

Summary

30 December 2004

1. On 29 September 2004 the Office of Fair Trading (OFT) referred the proposed acquisition by Serviced Dispense Equipment Limited (SDEL) of the Technical Services function of Coors Brewers Limited (Coors) to the Competition Commission (CC) for investigation and report. The reference was made under section 33(1) of the Enterprise Act 2002 (the Act). We are required to publish our final report by 15 March 2005.

2. Historically the national brewers were vertically integrated: brewing beer, owning on-trade outlets (outlets), and owning and servicing the dispense equipment. Following the Monopolies and Mergers Commission's report into the supply of beer and the implementation of the Beer Orders in the early 1990s, the vertically integrated market of the national brewers was broken down, leading to an increasingly free retail market, the emergence of some large pub companies (pubcos), and much higher levels of brand switching. The national brewers generally continued to own and service the dispense equipment.

3. Technical services equipment (TSE) is the equipment used to dispense draught beer and cider at outlets. It includes both branded and generic TSE. Technical services (TS) comprises the installation, servicing (including maintenance and refurbishment), replacement and removal of TSE. Brewers have provided outlets with TSE, TS and distribution, bundled into the price of a barrel of beer, for many years. TSE and TS represent a small proportion of the overall price of a barrel of beer to the retailer, and may have been perceived by some retailers to be provided free of charge.

4. The Four Brewers' Initiative (FBI) was set up in 2000, in response to increased brand switching, to reduce waste, recover asset value and minimize customer disruption

when generic TSE was installed in an outlet or was transferred between the signatories. The FBI principal supplier (usually the brewer with the most taps on the bar) owns the shared generic TSE, has the responsibility for servicing that TSE, and provides lines to other brewers with taps at that outlet. Must Buy Must Sell (MBMS) arrangements ensure that generic TSE is sold to the incoming principal supplier or new brand owner at a standard price.

5. In November 2003 Serviced Dispense Equipment (Holdings) Limited (SDEH) was created as a joint venture (JV) company owned primarily by Scottish Courage Limited (Scotco) and Carlsberg UK Limited (Carlsberg) (the SDEL brewers). SDEL, a wholly-owned subsidiary of SDEH, purchased the existing assets of the SDEL brewers for the dispense of draught beer, cider and wine, including their TSE and TS business (including TS employees). SDEL provides TSE and TS to the SDEL brewers under a ten-year rolling contract. SDEL subcontracted the provision of TS under an exclusive arrangement to Innserve Limited (Innserve) under a ten-year contract. We note the close links and long-term nature of the contract between Innserve and SDEL. The contractual relationship for the supply of TSE and TS remains between the SDEL brewers and the retailers as part of their beer supply arrangements.

6. The parties told us that the supply of TSE and TS was an important but non-core activity for brewers. Brewers' primary focus is competition in beer brands. They have therefore been looking to cut costs, in part through outsourcing non-core activities to specialist service providers. The proposed merger sees the addition of Coors' TSE and TS business to SDEL. The parties told us that it was expected to generate efficiencies and consequential cost savings for the SDEL brewers and Coors, which, we were told, would be to the ultimate benefit of the consumer.

7. We concluded that arrangements were in progress which, if carried into effect, would result in the creation of a relevant merger situation.
8. We included all outlets in our definition of the markets for TSE and TS. Beer was defined to include all draught ale, lager and cider, and to include both keg and cask beer. We concluded that the markets primarily affected by the proposed merger were two separate but interdependent markets for the supply of TSE and the supply of TS in Great Britain.
9. Overall, we considered that prior to the proposed merger SDEL had much the largest share of both the TS and TSE markets (30 to 40 per cent). Coors, the next largest TSE and TS provider prior to the proposed merger, would increase SDEL's market share by around 15 percentage points for TS, and 25 to 30 percentage points for TSE, leaving SDEL several times larger than the next largest TS and TSE providers.
10. We noted that the markets for independent supply of both TSE and TS were very much in their infancy, particularly in the case of TSE. We believed that competition in both TSE and TS was currently limited by several features of the market—the bundling of prices of TSE and TS with beer; the interdependency of TSE and TS coupled with brewer ownership/control of TSE; switching costs and difficulties in valuing TSE; and customer inertia—although a market for TS in particular was slowly starting to emerge.
11. Price unbundling would be critical to the likely success of any alternative arrangements that the retailers might 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. We considered

it likely that as pubcos look more carefully at their costs, they would continue to press for unbundled prices provided there were credible alternative providers of TSE and TS.

