

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

ANNEX ONE
PARTIES' COMMENTS ON THE PROVISIONAL
FINDINGS REPORT

19 JANUARY 2005

**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**

**ANNEX ONE
PARTIES' COMMENTS ON THE PROVISIONAL FINDINGS REPORT**

In this Annex, the parties set out their comments on the Commission's Provisional Findings Report and explain how the concerns expressed by the Commission have been addressed in the main body of this document.

TS MARKET

The Commission's views regarding the TS market are summarised in paragraph 6.2 of the Provisional Findings:

"We provisionally concluded that the increment in market power resulting from the proposed merger was significant enough to constitute an SLC in the TS market for the reasons set out in paragraphs 5.73 to 5.80. We expected that the increased market share of SDEL/Innserve would lead to a reduced platform for entry, resulting in a reduction in the level of competition compared to the counterfactual, with likely adverse effects on service quality and/or price of TS provision."

Each of these three concerns, reduced scope for entry, adverse effects on price and adverse effects on quality, is considered below.

1. BARRIERS TO ENTRY IN TS

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 to:

- (a) The scale of a new entrant;
- (b) Buyer power in TS;
- (c) Bundled pricing;
- (d) Interdependency of TSE and TS;
- (e) Switching costs;
- (f) Valuation of TSE; and
- (g) Customer inertia.

1.1 Scale of a new entrant

1.1.1 The Commission argues at a number of points that in order to compete effectively with Innserve, a TS provider would have to have a substantial platform for entry with sufficient scale to achieve similar economies of density. For example:

5.53 *"We were told by two potential entrants of the importance of having a substantial platform for entry. Both said that it would be important to have a sufficient volume and density of outlets. One said that it needed at least two national brewers' businesses. The other said that one brewer's business might be sufficient provided there were sufficient headroom for growth."*

5.54 *"The parties told us that pubcos provide a better entry platform, and SDEL suggested that it might be possible to enter through at least two large pubcos.¹ However, we did not agree that pubcos provided a better platform for entry, due to insufficient scale, lack of ownership of TSE assets, and the lack of infrastructure (including ready access to staff and skills,² as well as the physical infrastructure such as a call centre). In terms of scale, for example, Coors told us that it was principal supplier in around 17,000 outlets and provided TS to more than 40,000 outlets in total. The two largest pubcos between them own around 15,000 outlets, but the next largest pubco had fewer than 3,000 outlets. In addition, a managed pubco might provide a better entry platform than a tenanted pubco, due to the greater centralization of decision making, but there were only two large managed pubcos, with fewer than 5,000 outlets between them. Third parties told us that a successful business could not be created by providing TS to a network of independent retailers, to regional brewers, or to pubcos. These options would fail to provide a sufficiently large platform to gain the synergies required. Moreover, as we noted earlier, there would be likely to be ongoing tensions with the owners of the TSE assets if the TS provider did not own them."*

5.78 *"We also considered whether a new entrant was likely to provide retailers with alternatives in terms of TS provision. Given the nascent nature of the market, we considered this to be critical to our assessment of the effects of the proposed merger. As discussed in paragraphs 5.53 and 5.54, it was clear to us from the evidence that we received from potential entrants that the options for entry would be significantly reduced or removed as a result of the proposed merger. We believe that this would be likely to be true for other potential new entrants."*

6.2 *"We also considered whether a new entrant was likely to provide retailers with alternatives in TS provision. It was clear to us from the evidence we received from potential entrants that the options for entry would be significantly reduced or removed as a result of the proposed merger. They believed that the merged entity's market share would be so large as to make it impossible to enter the TS business on a sufficient scale. We believed that this was likely to be true for other potential new entrants."*

- 1.1.2 The Commission finds that the proposed transaction will remove Coors as a potential platform for entry into TS, and that retailers are not a realistic alternative entry platform.
- 1.1.3 The proposed remedy set out in the parties' response, whereby SDEL would undertake to allocate not more than a specified amount by value of its TS business to Innserve, would result in SDEL allocating an amount of work broadly equivalent to the size of Coors' TS business to third party TS providers, thereby addressing this concern.

¹ We heard conflicting evidence about the number of large pubcos that would provide a reasonable entry platform. One of the national brewers told us that this might be as many as four; another revised its estimate from two down to one.

² The entry models adopted by Innserve, [] all assumed that the brewers' TS workforce would be transferred to the new TS provider under TUPE.

