# 5 Views of Interbrew

## Contents

*Page*

Introduction .......... 85
Summary .......... 85
The rationale for the transaction .......... 88
Industry background .......... 90
Trends in demand .......... 90
Reduction of vertical integration .......... 91
Growth of the independent pubcos .......... 92
Developments in the off-trade .......... 93
Consolidation among the regional brewers .......... 94
Developments at the wholesale/distribution level .......... 95
Imports and the international dimension .......... 97
Competitive pressures in the UK beer market .......... 97
Consumer pressure .......... 98
Customer pressure .......... 98
Competitive pressures from brewers .......... 99
Public interest issues .......... 101
Impact at the brewing level .......... 102
Impact at the wholesale and distribution level .......... 109
Effect on prices .......... 109
Effect on consumer choice .......... 110
Public interest benefits .......... 110
Response to the issues and remedies letter .......... 111
Issues .......... 111
Effects of the merger on the public interest .......... 112
Effects of the merger on brewing .......... 113
Effects of the merger on beer wholesaling and distribution .......... 120
Effects of the merger on the retailing of beer .......... 125
Possible adverse effects on the public interest .......... 126
Further points on public interest benefits .......... 127
Comparison with the 1997 proposed Bass/Carlsberg-Tetley merger .......... 128
Possible remedies .......... 129

## Introduction

5.1. This chapter summarizes the views of Interbrew provided to us in written submissions, and at hearings. Interbrew provided submissions, saying that these had been prepared with the benefit of input from both Interbrew UK Ltd (Interbrew UK) and Bass Brewers and reflected their views; we refer to Interbrew as the author of the submissions.

## Summary

5.2. Interbrew provided a summary of its position. The main points were:

*(a)* The acquisition would not give rise to any public interest detriment: indeed there would be public interest benefits, including the ending of vertical integration between Bass Brewers and BLR, and the creation of synergies which would allow investment in the business thereby preserving brand diversity. The transaction should be seen in both a UK and global context. Vertical integration in the UK beer industry had reduced in the last ten years, with corresponding growth of large independent pubcos, and accompanied by consolidation at the retail level, both on- and off-trade. During the same period, brewers had experienced pressure from: continuing decline in demand; shift from on-trade to off-trade competition; and growth in imports (including 'grey'-market imports, notably via Calais). The increasingly competitive market environment had resulted in a decline in real terms of brewers' net selling prices, with a corresponding decline in margins.

*(b)* The developments outlined in paragraph 5.2*(a)* had led to inevitable consolidation of brewing activities in an effort to reduce costs. Whitbread and Bass had both decided to exit from brewing in order to concentrate on their retail interests. While brewers' net selling prices (excluding duty) had declined in real terms by over 15 per cent over the last ten years, on-trade retail prices of beer had risen by over 20 per cent over the same period.

*(c)* At the global level, the brewing industry was undergoing a period of rapid consolidation, illustrated by a number of major international transactions over the last 12 months (see paragraph 5.6). Brewing was Interbrew's core business and Interbrew sought to be part of the global consolidation. The acquisition of WBC by Interbrew was a natural development because WBC had been brewing Interbrew's leading international beer, Stella Artois, for more than 20 years. The transaction gave Interbrew the opportunity to participate in the UK market, which was the second largest in Europe.

*(d)* Interbrew had seen a number of commercial attractions from the acquisition of the Bass brewing interests. The product ranges of Interbrew UK and Bass Brewers were complementary, in that Interbrew UK did not own or have a licence to any standard lager brand, while Bass Brewers did not own a major premium lager brand. By contrast, S&N and Carlsberg-Tetley both owned standard and premium lager brands. The combination of the Interbrew UK and Bass Brewers businesses would create a number of synergies. These would result in reductions in the cost base and consequently would arrest the declining margins resulting from falling wholesale prices. Interbrew's international reach would open up major new export opportunities for Bass Brewers' British brands. Bass also had a presence in the Czech Republic, a part of central Europe in which Interbrew had not hitherto been active, and in Italy, Spain, the USA and Canada, thereby complementing Interbrew's own existing international business.

*(e)* As to the impact on competition, Interbrew submitted that the UK beer market was and would remain highly competitive. Four of the top eight global brewers brewed in the UK, as did Guinness, another major international brewer. Two other of the top eight global brewers, Heineken and Miller, had their beers brewed under licence in the UK and had a significant brand presence. The third largest UK brewer, Carlsberg-Tetley, was owned by one of the world's largest brewers and had both leading lager and ale brands. It had a strong national distribution network and a guaranteed supply agreement until [✂] with the former Allied-Domecq retail estate, one of the largest in the country (now split between Punch and BLR). In addition, the major regional brewers provided a strong competitive offering, bolstered by their tied estates.

