switching to another outlet for the same brand). The retailer will not be affected, as he will still be selling beer. However, the brand owner will lose out, as its brand will not be being sold. In the event that more than one line or the remote cooler is affected, so that more than one brand is unavailable, the call is treated as an emergency, and therefore no one brand will lose out. However, the evidence shows that the overwhelming majority of TS calls are for (non-emergency) repair of single lines.
- 2.6.11 Under the parties' new proposals, SDEL will have its own resource to monitor the performance of its sub-contractors (including Innserve) and will maintain and operate its own sub-contract letting function. If services are provided better and more cheaply by other contractors, the benchmarking provisions of Innserve's own contract will be brought into play. SDEL's ability to employ benchmarking techniques will be improved for the reasons given above. This will mean that there are more TS providers for SDEL to benchmark Innserve against and will provide a further incentive for Innserve to provide high quality TS.
- 2.6.12 The Commission states that it is not persuaded that the contractual provisions, allowing SDEL to terminate the contract for Innserve's failure to meet the KPIs is realistic, given the ten year term of the contract. The Commission also states that it does not believe that SDEL's right to change the management of Innserve is an effective sanction, and might terminate the contract. The Commission has not properly understood the relevant provisions. SDEL would not tie itself in to a ten year agreement with Innserve if there were no effective exit route in the event of inadequate performance by Innserve. SDEL has the right to terminate the Services Sub-Contract and purchase the issued share capital of Innserve (i.e. purchase Innserve as a going concern and replace the management) if Innserve fails to meet any of the KPIs for three consecutive contract quarters (this may be a different KPI failure in each quarter). Therefore replacement of the management is a result of termination, not a cause of termination. In any event, this is a most effective sanction for failing to meet the KPIs. Moreover, the fact that, if SDEL exercises its option to terminate the Services Sub-Contract and purchase Innserve's share capital, it acquires the business as a going concern,

means that SDEL will have no disincentive to apply this sanction. The business will be fully operational.

2.6.13 Appropriate benchmarking will also apply. SDEL will discuss appropriate action if Innserve fails to achieve the same level of performance as other contractors.

2.6.14 Nonetheless, the parties recognise that it would be possible to include contractual provisions incentivising Innserve to meet higher quality standards.

Parties' suggested undertaking on quality of TS

2.6.15 To satisfy any residual concerns that the Commission may have, SDEL will undertake to introduce a financial incentive for Innserve to achieve the target level of KPIs on a sustainable basis. The bonus will be an amount equal to the level of penalties for failing to achieve the threshold level of KPIs.

2.6.16 The SDEL brewers and Coors will undertake to publish the KPI service commitments that are being made by SDEL and the projected time period within which the KPI targets will be delivered.

2.6.17 SDEL will undertake to ensure that the monitoring of Innserve's and its other sub-contractors' performance is adequately funded and to employ personnel to monitor this performance, who will be independent of the sub-contractors (including Innserve).

Parties' comments on quality of TSE

2.6.18 As the parties have consistently stated, the fact that SDEL can envisage owning the assets for a longer period will encourage SDEL to invest in higher quality TSE.

2.6.19 The KPIs on installation times are driven by the fact that manufacturers of non-standard TSE take longer to deliver the goods, compared with standard TSE. For example, non-standard TSE which many brewers purchase from Italy has a current lead time on delivery of 3-4 weeks. Once the equipment has arrived in SDEL's depot, the time to install the equipment is the same. These installation times are the same as exist already in the market. Therefore the proposed merger has no effect on this issue. Retailers and brewers currently order this equipment even though it has a longer lead time. There is no reason to believe they would change their policy following the merger.

2.6.20 Any retailer will in any event be free to purchase and upgrade generic TSE under the TSE purchasing provisions of the Asset Access Protocol.

Parties' suggested undertaking on quality of TSE

2.6.21 SDEL, the SDEL brewers and Coors will undertake not to change SDEL's current contractual commitments to ensure that the TSE achieves the brand dispense characteristics and that all new TSE is serviceable including meeting the legislative requirements (including industry codes of practice and the FBI). This will ensure that SDEL does not purchase lower quality equipment. The brand

dispense characteristics are the specification supplied by the SDEL brewer to SDEL for the dispense of each brand.

TSE Buyer Power

2.6.22 The Commission expresses a concern that SDEL will have a strong negotiating position with manufacturers of generic TSE.

2.6.23 The Commission's concerns are misguided because it has adopted the wrong geographic market definition. The Commission has adopted Great Britain as the relevant geographic market. However, evidence from the parties' purchases of generic TSE strongly supports the view that the market is at least Europe-wide:

2.6.23.1 [].

2.6.23.2

(a) []

2.6.24 Therefore the parties repeat their earlier submissions that the market for TSE purchasing is at least Europe-wide. On this market, SDEL will have an []% share of purchasing. Accordingly, the parties do not agree with the Commission's finding that the proposed transaction is likely to lead to an increase in the TSE buyer power of SDEL.

2.7 Adjudication

Commission's suggested undertaking

'The appointment of an adjudicator, who would make final decisions on any disputes in relation to all of the above, paid for by the parties.'

Parties' comments

2.7.1 The parties would welcome and endorse the appointment of an adjudicator in relation to issues which require adjudication.

2.7.2 The parties submit that an adjudicator would only be required to settle disputes on three issues:

2.7.2.1 The value of TSE which a third party wished to purchase in estates of fewer than ten outlets, where the retailer requests adjudication;

2.7.2.2 Whether SDEL is adhering to the Code of Conduct for sub-contractors;

2.7.2.3 Whether SDEL is adhering to the Asset Access Protocol.

Parties' suggested undertaking

2.7.3 To avoid frivolous and vexatious claims, the adjudication should be subject to two conditions:

2.7.3.1 The request for adjudication should be subject to a "reasonableness" test (in the administrative law sense), so that if, in the opinion of the adjudicator, a request has been made unreasonably, the party which made the request will bear the full costs of having made it;

2.7.3.2 In any event, all costs other than the adjudicator's remuneration will be borne by the party against whom the adjudicator makes a finding.

2.7.4 In addition, where the adjudication relates to the valuation of TSE assets to be purchased, the number of requests for adjudication of a particular set of assets that a party would be entitled to make in any one year would be limited to two.

3. CONCLUSIONS

3.1 The parties believe that the set of remedies proposed above addresses the SLCs identified by the Commission.

3.2 As set out in Annex 2, the parties believe that this set of remedies is proportionate to the SLCs as identified by the Commission, in that is the remedies are practicable, will not be intrusive or restrictive, will not result in heavy compliance costs and will be effective in resolving the SLCs.

3.3 Furthermore, the customer benefits which result from the transaction will not be significantly reduced as a result of compliance with the remedies. Indeed, many of the proposed remedies lead to greater customer benefits, as identified in Annex 3 below. Following the transaction the nascent markets for TS and TSE should be more competitive than in either the current situation or the counterfactual identified by the Commission. Entry would be facilitated because new entrants would benefit from:

- the Asset Access Protocol;
- the Code of Conduct for sub-contractors; and
- the opportunity to tender for the balance of SDEL's TS business not allocated to Innserve.

3.4 Accordingly, the parties believe that the proposed set of structural and behavioural remedies will fully meet the concerns expressed in the Commission's Provisional Findings Report and will facilitate the development of the nascent TS and TSE markets when compared with the current situation or the counterfactual identified by the Commission.

SERVICED DISPENSE EQUIPMENT LIMITED

COORS BREWERS LIMITED

19 JANUARY 2005