1.2 Buyer power in TS

- 1.2.1 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 subcontractors:

5.75 "However, we considered that following the proposed merger SDEL/Innservice would have the ability and incentive to organise its third party TS sub-contracting strategically to ensure that no sub-contractor developed a sufficiently strong presence to become a national competitor. SDEL/Innservice's ability and incentive to do this would be strengthened by the proposed merger."

5.76 "SDEL/Innservice's increased market power as a result of the proposed merger would give Innservice a strong negotiating position with third party subcontractors and it appears to us that a tightening in subcontractor rates is one logical way of achieving cost reduction targets. Innservice could demand substantially improved terms from the subcontractors, which would be highly dependent on Innservice for business. Given the lack of alternative buyers for their TS services, the subcontractors might well have no alternative but to accept reduced terms. This would put pressure on the margins of the subcontractors, reducing the possibility of any such third parties having the necessary funds and levels of profitability to grow to compete on a national scale. Although they might have the opportunity to switch some of their business away from the provision of TS on beer dispense equipment, we received no evidence which allowed us to assume that the subcontractors could successfully diversify, nor that this would be cost free. Innservice would also have the ability and incentive to restrict the level of business with any sub-contractors who chose to compete head to head as principal suppliers. "

- 1.2.2 These concerns are addressed by three of the proposed undertakings set out in the parties' response:

1.2.2.1 SDEL will be responsible for handing out to subcontractors a proportion of the TS work equivalent to the value of Coors's TS business. This will mean that there is no increase in the TS buyer power of Innservice.

1.2.2.2 The allocation of subcontracting work by SDEL will be done by a Contracts Manager who reports to a Managing Director who will report directly to the board of SDEL.

1.2.2.3 SDEL will adhere to a Code of Conduct regulating its interactions with TS sub-contractors.

1.3 Bundled pricing

- 1.3.1 The Commission expresses three concerns in relation to bundled pricing as a barrier to entry into TS. The first relates to whether the SDEL brewers and Coors will give discounts if retailers begin using third party providers of TS:

5.79 "The retailers told us that they had to have a credible alternative to put pressure on the national brewers to offer unbundled prices."

- 1.3.2 This concern is addressed by the parties' undertaking to provide an unbundled price on request.

- 1.3.3 The second concern relates to the amount of discount the parties will offer retailers. The Commission is concerned that the £[] per line, if passed directly through as a discount, would be insufficient to cover the costs of an alternative TS provider:

5.20 *“In addition, bundled pricing makes it difficult for the retailer to know the element of the price associated with TSE and TS provision. Further, given the bundled pricing, brewers have a flexibility in price negotiations to price strategically that is not available to a third party provider of TSE or TS.”*

5.22 *“Price unbundling would be critical to the likely success of any alternative arrangements that the retailers may wish to make for the separate provision of TSE or TS. Such arrangements would depend in part on the ability of the retailer to obtain an appropriate discount off the price of a barrel of beer from the brewers that was at least sufficient to meet the cost of an alternative TSE or TS provider. When unbundled pricing has been agreed in the past, discounts reflecting the fact that TS was no longer being provided varied from [...] to [...] per barrel. It is not clear whether the agreed discounts reflect the marginal or average cost to the brewer of not providing TS for a particular outlet, nor how they are related to the amounts shown in paragraph 5.21 [the discounts per barrel]. One of the national brewers provided us with estimates of [...] as a marginal cost and [...] as an average cost for the provision of TS servicing. In addition, the SDEL brewers/Coors provided us with calculations of their avoidable TS costs per barrel, which were again somewhat lower than the total cost figures shown in paragraph 5.21.”*

5.55 *“...Bundled pricing is an issue because of the difficulty of establishing a benchmark against which to compare an entrant's bid, and the need to negotiate an appropriate discount off the beer price. With the creation of SDEL, the densities of TS provision have been improved, leading to cost savings. Assuming that the cost reduction from the brewer would be likely to be based on the marginal cost saving to the brewer of no longer providing the TS, the improved densities that have been achieved as a result of the creation of SDEL would be likely to reduce the potential discount and make it difficult for a new entrant (which would have to cover its average costs) to offer a competitive service unless it were of comparable size to SDEL (see paragraph 5.22).*

1.3.4 The parties submit that this concern is no longer valid for the reasons set out in section 2.5 of the parties' response.