*(f)* The UK market showed a high degree of brand fragmentation and drinking 'promiscuity'. The leading brand had only 10 per cent of the market; the top three beer brands accounted for only 22 per cent of the market; six different companies had brands in the top ten; and the positioning of brands in the UK was not static, as could be seen from the fact that between 1989 and 1999 three brands entered the top ten and three fell out. Accordingly, there was significantly more brand dynamism than in most other beer markets or in other fast-moving consumer goods markets.

*(g)* As the total size of the UK beer market declined, competitive pressure was increasing from other parts of the overall beverage market, notably FABs, wine and cider. Products such as Bacardi Breezer and Smirnoff Ice had a very strong appeal to young beer drinkers.

*(h)* Since 1989, the proportion of UK pubs owned by brewers had fallen from 73 to 21 per cent, one-fifth of which were owned by S&N. The effect of the Whitbread and Bass transactions would be to change the largest two captive retail estates into two of the largest independent pubcos. The recent announcements regarding the proposed sale of the Whitbread estate and part of the BLR estate would be likely to lead to further consolidation among pubcos.

*(i)* Independent pub chains now accounted for over 50 per cent of all UK pubs and exercised very considerable purchasing power. Consolidation continued at the retail level, both on- and off-trade. The very recently announced Nomura/First Quench deal would bring under common ownership one of the largest on-trade groups with the largest chain of off-licences. Even in the relatively unconsolidated independent on-trade sector, wholesale competition had intensified dramatically, with discounts escalating by over 50 per cent since 1995.

*(j)* Following Interbrew's acquisition of Bass's brewing interests, beer produced under brands owned by or licensed to Interbrew would account for approximately 32 per cent of the UK market. This was not high by comparison with other major beer markets or other UK consumer goods markets. In 1999, [✂] per cent of the volume represented by that market share—ie approximately [✂] per cent of the total UK market and [✂] per cent of UK on-trade supply—had been accounted for by Bass and Whitbread (which would progressively be opened to competition—see paragraph 5.2*(k)*).

*(k)* Interbrew had entered into [✂]-year supply agreements with each of the Whitbread and Bass retail estates in order to adapt to the post-vertical ownership position. The Bass retail estate would be entitled [ *Details omitted. See note on page iv.* ]; after [✂] years, those estates would be able to buy from any brewer. By contrast, S&N remained vertically integrated and Carlsberg-Tetley had a major supply agreement with the former Allied-Domecq retail estate comprising some 3,500 outlets until [✂] (see paragraph 5.2*(e)*).

*(l)* The market would also remain highly competitive at the wholesaling and distribution level. At the wholesaling level, there would continue to be a number of routes to market, namely: Interbrew, S&N and Carlsberg-Tetley; regional brewers; and the independent wholesale sector. The strength of the independent wholesale sector had been boosted significantly in the last two years by the acquisition of two of the major independent national wholesalers by major drinks organizations (The Beer Seller by H P Bulmer and Matthew Clark by Canandaigua, now renamed Constellation Brands).

*(m)* E-commerce represented a significant new opportunity for entry at the wholesale level of the UK beer market. Some e-commerce wholesalers were already commanding very significant discounts.

*(n)* A brand owner seeking physical distribution would continue to have a large range of choices available. Both S&N and Carlsberg-Tetley had logistics operations, as did the regional brewers and independent wholesalers. Physical distribution for Bass was contracted out to Tradeteam, a joint venture with Exel which was managed independently by Exel. Other possibilities were logistics operators such as Wincanton.

*(o)* Independent pubcos were increasingly taking over the wholesale function and taking control of the distribution function. That not only significantly increased their negotiating position vis-à-vis the brewers but also meant that brewers could soon have no direct access to the 50 per cent of UK pubs for which those pubcos currently accounted.

*(p)* As to public interest benefits, Interbrew submitted that Bass was an important UK brewer. Bass's decision to exit brewing had inevitably created uncertainty for the business. Interbrew said that, as a committed and focused brewer, it would end that uncertainty. Interbrew did not own any pubs in the UK to provide it with a secure outlet for its products. Although Interbrew had supply agreements with the Whitbread and Bass retail estates, these included declining volume purchase obligations and, at the end of [✂] years, the [✂] per cent of the market represented by these agreements would be subject to full competition. The recent announcement regarding the proposed sale of the Whitbread estate and part of the Bass estate increased the uncertainty faced by Interbrew with regard to these volumes. It therefore needed to appeal to pubs as purchasers of

its beers and, through them, to the ultimate consumers. It aimed to do this through the variety and quality of its beers, in the context of a highly competitive and open market.