12. 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.
13. We noted that there were significant switching costs associated with replacing generic TSE. In addition, differences in the way that TSE was valued by the brewers might make it more difficult for the TSE assets to be sold. Finally, we noted the relatively high level of retailer inertia in the markets for TSE and TS.
14. We considered that there were, at least in theory, both direct and indirect mechanisms through which retailers could choose their TSE and TS provider. The indirect mechanism occurs through the retailer influencing which brewer is principal supplier and hence supplies the shared generic TSE and provides associated TS. This could occur either through a change in beer brands leading to a change in the supplier of shared generic TSE and associated TS or through the outlet opting to switch the brewer designated as principal supplier despite not having changed beer brands.
15. Since Coors and Interbrew both told us that they would only provide TSE and TS associated with the supply of beer, direct competition in the TS market today and in the near future was effectively limited to third party TS providers. Few, if any, third parties other than City Refrigeration Services (City) could claim to be truly independent of the national brewers, since the vast majority of third party contractors'

business was performed under subcontracts to the national brewers. In the TSE market, we have seen less evidence of direct competition than in the TS market. Retailers could seek to buy their TSE assets from SDEL or the brewers, or install their own or leased TSE assets. Entry into the supply of generic TSE could also occur in conjunction with the provision of TS.

16. We considered that the indirect mechanism for competition was relatively weak in both the TSE and TS markets. There was little direct competition in the TSE market, but more history of direct competition from third party providers in the TS market. However, as these two markets emerge and develop, and despite the existing features of the market, we would have expected levels of competition to increase in the future in the absence of the proposed merger, particularly in the TS market.
17. We considered that, in the absence of the proposed merger, SDEL/Innserve would continue to operate with SDEL as a JV between the two SDEL brewers. We also assumed that the national brewers would continue to participate in the FBI. We adopted the assumption that, in the absence of the proposed merger, Coors's TSE and TS business would remain in the market in the short to medium term providing TSE and TS only in conjunction with beer supply.
18. The major concerns that were put to us focused on the increased ability of the SDEL brewers/Coors and SDEL/Innserve to act independently and exploit their market power as a result of the large increase in SDEL's market share following the proposed merger. We have looked at the possible effects of the proposed merger in each of the three markets—the supply of TS, TSE and beer. Given the size of SDEL's market share following the proposed merger, our analysis focused on unilateral effects.

19. In the absence of the proposed merger, the two SDEL brewers would be using the SDEL/Innserve arrangements to provide TS to retailers, while Coors and Interbrew would be providing TS through a mix of in-house staff and subcontractors. However, after the proposed merger, Coors would also use SDEL/Innserve to deliver TS. Innserve would be the exclusive provider of TS to SDEL.

20. We believed that competition for the provision of TS in the absence of the proposed merger was relatively limited. We considered the likelihood of an existing smaller-scale third party TS provider expanding to provide more direct competition for the provision of TS on a national scale. SDEL/Innserve's increased market power as a result of the proposed merger would give Innserve a strong negotiating position with third party subcontractors. Innserve could demand substantially improved terms from the subcontractors, which would be highly dependent on Innserve for business. We considered that following the proposed merger, SDEL/Innserve 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. SDEL/Innserve's ability and incentive to do this would be strengthened by the proposed merger.

21. 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.

22. Given that credible third party TS providers with a national capability would be less likely to emerge and would struggle to compete on level terms with SDEL/Innserve, retailers' incentives and ability to find alternatives to their existing TS provider would be much reduced compared with the counterfactual. We believed that, given the lack of credible alternatives for TS provision to retailers, the proposed merger would reduce the prospect of discounts being offered at a level which would allow viable competing bids for independent TS provision.

23. Overall we considered that there would be a reduction in competition as a result of the proposed merger. The adverse effects of such a reduction in competition are difficult to predict in view of the nascent nature of the market. We considered possible adverse effects on service quality and on price. We believed that the incentives to standardize at a lower level of service—one which was 'adequate'—were high.

24. Given the interdependence of the TSE and TS markets, the possible effects in the TSE market are similar to those already identified in the TS market. At present, the majority of retailers could be supplied with generic TSE owned by SDEL (for the two SDEL brewers), by Coors or by Interbrew. There was no well-developed third party provision of TSE. As a result of the proposed merger, the TSE required by Coors would also be provided to Coors by SDEL. We believed that retailers would be discouraged from seeking alternatives to their existing generic TSE owner (including taking ownership themselves) as a result of the proposed merger. The reduction in the headroom available in the market after the proposed merger made entry less likely. We therefore considered that there would be a reduction in competition as a result of the proposed merger, in particular a reduction in future competition that would otherwise have emerged. We believed that there would be likely to be adverse effects on the quality and/or price of generic TSE.

25. We also considered the longer-term future of the FBI as a result of the proposed merger. On the evidence available, we were unable to form a view as to whether the FBI arrangements would cease to operate or would be substantially changed as a result of the proposed merger
26. We provisionally concluded that the increment in market power resulting from the proposed merger was significant enough to constitute a substantial lessening of competition (SLC) in the TS market. 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 with the counterfactual, with likely adverse effects on service quality and/or price of TS provision.
27. 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. 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 with the counterfactual, with likely adverse effects on the quality and/or price of generic TSE.
28. Finally, we provisionally concluded that the arguments we had received did not carry enough weight to lead us to form an expectation of an SLC in the beer market.