1.3.5 The Commission's third concern relating to bundled pricing is that brewers may not pass on all of the £[] in order to protect the position of Innserve:

5.81 *“The SDEL brewers already have the incentive and ability strategically to foreclose their portion of the TS market to new entrants, and this would be strengthened by the proposed merger. The parties told us that they would have improved knowledge of the costs associated with TS provision as a result of the creation of SDEL/Innservice, which would make it easier to assess the gains or losses from unbundling prices. We agreed. However, given the lack of credible alternatives for TS provision to retailers, we believed that the proposed merger would reduce the prospects of discounts being offered at a level which would allow viable competing bids for independent TS provision.”*

1.3.6 In light of the parties' proposed undertaking to allocate a significant share of SDEL's TS work to providers other than Innservice, this concern is no longer valid. Neither the brewers nor SDEL have any incentive to protect Innservice. SDEL will have no interest in manipulating the sub-contractor market to the detriment of its other (non-Innservice) 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. The brewers' aim is to have TS provided efficiently, allowing them to focus on the sale of beer.

1.4 Interdependency of TSE and TS

1.4.1 The Commission expresses concerns relating to the repair/replace decision and in relation to access to assets for TSE serviced by an independent third party TS provider:

5.24 *“Repair or replace decisions that need to be taken daily inevitably create tensions when ownership and servicing of TSE are in different hands. Given the continuing ownership of TSE by SDEL or the brewers, this in principle creates difficulties for an independent provider of TS. The SDEL brewers/Coors have recognized this difficulty and are in the process of drafting a protocol for access to assets by independent TS providers.”*

5.25 *“In addition, more detailed ‘rules of engagement’ are likely to be required for a third party TS provider requiring access to TSE in order to service it. Such rules would also need to be acceptable to the retailer. The intrinsic difficulties of separate ownership mean that the success of third party TS provision would depend not only on a clear set of TSE access rules, but also on goodwill and co-operation. 51 per cent of respondents to our buyer survey thought that the owners of shared generic TSE were able to prevent independent servicing. In our TS questionnaire, 33 per cent of respondents who had carried out independent servicing work had found access to branded and non-shared generic TSE difficult. Whatever the extent of the difficulties encountered in practice, it seems clear that access to brewer-owned TSE is widely perceived in the industry to be an issue.”*

5.56 *“The conflicts between ownership of assets and third party TS provision were discussed in paragraph 5.24, both in terms of the potential administrative obstacles that might arise, and the inherent tension in the need to balance repair and renewal decisions. These are likely to make it difficult for a national scale entrant unless it were also prepared to take ownership of the TSE assets, or detailed ‘rules of engagement’ for access and for repair/replace decisions were developed and implemented efficiently. We heard from two potential entrants which told us of the ownership of assets for the effective provision of TS. One considered a TS provision-only model to be unworkable; the second thought that it could be achieved provided appropriate agreements could be put in place to ensure fair and reasonable access to the assets.”*

5.71 *For competition to develop and to exert a competitive pressure on TSE/TS quality standards and price, it would be necessary for credible alternative suppliers to be available, with the ability either to take ownership of TSE, or to have assured and sufficient access to TSE, not only for brewers, but also for retailers, third party TS providers or others.*

1.4.2 In SDEL and Coors' view, there are numerous alternative credible TS suppliers which are available, who would be able to take ownership of TSE or to have assured and sufficient access to TSE. SDEL's proposed Asset Access Protocol will facilitate this, and represent a significant improvement on the current situation or the counterfactual identified by the Commission.

1.5 Switching costs

1.5.1 The Commission expresses concerns relating to the costs of installing new TSE:

5.28 *“Third, there are significant switching costs associated with replacing generic TSE. Generic TSE is often integrated into the structure of the outlet, with pythons and lines running through floors and walls. Installing new generic TSE would therefore be likely to involve closing the outlet for at least a couple of days. Whilst changes of ownership between the national brewers are generally covered by*

the MBMS arrangements of the FBI (or largely similar arrangements for brewers which are not members of the FBI), if a retailer were looking for a change of ownership of TSE away from SDEL (either by sale to a TSE manufacturer, a financing house, independent service provider or ownership by the retailer), these switching costs mean that the retailer would need to reach agreement with the owner of the generic TSE (either a brewer or SDEL) to sell at a price reflecting the current economic value of the assets in place (not necessarily reflected by the rates paid by non-FBI members). This might be complicated by what were described to us as the lack of detailed records on the age and state of assets. Even when SDEL has a complete and accurate asset register, []. A potential buyer would be reluctant to buy a set of generic TSE assets unless he could be satisfied that the total valuation adequately reflected their age and condition.”