*(q)* Interbrew believed in the importance of brand diversity. Its range of speciality beers in Belgium and other continental European countries showed its willingness to provide a wide range of beers to its customers, and ultimately to consumers, and indicated that, in contrast with the other international brewers that had participated in the auction for Bass Brewers, it did not have a 'single product' mentality. Interbrew offered real opportunities for Bass Brewers and the former Whitbread brewing business, which were operating in a declining UK market to develop their relevant export businesses.

## The rationale for the transaction

5.3. Interbrew submitted that the transaction would produce beneficial effects. These were as follows:

*(a)* The transaction (as was the case with the acquisition of WBC) would bring to an end the vertical ownership links between Bass's brewing and retail operations and provide Bass's retail estate with the flexibility to source more beer from other brewers. The Bass retail estate was the fourth largest independent pub group estate in the UK measured by number of outlets, accounting for about [✂] per cent of UK on-trade beer purchases.

*(b)* Interbrew was committed to brewing. That was its sole core business. In that respect, it contrasted strongly with both Whitbread and Bass, each of which had concluded that brewing was no longer core to their business. Interbrew was committed to local brands in the countries where it operated. That commitment would ensure that the acquisition of Bass's brewing interests would benefit the consumer, by promoting existing brands and developing new products. Interbrew's commitment to brand variety at the local level distinguished it from the other major international brewers who had been bidders for the Bass brewing interests, namely Carlsberg, Heineken and South African Breweries, and also contrasted with the approach of Anheuser-Busch and Guinness.

*(c)* The decisions of both Whitbread and Bass to exit brewing had created inevitable uncertainty, particularly given the declining margins of UK brewers in recent years. Interbrew estimated that the total profit pool for brewing activities had declined from £673 million in 1986 to £550 million in 1999—a reduction in real terms of over 50 per cent—despite the significant cost reductions that had been implemented over that period. That decline was largely due to the fact that the overall margin pool available to brewers and retailers had switched significantly in favour of the retailers, as retail prices had risen and wholesale prices had fallen. Interbrew's acquisition of the Bass and Whitbread brewing businesses would end that uncertainty, with beneficial effects for customers, consumers and employees of the two businesses. The merged group would have access to resources for investment in brands and new product development and would be able to optimize the efficiency and cost effectiveness of its operations.

*(d)* As part of a major international brewing group, the merged UK entity would have significantly greater export opportunities, in particular in the USA and mainland Europe. Interbrew's extensive operations around the world would provide the merged entity with a platform to increase sales outside the UK of beer brands such as Bass, Boddingtons, Caffrey's, Carling and Tennents.

5.4. Interbrew further submitted that the commercial rationale of the transaction had to be seen in both a UK and global context. The UK beer market had historically been very fragmented. As a result of the 1989 Beer Orders,[1] the degree of vertical integration had substantially reduced and had led to the emergence of large chains of independent pubcos which exerted considerable purchasing pressure on brewers. These pubcos now played a major role with regard to brand development in the UK. In 1989, approximately 73 per cent of UK pubs had been owned, and either managed or leased, by a brewer. After Interbrew's acquisition of WBC and Bass Brewers, that proportion had reduced to approximately 21 per

[1]See glossary.

cent, of which one-fifth—ie about 4 per cent of all UK pubs—was attributable to S&N. The remaining 17 per cent was owned by regional brewers.

5.5. Brewers' net selling prices had declined in real terms by over 15 per cent in the last ten years, excluding duty, because of the increasingly competitive market environment, coupled with a fall in demand from about 65.5 million hectolitres in 1990 to under 59 million hectolitres in 1999, particularly in the on-trade, reflecting the continued trend towards increased off-trade consumption driven in part by increased on-trade retail prices and decreasing off-trade prices, demonstrating consumer price sensitivity. That had caused a significant decline in brewers' margins despite major cost reduction programmes. Those developments had led to an inevitable consolidation of brewing activities in an effort to reduce costs. Between 1990 and 1999, 28 breweries were closed in the UK but the industry still had excess capacity and only minimal capital expenditure would be required to increase or modify capacity should this be necessary. A number of brewers had exited brewing in order to focus on their retail or other leisure activities. However, the regional brewers exhibited a different trend. The recent acquisition of both Marston's and Mansfield by Wolverhampton & Dudley and that of Morland by Greene King had led to the emergence of two major 'supra-regional' brewery groups, both of which remained vertically integrated with retail estates, as did nearly all regional brewers.

