

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 TWO
PROPORTIONALITY OF THE PROPOSED REMEDIES

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 TWO
PROPORTIONALITY OF THE PROPOSED REMEDIES**

1. RELEVANT CONSIDERATIONS

- 1.1 The Competition Commission lays out the relevant considerations in assessing the proportionality of remedies in merger cases in Section 4 of its Guidelines on Merger References (CC). It states that:

"4.6 Although the Commission must always consider the appropriateness of any remedial action, it is unlikely that the Commission will decide that there is no case for remedial action if it has decided that a merger results, or is expected to result, in an SLC. Examples of exceptional circumstances where the Commission may conclude that no action is appropriate might be where the costs of any practicable remedy seem disproportionate in the light of the size of the relevant market, or where the only appropriate remedial action would fall outside the United Kingdom's jurisdiction."

It continues:

"4.9 The Commission must have regard to the reasonableness of any remedy and this will include consideration of the costs of any action it may decide is appropriate. The Commission will aim to ensure that no remedy is disproportionate in relation to the SLC or other adverse effect. If the Commission is choosing between two remedies which it considers would be equally effective, it will choose the remedy that imposes the least cost or that is least restrictive."

4.10 The Commission will generally include in its consideration of costs the costs of implementing a remedy. [...]

[...]

4.12 The Commission will endeavour to minimise any ongoing compliance costs to the parties, subject to the effectiveness of the remedy not being reduced, and will have regard to the costs to the OFT in monitoring compliance with any remedies that the Commission may put in place."

- 1.2 The Guidelines therefore indicate that the following considerations are relevant in assessing whether proposed remedies are proportionate:
- 1.2.1 What are the costs of the remedies in comparison with the size of the market?
- 1.2.2 How do the remedies compare with the SLC or other adverse effect?
- 1.2.3 How restrictive or intrusive are the remedies?

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1.2.4 What are the costs of implementing the remedies?

1.2.5 What are the costs to the OFT in monitoring compliance?

2. PREVIOUS EXAMPLES OF APPLICATION OF THESE CONSIDERATIONS

2.1 The Competition Commission has expressly considered the proportionality of proposed remedies in two cases under the Enterprise Act 2002:

2.1.1 In *FirstGroup plc and the Scottish Passenger Rail Franchise* (June 2004), the Competition Commission considered that since structural undertakings would involve divestments of routes significantly wider than those on which competition issues were identified, and the Commission could identify behavioural remedies which would be effective, the structural remedies would be disproportionate. This indicates that the second consideration listed above was taken into account.

2.1.2 In *Knauf Insulation Limited and Superglass Insulation Limited* (November 2004), the Competition Commission considered that divestment remedies were disproportionate in the sense of being more intrusive or costly than prohibiting the merger. This indicates that the third and fourth considerations were taken into account.

3. APPLICATION TO THE SDEL/COORS TRANSACTION

What are the costs of the remedies in comparison with the size of the market?

TSE market

3.1 According to the Commission's Provisional Findings Report, BFBi estimated the annual churn in TSE assets at £80 million for the UK, including refurbishments¹. The Commission used annual churn as a proxy for the sourcing and provision of TSE assets.

3.2 The remedies proposed by the parties include the following which relate to TSE:

3.2.1 Asset access rules;

3.2.2 Sale of TSE;

3.2.3 Price and quality;

3.2.4 Unbundled pricing;

3.2.5 Appointment of an adjudicator.

3.3 The parties cannot, at this stage, quantify the costs of these undertakings although the parties submit that any costs will be very small compared with the size of the market. They are therefore proportionate.

TS market

3.4 The parties have estimated the value of the market for TS as around £[].

3.5 The remedies proposed by the parties include the following which relate to TS:

¹ Appendix B, paragraph 2

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- 3.5.1 Restructuring of SDEL and level of sub-contracting;
 - 3.5.2 Asset Access Protocol;
 - 3.5.3 Code of conduct for sub-contractors;
 - 3.5.4 Price and quality;
 - 3.5.5 Unbundled pricing;
 - 3.5.6 Appointment of an adjudicator.
- 3.6 As with the TSE remedies, the parties cannot, at this stage, quantify the costs of these undertakings although the parties submit that any costs will be very small compared with the size of the market, and therefore proportionate.
- 3.7 The same does not, however, hold for the undertaking suggested by the Commission under which SDEL would not subcontract to Innserve more than 50% of its total TS business. []. For this reason, the Commission's proposed 50% remedy would be disproportionate in the *Knauf* sense.
- 3.8 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.

How do the remedies compare with the SLC or other adverse effect?

- 3.9 In the *FirstGroup* decision the Commission's concerns were related to overlaps between rail and bus routes for certain passengers in certain parts of Scotland. Because the overlaps only related to certain passengers, the Commission concluded that to require divestment of particular routes would go beyond what was necessary to resolve the competition issues that had been identified. Therefore such structural remedies would have been disproportionate.
- 3.10 As regards the current transaction, the parties submit that the package of remedies proposed is directly proportionate to the potentially adverse effects on competition identified by the Commission in its Provisional Findings Report. Each of the remedies directly addresses one or more concerns registered by the Commission but, unlike in the *FirstGroup* case, none of the remedies, either individually or as a package, is disproportionate to the need to resolve those concerns.
- 3.11 The remedies address the Commission's concerns as follows:
- 3.11.1 Restructuring of SDEL and level of sub-contracting

In paragraph 5.75 of the Provisional Findings Report, the Commission states that "following the proposed merger, SDEL/Innservice would have the ability and incentive to organize its third party TS subcontracting strategically to ensure that no subcontractor developed a sufficiently strong presence to become a national competitor." The remedies proposed by the parties regarding restructuring of SDEL (including making SDEL and Innservice fully independent of one another) and regarding levels of sub-contracting directly address this concern.
 - 3.11.2 Asset Access Protocol

In paragraphs 5.53, 5.54 and paragraph 5.78 (and elsewhere throughout the Report), the Commission explains that the transaction may reduce the chances for

entry into the TS market. The Asset Access Protocol proposed by the parties directly addresses this concern by allowing third party TS providers access to SDEL's assets.