1.5.2 These concerns are dealt with by the parties' proposed Asset Access Protocol.

1.6 Valuation of TSE

1.6.1 The Commission states that there are difficulties surrounding the valuation of TSE and the price at which the parties are able to sell their assets:

5.29 *“Fourth, the national brewers have told us of some significant differences in the way that assets are valued on their book, relating to depreciation lives, and the capitalization of labour costs. These differences, combined with the lack of transparency, might make it more difficult for the TSE assets to be valued and therefore sold.”*

5.43 *“As an alternative, retailers could seek to buy their generic TSE assets from SDEL or the brewers, or install their own generic TSE assets. Traditionally, the TSE assets have always been owned by the brewers, and many retailers still see them as provided free of charge. The SDEL brewers have told us that they would be willing to arrange for SDEL to sell its generic TSE at a fair market value to the retailers (or to other entrants, including the retailer's independent TS provider or a third party leasing company). However, there remains a difficulty in agreeing such a 'fair market value' given the absence of any benchmark transactions (see paragraphs 5.24 and 5.29). Furthermore, as mentioned previously, []. In addition, some third parties told us that some of the pubcos would not be in a position to fund such an acquisition, which might amount to over £5,000 per outlet, since they were relatively highly geared. In any case, retailers might be reluctant to incur the cost, for an uncertain improvement in dispense quality, as it would not be easy to demonstrate a satisfactory rate of return that would flow from the acquisition of TSE given the opacity of bundled pricing.”*

1.6.2 The parties set out in section 2.4 of their response the reasons why, in most cases, net book value will be a fair and reasonable measure of the value of TSE.

1.6.3 The parties have also proposed an undertaking to submit to an independent adjudication of the value of the assets in cases where the retailer wishes to buy the assets in fewer than ten outlets and requests adjudication.

1.7 Customer Inertia

1.7.1 The Commission refers to customer inertia as another barrier to entry into TS:

5.30 *“Finally, we noted the relatively high level of retailer inertia in the markets for TSE and TS. ”*

5.31 *"We have identified two causes for this inertia. The first is suggested by our buyer survey, which showed that around 95 per cent of respondents were satisfied or very satisfied with their current TSE and TS provision."*

5.32 *"The second cause of market inertia is the fact that the markets for TSE and TS are just emerging."*

1.7.2 In view of the parties' proposed undertaking on their Asset Access Protocol, which will facilitate the shift to third party TS providers and allow retailers to purchase their own TSE, this is no longer a valid concern. In addition, the publicity for the proposed transaction and publication of the parties' proposed remedies is likely to make retailers aware of the enhanced options available to them.

2. PRICE OF TS

2.1 The Commission states that the proposed transaction may lead to increases in the price of TS:

5.86 *"Given the size of SDEL/Innserve, the relative lack of competitive constraints or benchmark prices, and the fact that some TS costs would be common between the SDEL brewers/Coors, there would be little to restrain SDEL/Innserve, and their customers, the SDEL brewers/Coors, from allowing the price of TS to rise, at least over the longer term. Since any price increase (or cost decrease) would generally be reflected in the bundled price for the supply of beer, and TS represents a small percentage of the total beer price, such price rises (or cost reductions) may not be apparent to retailers (or may not be passed on to retailers...). In practice this might mean that prices stayed level despite the achievement of cost reductions. Further, as SDEL/Innserve would have a very large market share following the proposed merger, their prices may well become the market rate, adversely affecting even those retailers who do not receive their TS directly from SDEL/Innserve."*

2.2 SDEL has proposed an undertaking not to change the contractual provisions on price in its contract with Innserve. This will ensure that Innserve is unable to increase the price of TS. Additionally, [].

2.3 Furthermore, the new SDEL/Innserve structure will improve the ability of SDEL to employ benchmarking techniques, further ensuring that Innserve remains competitive with other TS providers and removing any scope for price increases.

3. QUALITY OF TS

3.1 The Commission expresses two concerns regarding the quality of TS:

(a) SDEL will have insufficient resources to monitor the activities of Innserve;

(b) The proposed transaction will make it less likely that effective rivals to Innserve will emerge, thereby reducing the competitive pressure on Innserve to maintain high levels of quality.