5.6. At the global level, the brewing industry was undergoing a period of rapid consolidation; over the last 12 months the following transactions had occurred:

— Heineken's acquisition of Cruzcampo in Spain (about 34 per cent of the Spanish market);

— the Brahma/Antarctica merger in South America (about 67 per cent of the Brazilian market);

— S&N's acquisition of Danone's European operations including, in particular, Kronenbourg of France (about 41 per cent of the French market);

— the Carlsberg/Orkla merger announcement (about 61 per cent of the Norwegian market, 57 per cent of the Swedish market and 72 per cent of the Lithuanian market);

— Carlsberg's acquisition of Feldschlossen, the largest Swiss brewer with 45 per cent of the Swiss market;

— the acquisition by South African Breweries of Radegast and Pilsner Urquell from Nomura in the Czech Republic (about 44 per cent of the Czech market); and

— the very recent announcement by S&N that it was entering into a joint venture to run Central de Cervejas, the Portuguese brewer and distributor (about 41 per cent of the Portuguese market).

5.7. Interbrew submitted that, as a major international brewer, it sought to be part of this global consolidation. Its international reach had developed substantially over the last ten years, illustrated by its acquisition of Labatt in Canada, its acquisitions in central and eastern Europe and its investment in south-east Asia. Earlier this year it had sought to acquire Kronenbourg but had been outbid by S&N. It was not surprising that the auction process for Bass Brewers had provoked the interest of a number of leading international brewers.

5.8. Interbrew said that within the global context it was always watching for opportunities for expansion. It had decided to take the opportunity presented by the Whitbread exit from brewing to secure the position of Stella Artois in the UK and gain access to the full economic income stream, rather than simply a royalty stream. At the same time, Interbrew was gaining a direct presence in the UK beer market, a major market and the second largest in Europe, and which had a strong reputation for local speciality beers and ales which matched Interbrew's unique approach to the beer industry.

5.9. Interbrew said that Bass's decision to dispose of its brewing interests at around the same time as Whitbread exit was, from Interbrew's perspective, purely coincidental, although not surprising. However, Interbrew's decision to acquire WBC was only made after it was judged that there was a strong prospect of acquiring Bass. Interbrew had a strong commercial rationale to acquire the Bass brewing interests for the following reasons:

*(a)* Bass operated its brewing business in the UK, which was one of the major European markets; and it had a presence in the Czech Republic, where Interbrew had not hitherto been active.

*(b)* The combination of the Bass Brewers and Interbrew UK businesses would provide a number of synergies which would enable the businesses to reduce their cost base and consequently reduce the decline in margins resulting from falling wholesale prices, thereby providing an opportunity to increase brand investment and maintain diversity of brands. [

*Details omitted. See note on page iv.*

]

*(c)* There was a complementarity in the product ranges of the two businesses in that Interbrew UK did not own or have a licence to produce any major standard lager brand, while Bass Brewers did not own any major premium lager brand. The only significant premium lager in its portfolio was Grolsch, which was brewed under licence by a joint venture company of which Bass Brewers was a 49 per cent shareholder.

*(d)* Interbrew's international reach would open up major new export opportunities for Bass Brewers. Bass was already the UK's leading beer exporter but the lack of any significant international brewing presence on the part of Bass had meant that opportunities to grow the export business of Bass Brewers further were limited. That would now change. Given the decline in demand for beer in the UK, that had important consequences for the longer-term security of Bass Brewers and the cost effectiveness of its operations.

## Industry background

5.10. Interbrew described the changes in the UK beer industry during the last ten years and the effect these had had on the market. It submitted that the following factors should be considered when evaluating the competitive impact of the transaction: trends in demand; reduction of vertical integration; growth of the independent pubcos; developments in the off-trade sector; consolidation among the regional brewers; developments at the wholesale/distribution level; and imports and other related developments.

### *Trends in demand*

5.11. As regards trends in demand, Interbrew said that beer competed with other beverages, notably cider, wine, FABs, spirits, soft drinks and bottled water. Total UK beer consumption had declined in recent years while overall consumption of other beverages, particularly cider, wine and FABs, had grown. In 1975, 64.6 per cent of UK alcohol consumption in the UK was represented by beer, 12.1 per cent by wine and 2.3 per cent by cider. By 1997, the share of alcohol consumption in the UK represented by beer had fallen to 53.5 per cent, while the share of wine had risen to 22.7 per cent and of cider to 5.5 per cent. Total UK beer consumption was declining year on year, although the rate of decline had been slower in the last five years than in the previous five years. Consumption in 1990 had been 65,184,000 hectolitres; in 1994, 60,575,000 hectolitres; in 1999, 58,917,000 hectolitres. One area of beer consumption which had prospered had been that of personal imports, mostly from Calais, which in 1990 had amounted to 3 million hectolitres—just under 5 per cent of overall UK consumption—and was still growing. Total imports now represented almost 14 per cent of the UK market.