3.11.3 Sale of TSE

In paragraph 5.89 of the Provisional Findings Report, the Commission expresses its concern 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". The proposed undertakings on sale of TSE directly address this concern by facilitating the purchase of TSE by third parties from SDEL. They also address the Commission's concerns regarding asset valuation.

3.11.4 Code of conduct for sub-contractors

In paragraph 5.76 of the Provisional Findings Report, the Commission states that "Innserve could demand substantially improved terms from the subcontractors, which would be highly dependent on Innserve for business. Given the lack of alternative buyers for their TS services, the subcontractors might well have no alternative but to accept reduced terms." The fact that SDEL, rather than Innserve, is now proposed to be responsible for sub-contracting and to be subject to the proposed Code of Conduct for sub-contractors directly addresses this concern.

3.11.5 Price and quality

A further concern set out in the Provisional Findings Report is that "it was not clear how effectively service standards would be monitored. SDEL does not have the resources to carry out any monitoring." The undertakings proposed by the parties include a commitment to ensure that the monitoring of Innserve's performance is adequately funded and to employ personnel to monitor Innserve's performance who will be independent of Innserve and who will report directly to the SDEL board. This directly addresses the Commission's concern.

The Commission also thought that there would be few incentives to maintain high levels of quality (paragraphs 5.84 and 5.85 for TS and 5.92 and 5.95 for TSE) and adverse effects on price (paragraph 5.86 for TS and 5.93 for TSE). Again, the undertakings proposed by the party directly address these concerns.

3.11.6 Unbundled pricing

Throughout its Provisional Findings Report, the Commission expresses concerns about the lack of transparency of pricing as a barrier to entry for third party TS and TSE providers. In paragraph 5.80 of the Report, the Commission acknowledges that the parties have already that they will provide unbundled pricing on request. The undertaking proposed by the parties in this regard strengthens their previous commitment.

3.11.7 Appointment of adjudicator

Given the need for some independent assessment of the workings of the proposed remedies (see further below on the costs of monitoring compliance), the appointment of an adjudicator to resolve disputes arising between the parties and third parties is proportionate to the need to ensure the effectiveness of the remedies.

How restrictive or intrusive are the remedies?

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- 3.12 In the *Knauf* decision, the Commission found that the divestment of a particular site which did not operate as a free standing business would be a more intrusive remedy than prohibition.
- 3.13 In contrast, in the current transaction, none of the remedies proposed, either individually or as a package, are more restrictive or intrusive than prohibition (unlike the Commission's proposed 50% undertaking). Whilst prohibition would prevent the transaction going ahead, the proposed undertakings will permit the transaction to continue, in a manner that does not substantively change the parties' original positions (unlike the proposed divestment in *Knauf*).
- 3.14 Furthermore, the parties propose that the package of remedies should remain in place for five years, to enable the nascent TS and TSE markets to develop. This time limit is consistent with the duration of undertakings in previous cases (see for example *British Airways/CityFlyer Express* (DTI Press Notice P/99/865, dated 28 October 1999)) and is not unduly restrictive or intrusive.

What are the costs of implementing the remedies?

- 3.15 In sections 3.2 and 3.4 above the parties have demonstrated that, compared with the size of the TS and TSE markets, the costs implications of the remedies are not disproportionate.
- 3.16 Another factor to be considered is the costs of implementing the proposed remedies as compared with the costs of prohibiting the SDEL/Coors transaction. In the *Knauf* decision, the Commission considered that a potential remedy, whereby the parties would be required to divest one particular site, would be disproportionate in the sense of being more costly than prohibiting the merger. The site in question was much larger than the site that would be acquired as a result of that merger.
- 3.17 In the present case, the package of remedies proposed by the parties would not have greater costs implications than an outright prohibition. Annex 3 to this document also sets out the customer benefits which the parties have identified as likely to result from the transaction. Balancing the synergies and customer benefits against the costs to the parties of implementing the package of remedies shows that, unlike the *Knauf* case, the costs of implementing the remedies and proceeding with the transaction are less than the costs of prohibition; therefore the remedies proposed are proportionate.

What are the costs to the OFT in monitoring compliance?

- 3.18 The parties have proposed the appointment of an independent adjudicator to resolve disputes as set out in the parties' response. Such an independent adjudicator would therefore perform a role very similar to an independent monitoring trustee or agent, as the adjudicator would be empowered to enforce the undertakings in the event of a dispute.
- 3.19 The appointment of an independent adjudicator would minimise the costs to the OFT of monitoring compliance. The parties cannot estimate what the residual costs to the OFT would be, but submit that they would be minimal. The parties further submit that any such residual costs would not be of such an order of magnitude as to make the proposed remedies disproportionate.