3.2 Monitoring of Innserve

5.83 *"SDEL does not have the resources to carry out any monitoring.... In addition to these two contract features, we noted that SDEL/Innserve had entered into contractual commitments without agreeing the per-event rate card..., reflecting a lack of competitive pressure in bidding for this contract"*.

3.2.1 SDEL has proposed undertakings to change its structure, to become a more substantial business. One of the results of this is that it will have the necessary

resources to monitor the activities of Innserve (and the other TS providers to which it allocates work).

3.2.2 [].

3.2.3 [].

3.3 Pressure on Innserve to maintain high levels of quality

5.82 *"We have been told that in general the national brewers' service contracts with the retailers do not specify service levels to any degree of detail. In addition, even in cases where targets have been specified, there is no penalty for non-achievement of targets. It has, however, been a feature of the emerging competition that well managed pubcos have been able to use the competitive operation of the market to negotiate contractual service terms to reflect their requirements. We considered that because of the foreclosure effect of the proposed merger, and the diminished level of prospective competition in this market, it would be more difficult after the proposed merger for retailers to force the SDEL brewers and Coors to adhere to demanding service levels."*

5.84 *"The parties have told us that they would not wish to risk damaging their brands by poor dispense quality. They told us that quality would be safeguarded by SDEL's contract with Innserve, which, they said, contained demanding performance targets which Innserve must satisfy to keep its contract. However, it is not clear to us that there is an alternative TS provider capable of providing the service that Innserve will be contracted to provide, and so it seemed to us that the threat of termination was not real. The TS employees of the SDEL brewers and Coors would have been transferred to SDEL and then to Innserve, and, although TUPE might operate if Innserve lost its contract, we were not certain that a sufficient workforce would be readily available to any other service provider. Innserve has been set up to make a profit, with a focus on achieving cost reductions. Whilst some of these cost reductions will be achieved through synergies, there will be an incentive on the part of Innserve to cut costs at the expense of service standards. We therefore believed that the incentives to standardize at a lower level of service – one which, in the words of one of the national brewers, is 'adequate' – were high."*

5.85 *"...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."*

3.3.1 The parties have proposed a number of undertakings to deal with these concerns. These are set out in detail in section 2.6 of the parties' response. They include undertakings to publish the KPIs, and to incentivise Innserve to achieve the target level for service provision.

3.3.2 In addition, the Asset Access Protocol will facilitate entry into the provision of TS giving retailers more options. The proposed undertaking on the restriction of SDEL's TS requirement which can be sub-contracted to Innserve, and the Code of Conduct for sub-contractors will ensure that there is a significant amount of work for sub-contractors and that they can grow significantly, so that they can provide a national service.

3.3.3 Sub-contractors working for SDEL will be servicing the TSE of three brewers, allowing them to do more work per outlet. Furthermore, they will be serving a larger number of outlets in an area as they will be servicing all the outlets where an SDEL brewer is principal supplier. This will allow them to achieve higher economies of

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density and scale, improving their efficiency and facilitating their expansion to provide a national service, if they wish to compete for direct TS provision to retailers.

- 3.3.4 The parties have also set out in section 2.6 of the main document arguments as to why the Commission's views that consumers are more likely to switch outlet than switch brand are misconceived.

FN 52 The parties told us that SDEL had the option to change the management team. However, we were not persuaded that this was an effective sanction, and moreover thought that this might, in effect, terminate the contract between SDEL and Innserve.

- 3.3.5 The Commission should note that as a matter of employment law, TUPE would (rather than "might") operate if Innserve lost its contract to transfer the relevant employees to the new provider. So, notwithstanding the existing resources of any alternative service provider, a sufficient workforce would be readily available to any alternative service provider.

- 3.3.6 Section 2.6 of the parties' response explains why the Commission's view, expressed in footnote 52, is misconceived.

TSE MARKET

The Commission's provisional findings regarding the TSE market are summarised in paragraph 6.3:

"We further provisionally concluded that the increment in market power resulting from the proposed merger was significant enough to constitute an SLC in the generic TSE market for the reasons set out in paragraphs [unspecified paragraph] to 5.91. We expected that the increased market share of SDEL/Innserve would lead to a reduced platform for entry, resulting in a reduction in the level of competition compared to the counterfactual, with likely adverse effects on the quality and/or price of generic TSE."

In addition to these three concerns, in paragraph 5.94 of the provisional findings the Commission raises a concern regarding buyer power in the TSE market. We address these four concerns below.