5.12. As to the differences between the on-trade and off-trade markets, demand for beer was in overall decline, but there was a continuing shift towards off-trade consumption, driven largely by the widening retail price differential between these two channels. In 1996, the on-trade share of total consumption was 72.3 per cent and the off-trade share was 27.7 per cent; in 1999, the on-trade share was 68.1 per cent and the off-trade share was 31.9 per cent. Interbrew expected this shift towards the intensely competitive off-trade market to continue and intensify: it pointed out that a number of third parties had forecast a continued shift from the on-trade to the off-trade.

5.13. Interbrew said that the UK beer market had shown a shift from draught beer products to packaged products. In 1980, about 79 per cent by volume of all beer consumed had been draught beer and 21 per cent had been packaged beer. Interbrew estimated that, in 2000, 62 per cent of all beer consumed would be draught beer and 38 per cent would be packaged beer. Almost all packaging in the

UK beer market was non-returnable, which removed the barriers to entry present in other European beer markets. Forecasts indicated a further shift from draught to packaged beer. One forecast suggested that that draught lager was set to continue to lose market share to bottled lager.

5.14. Interbrew concluded by saying that all the trends in demand noted above had served to place growing competitive pressures on brewers in the UK.

## *Reduction of vertical integration*

5.15. Interbrew stated that the previously high level of vertical integration between brewers and pubs had declined significantly since the 1989 Beer Orders, as the national brewers had disposed of thousands of pubs and some brewers had exited brewing altogether. The acquisition by Interbrew of the Whitbread and Bass brewing interests had severed two major sets of vertical links and reduced the proportion of the retail on-trade effectively foreclosed to competition by ownership or tying relationships. Whitbread accounted for about 4.5 per cent of UK on-trade volume (about 3,350 outlets) and Bass accounted for about 5.6 per cent (about 3,050 outlets). As discussed in paragraph 5.4, the proportion of UK pubs owned by brewers had declined from 73 per cent in 1989 to 21 per cent in 2000.

5.16. Interbrew stated that there were four methods by which a pub might be supplied by a brewer. In decreasing strength of vertical link, these were:

*(a)* *Managed estate.* A managed estate was owned by a brewer and managed on its behalf by employees of the brewer or of the brewer's group. Such estates were not subject to the guest beer provision[1] of the Beer Orders. Interbrew owned no managed estates.

*(b)* *Leased estate.* The lessee would typically lease the outlet from the brewer and would normally be required to acquire all or a proportion of the beer from the landlord brewer, subject to the guest beer provision of the Beer Orders. Interbrew had no leased estate.

*(c)* *Loans.* Up to the early 1980s, UK brewers actively used loans to secure distribution relationships with independent outlets, known as 'free trade' outlets. Loans were granted at favourable market rates of interest in return for the outlet purchasing beer from the lending brewer at full price list or lower than average levels of discount, and were subject to the provisions of the Beer Orders. Both Interbrew UK and Bass Brewers had been scaling down their loan books as loan ties had become less significant in the industry because of the increasing willingness of banks to provide funding to independent outlets and also because of changes in brewers' own strategies. Interbrew expected this decrease in the importance of loans from brewers to continue as loans from brewers granted in the early 1990s came to an end. Bass Brewers' loan book now stood at about [ ✄ ] of what it had been at its height and Interbrew UK's loan book stood at about [ ✄ ] of what it had been at its height.

*(d)* *Other trading arrangements.* If a pub were not party to any of the above three types of arrangement, it normally either traded with one or more brewers on the basis of trading letters or it could choose to enter into supply agreements with one or more brewers or with an independent wholesaler.

5.17. Interbrew said that the different forms of supply relationship had different competitive significance. Pubs managed by a brewer or leased to self-employed individuals were essentially retail outlets for the products of the relevant brewer who might also wholesale other beers on a factored basis (see paragraph 5.41). There was little scope for competitive penetration of such outlets by other brewers.

5.18. Under the Beer Orders, loan arrangements must be terminable upon three months' notice by the borrower. That, combined with the increased ease of availability of alternative means of finance for outlets, meant that loan arrangements were now no more restrictive of a pub's purchasing choices than an ordinary short-term supply agreement. In both cases, the pub was able to switch supplier at little cost and relatively quickly sometimes on the same day. However, switching costs for the retailer was avoided by a

[1]The guest beer provision is a provision of one of the Beer Orders under which a tied customer, lessee or tenant, must be free to purchase at least one brand of cask-conditioned beer from a supplier other than the brewer to which its custom is tied. See glossary.

Code of Practice[1] whereby cellar equipment remained in its place with ownership simply transferring between outgoing and incoming brewer according to an agreed formula. [ *Details omitted. See note on page iv.* ] The value of loans to outlets by national brewers was estimated to have nearly halved over the last seven years.

5.19. Supply agreements and trading letters gave the greatest scope to competitive sourcing. They were negotiated on an arm's length basis, and were usually non-exclusive: that meant that several brewers provided beer, allowing publicans to select a range of different beers and supplement their requirements on a 'spot' basis from wholesalers and/or cash-and-carry outlets. These agreements were usually for a period not exceeding three years and rarely beyond five years. Such agreements might require the pub to take a minimum specified volume of beer from the supplying brewer, but these volumes were often set at a low level. In addition, it was increasingly common for pubs to switch suppliers even before the end of existing supply agreements. These agreements were extremely complex and were negotiated on a number of issues depending upon the requirements of individual customers.

## *Growth of the independent pubcos*

5.20. Interbrew submitted that the very considerable reduction in vertical ownership links over the last ten years had facilitated the growth of independent pubcos. There were essentially two types of independent pubco, leased pubs and managed pubs. Leased pubs were leased by a pubco, such as Pubmaster Limited (Pubmaster), Nomura or Enterprise, to an individual, while managed pubs were managed by employees of a pubco, examples being Regent Inns, Yates Brothers and Wetherspoon. Some pubcos, such as Punch, had a mix of managed and leased pubs. These pubcos were increasingly acting as independent wholesalers for the outlets in their managed or leased estates. By taking over the order-capture function, the pubcos interposed themselves between the brewers and the individual outlets within their estates.

5.21. As regards leased pubs, pubcos provided their lessees with extensive lists of products from which each individual lessee might choose the products to be supplied to it. Interbrew provided a list of the wide range of products from a number of brewers made available to lessees of Punch, Pubmaster and Enterprise. As regards managed pubs, the choice of beers sold was generally centrally negotiated and the individual outlets, although not the groups of which they were part, had a more limited choice of the beers that were to be sold on their premises. In neither managed nor leased pubs did brewers' sales representatives have access to individual outlets without agreement with the pubco and even then it was only to implement steps agreed with the pubco.

5.22. Over the last ten years, there had been significant developments in pub ownership. Outlets owned by national brewers had reduced from 32,000 in 1989, before the Beer Orders, to under 9,000 by January 1999, and further to 2,650 owned by S&N by September 2000, as a result of Bass and Whitbread having shed their brewing operations. The size of the leased estates of the regional brewers had also fallen, from 9,000 in 1989 to 5,939 in September 2000; the managed outlets of the regional brewers had numbered 3,000 in 1989 and 3,948 in September 2000. The most significant increase was in relation to the number of independent operators with multiple outlets, from none in 1989 to 31,606 by September 2000. Independent pubcos with 30 or more outlets now accounted for approximately 50 per cent of all UK pubs; the largest of these were Punch, Nomura, Bass and Whitbread.

5.23. In 1994, the then four national brewers (Allied, Whitbread, Bass and S&N) owned the four largest pub estates. By 2000, the size of those estates had been surpassed by Punch and Nomura. Whitbread and Bass themselves were now major independent pubcos; S&N was now the only national brewer with its own pub estate. Two regional brewers, Wolverhampton & Dudley and Greene King, featured among the ten largest pub-owning groups. Substantial pub-owning entities had been created by Punch, Enterprise Inns, Nomura, Pubmaster and others. The strength of the independent pubcos could be seen in the supply agreements they entered into with the brewers; Interbrew provided examples of these, stating that they showed the rise in the negotiating power of the pubcos in recent years with the result that wholesale margins had been forced downwards and the number of brewers and other suppliers supplying any one estate had increased across the board. Pubcos derived their income in large part from the discounts obtained from brewers and the difference between the price paid for beer, and the price at

[1]BLRA 1994 Code of Practice for the Dispense of Beer by Pressure Systems in Licensed Premises.

which it was retailed or sold to their lessees. Pubcos were increasingly renegotiating their supply agreements part-way through the term of existing agreements and were playing suppliers off against one another on the issue of price during the course of such renegotiations in order to expand their margins.