4. BARRIERS TO ENTRY IN TSE

4.1 The concerns expressed by the Commission appear to imply that the same arguments that applied to TS apply to TSE:

5.49 *"In particular, bundled pricing makes it difficult to attribute a market price to the generic TSE assets or identify a rate of return attributable to ownership of generic TSE assets. This lack of knowledge of either the price or the true economic value of the TSE assets could in theory, in itself, act as a barrier to entry. There are two particular issues associated with the valuation of generic TSE. First, these assets are usually valued in aggregate using an average age, but it would be necessary for any potential buyer to be satisfied that the total valuation of any particular set of generic TSE assets adequately reflected their age and condition. Second, as set out in paragraph 3.8, SDEL is []. Such a value might be a poor representation of their true worth. Both of these aspects could represent a barrier to the sale of TSE assets, particularly in the absence of any benchmark transactions which could provide a comparison against which to assess prices."*

5.50 *"Finally, SDEL currently represents a large buyer in the TSE industry, accounting for around 30 per cent of industry sales. For some manufacturers, SDEL represents the majority of their sales. The consequence is that SDEL may be able to purchase TSE at lower prices than other buyers, giving rise to absolute cost advantages vis-à-vis non-brewer entrants."*

5.51 *"Although we heard evidence to suggest that there were at least two serious potential entrants which might have entered by means of a JV (see paragraph 5.47(e)) prior to the proposed merger, we were told that the proposed merger represented an 'insurmountable barrier to entry to them (see paragraph 5.57)."*

5.89 *"Paragraph 5.47 outlined the various mechanisms through which entry into the TSE market might occur in principle, and paragraphs 5.48 to 5.51 discussed entry into the supply of generic TSE in the absence of the merger. We believed that incentives for retailers to seek alternatives to their existing TSE owner would be reduced as a result of the proposed merger, due to the difficulty that alternative providers would have in competing with the enlarged SDEL (see paragraphs 5.78 to 5.81). Moreover, the SDEL policies on asset valuation and sale would be likely to deter individual pubcos from purchasing the TSE in their cellars (see paragraph 5.49)."*

5.90 *“In addition, both of the potential large-scale entrants that we spoke to told us that they would prefer to purchase some or all of the brewers’ TSE assets, although their business models were based primarily around providing TS.”*

4.2 The concerns can be summarised under four headings.

4.2.1 Bundled pricing, which makes it difficult for retailers to calculate the likely benefits (in terms of the beer discount) which they would obtain from owning their own TSE. The parties have undertaken to quote on an unbundled basis when retailers request this.

4.2.2 Switching costs, as any retailers purchasing and installing new TSE would have to incur the additional costs of removing the old and installing the new equipment. Furthermore, it is likely they would have to close their outlets for at least two days, reducing revenues. This is addressed by the parties’ Asset Access Protocol, which offers to sell the TSE in the retailers’ cellars to a retailer, the retailer’s independent TS provider or a third party leasing company at fair market value.

4.2.3 Difficulties in valuing TSE, due to the lack of a second-hand market in TSE and the contractual provisions which prevent SDEL from selling assets at less than their net book value. The parties’ arguments on this issue are discussed in section 2.4 of the parties’ response.

4.2.4 Advantages in purchasing TSE, which are dealt with below under TSE buyer power.

4.3 In addition, the proposed Asset Access Protocol would allow any retailer, any retailer’s independent TS providers or a third party leasing company to purchase the TSE, facilitating entry into TSE provision.

5. PRICE OF TSE

5.1 The Commission states that the proposed transaction may lead to increased prices for TSE:

5.93 *“We also believed it possible that there would be an adverse effect on prices in the TSE market. The increased market power of SDEL could provide SDEL, and hence the SDEL brewers and Coors, with the incentive and ability to allow prices to increase for TSE over time within the bundled beer price or fail to pass on any cost savings.”*

5.2 The parties’ undertakings on price, set out in section 2.6 of the parties’ response, address the Commission’s concerns.

6. QUALITY OF TSE

6.1 The Commission expresses concerns related to the quality of TSE and potential for less innovation in generic TSE.

5.33 *“We also took into account evidence from some of the professionally managed pubcos that there were shortcomings in the level of service provided as well as a lack of flexibility in dealing with non-standard requests for TSE and TS, which have led some of them to look for independent TS provision.”*

5.92 *“In terms of asset quality, one third party put it to us that it would be in the interests of the SDEL brewers and Coors to ‘sweat’ their assets, saving money on replacement costs. In addition, we believe that SDEL would have the incentives to standardize TSE in order to benefit from economies of scale in purchasing, and simplicity in terms of TS. We have seen that the KPI’s in the Innserve contract relating to the timescales for installations of non-standard TSE are [] days*

compared to [] days for standard TSE, which is likely to provide a strong incentive to retailers to use standard TSE. It is not clear that such a differential would have emerged if the market were to be more competitive."

5.94 *"However, pressure could be put on manufacturers by the enlarged SDEL such that manufacturers' margins were reduced, potentially restricting the development of the TSE manufacturers market, or even forcing some to exit the TSE market in Great Britain."*

5.95 *"With regard to generic TSE, many third parties told us that there was no potential for significant innovation in generic TSE, although several of the respondents to our TSE questionnaire did not agree. The parties argued that the proposed merger would increase incentives to innovate in generic TSE, because it would be less likely that brand switching would lead to a change in principal supplier outside the SDEL brewers or Coors, given that three of the four national brewers would be inside the arrangement. We believed, however, that there might be more incentive to standardise than innovate in generic TSE due to the reduction in competition, possibly leading to a reduction in quality."*

6.2 The fact that SDEL will be likely to own the assets for a longer period will encourage SDEL to invest in higher quality TSE.

6.3 Furthermore, the parties will undertake not to change SDEL's current contractual commitments to ensure that the generic 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.

6.4 As regards the differential in KPI times for installation of standard and non-standard TSE, this has nothing to do with the competitiveness or lack of competitiveness in the market. Standard TSE will be held by SDEL as regular stock and therefore can be installed at an outlet relatively quickly. Non-standard TSE will probably not be stocked by SDEL and will need to be ordered from the manufacturer. The longer lead time KPI for the installation of non-standard TSE as opposed to standard TSE therefore takes into account the fact that it may take several weeks for the manufacturer to deliver the non-standard TSE to SDEL. Once SDEL has taken delivery of the non-standard TSE, it will be able to install it as speedily as the standard TSE which it has in stock. In the industry today, both retailers and brewers order non-standard equipment even though there are longer installation times. Accordingly, there is no reason to believe the transaction will have any effect on their decisions regarding TSE.

6.5 Standardisation and innovation are not necessarily incompatible. It is possible that new equipment which SDEL will have the incentive to invest in will become standard.

7. TSE BUYER POWER

7.1 The fourth concern expressed by the Commission concerns buyer power in the market for TSE:

5.94 *"SDEL's increased market power would give it a strong negotiating position with manufacturers of generic TSE. Its ability to rationalize the supply chain and minimize inventory levels could benefit customers, depending on whether or not the savings were passed on. However, pressure could be put on manufacturers by the enlarged SDEL such that manufacturers' margins were reduced, potentially restricting the development of the TSE manufacturers market, or even forcing some to exit the TSE market in Great Britain. The BFBi told us that this was the view of*

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most of its members. Any negative impact on the TSE manufacturing base supplying SDEL/Coors would be likely to have a knock-on effect on Interbrew and the regional brewers which purchase generic TSE."

7.2 This concern is addressed in section 2.6 of the main body of this document.

OTHER POINTS

8. SUPPLY OF GENERIC TSE AND TS BY EQUIPMENT MANUFACTURERS DIRECTLY TO RETAILERS

5.42 *"In the TSE market, we have seen less evidence of direct competition than in the TS market. We have been told that one or two retailers have entered into small-scale trial arrangements with a major equipment provider [] to supply them with generic TSE. However, we were told that none of these arrangements has, after several years, resulted in a substantive contract..."*

8.1 The parties understand that [].

8.2 The parties also understand that [].

9. CUSTOMER BENEFITS

5.70 *"The parties told us that a fair share of the resulting benefits would be to the ultimate benefit of the end consumer. However, Coors also put it to us that the increasing strength of the larger pubcos in particular might force them to pass benefits on to the most powerful retailers which might not, in turn, pass the benefits on to the end consumer, although SDEL did not believe that the pass-through of cost savings would differ between large and small pubcos, and independents. It was not clear to us that the benefits would be passed through in full to all the retailers, and that, even if they were, that they would be shared between the different types of retailers."*

9.1 Please see the parties' comments in Annex 3.