5.24. The last five years had seen a period of consolidation and expansion of a number of significant pub chains, such as Nomura, Punch, and other independent retailers. About 12,000 UK pubs had changed hands in the last 20 months.

5.25. The changes in the retail sector which had taken place as a result of the creation of the pubcos and deal activity had had a direct impact on the supply of beer to the on-trade. Brewery-owned pubs acquired virtually all their requirements from the owner. By contrast, pubs that were owned by an independent pub group had access to a much wider range of products. This was particularly so in leased pubs, where the number of beers from which selection was possible often exceeded 100 and where the number of suppliers could exceed 20. Pubcos with managed estates exercised more control over the brand range within their outlets but, nevertheless, such outlets had access to a wider choice than was available in brewer-owned pubs.

5.26. The decision on which beers to stock was often the result of a tender process. Selection was made on the basis of a range of criteria, including price, brand position and service levels. The size of the independent pubcos and the importance of these in volume terms to the brewers, were such that each brewer was incentivized to compete strongly to win or retain a supply contract. By way of example, the total annual volume supplied to Punch (estimated to be about 2.5 million hectolitres) was the equivalent of the total production of 2.5 average-sized breweries in the UK. In addition, every transaction in the on-trade retail sector provided a renewed opportunity for the pubcos in question to renegotiate their supply agreements. For each brewer, the volumes supplied to these pubcos was key to fixed-cost recovery. By contrast, pubcos could easily replace brands. For this reason, apparently less-consolidated pubcos could impose conditions on and demand significant discounts from more consolidated brewers. Given that the market valued the brewers' profit margins with a multiple, a loss of a contract worth £10 million represented a loss in shareholder value of £100 million. This potential destruction in shareholder value forced brewers to compete vigorously to win volumes.

5.27. The growth of the independent pub chains had resulted in a significant increase in buyer power. The trading behaviour of the multiple pubcos was now very much in line with that of the multiple grocers and off-licences in the off-trade sector, with purchasers buying in bulk and becoming increasingly price-sensitive and willing to source products from outside the UK. Pubcos were mostly highly-leveraged financial vehicles reliant on lessees' lease payments to cover their debt repayments. The pubcos' profits in effect derived almost exclusively from the discounts they obtained on beer (which were wholly or largely retained and not passed on to lessees) and so price was the most important factor for the pubcos in negotiation of terms with suppliers. For a supplier, the potential loss of a supply contract and the consequent effect on its cost structure was a sufficient threat to ensure renegotiation on terms favourable to the customer. There was a high proportion of fixed costs associated with brewing, and so the loss of a significant volume of sales resulted in a substantial reduction in cost recovery.

5.28. Interbrew gave examples of recent negotiations between both Interbrew UK and Bass Brewers and some of the pubcos. It said that a recent example of the power in the hands of the pub companies could be seen in dealings between Interbrew UK and Pubmaster. By renegotiating its supply contract with Interbrew UK following the purchase by Interbrew of the Whitbread brewing interests, Pubmaster had achieved a total financial gain of approximately £[✂]. Further consolidation at the retail level, coupled with the move towards greater control by the pubcos of how brands were stocked in their outlets, would only serve to increase their purchasing power.

### *Developments in the off-trade*

5.29. Sales of beer through the off-trade were predominantly through multiple grocers, off-licence chains or independent off-licences. Interbrew estimated that the top ten off-trade customers accounted for about 60 per cent of all beer supplied to the off-trade. These multiple grocers were very powerful purchasing organizations which exercised considerable buying power. In addition, beer was being increasingly used as a key value indicator by the multiple grocers with low beer prices advertised to attract consumers. To be included in such promotions required substantial funding by the supplier.

5.30. Independent retail outlets were usually serviced by cash-and-carry operators, all of which were also purchasers of beer and exercised substantial purchasing power.

5.31. Multiple grocers offered an extremely broad range of both domestic and imported beers. Interbrew provided a sample layout for beer products in a Tesco superstore. Large retail outlets and supermarkets offered a ready means of access to the UK market by foreign suppliers. Imports had led directly to the introduction to the UK market of new packaging sizes, for example, 25 centilitre non-returnable bottles—so-called 'stubbies'. Interbrew estimated that a typical multiple grocer in a larger store would stock in excess of 200 different lines of beer. It also estimated that the top nine multiple grocers had between them at least 108 private label brands, of which at least 35 were believed to be sourced from brewers outside the UK. Non-UK brewers supplied multiple grocers with their own brands as well as with own-label brands.

5.32. Both in the off-trade and in the on-trade, customers were free to source direct from overseas suppliers if they wished. There was evidence which suggested that on-trade retailers were increasingly seeking to negotiate and purchase on a European rather than national basis.

5.33. As far as multiple specialist sellers (ie specialist sellers of wine, beer and spirits) were concerned, they too exercised very considerable purchasing power and were able to source the beer which they supplied from a very wide range of domestic and Continental brewers, including, in some cases, direct imports.

5.34. Finally, Interbrew said it should be noted that one immediate consequence of the sale by Whitbread to Interbrew of its brewing interests was that those interests no longer had any ownership link with First Quench, the largest off-licence specialist retail chain, with about 2,450 outlets, which was currently 50 per cent owned by each of Whitbread and Punch. Nomura had recently announced the acquisition of First Quench (see paragraph 5.2*(i)*). This acquisition would bring under one ownership the UK's second largest on-trade group with more than 4,800 outlets and the largest specialist off-trade group, with 2,450 outlets, thereby creating an entity with even greater purchasing power. These two separate developments would together weaken the position of the former Whitbread brewing interests, now Interbrew UK, in relation to First Quench, a key off-trade customer. [✂] per cent of Whitbread's supplies to the off-trade had been to First Quench in the year to February 2000.

## *Consolidation among the regional brewers*

5.35. Interbrew submitted that regional brewers represented a considerable competitive force. A number of them had strengthened their position considerably through acquisition in recent years. For example, Wolverhampton & Dudley had, in the last five years, more than doubled its share of the UK beer market, doubled the size of its retail estate to about 2,000 pubs and now possessed brands which had national reach and brand recognition, such as Pedigree, its own brand, and Harp Irish Lager, licensed from Guinness. Similarly, Greene King had expanded significantly both by acquisition and organic growth.

5.36. Regional brewers provided a strong source of competition, bolstered in nearly all cases by a managed and/or leased estate. These estates frequently represented and therefore underpinned more than half a regional brewer's total volume output. 23 regional brewers had estates of 100 or more outlets. It was noteworthy that, in the context of a declining on-trade sector, regional brewers owned some of the fastest-growing ale brands.

5.37. Overseas companies seeking to enter the UK market by way of licence could find a route to market through regional brewers as well as national brewers. Recent examples of entry of overseas brands through regional brewers included agreements between Kirin, the Japanese brewer, and Charles Wells; Hofbrau with Hall and Woodhouse; Kingfisher (India), Hurlimann Steinbok (Switzerland) and Interbrew in relation to its Oranjeboom brand (Netherlands) with Shepherd Neame; Warsteiner with Daniel Thwaites; and Red Stripe (Jamaica) and Amstel (owned by Heineken) with H P Bulmer (the cider manufacturer, which also owned one of the major independent beer wholesalers, The Beer Seller) and Charles Wells.

5.38. Interbrew submitted that, bearing in mind the general move towards lager consumption in preference to ale and the fact that the off-trade continued to gain market share from the on-trade, the

transaction would actually provide regional brewers with a significant new opportunity, along with other competitors, to supply their products in greater quantities to the now-independent Whitbread and Bass estates (now the third and fourth largest independent pubcos). The competitive advantage of regional brewers lay in their ale brands, local consumer loyalty and local knowledge. By building on these, regional brewers could build successful brands and wholesale and retail strategies, and they were likely to continue to be credible competitors in each of these areas. Two examples of companies that were successfully executing these strategies at the moment were Fullers and Adnams, with brands that attracted local loyalty within their areas and niche status across the country.

## *Developments at the wholesale/distribution level*

5.39. With regard to wholesaling in the on-trade, Interbrew submitted that a distinction needed to be drawn between the wholesaling function, including order-taking, and physical distribution. Wholesaling of beer to the UK on-trade was undertaken principally through three separate routes, namely, the national brewers, regional brewers and independent wholesalers. Interbrew estimated that about 70 per cent of the on-trade was supplied through national brewers, and 20 per cent by regional brewers. The remaining 10 per cent was accounted for by independent wholesalers and by on-trade outlets purchasing packaged beer direct from cash-and-carry outlets. With the emergence of a number of large pubcos, those pubcos were themselves taking over the wholesale function for their estates, thereby creating a new wholesale route to market.

5.40. There were about 700 wholesalers serving the on-trade. The three major independent national wholesalers were Matthew Clark, owned by Constellation Brands, a major Canadian company; The Beer Seller, owned by H P Bulmer; and Tavern. Major wholesalers faced competition from National Drinks Distributors, a consortium of 27 wholesalers. Matthew Clark and H P Bulmer were also producers of their own leading brands of cider, which strengthened their overall product offering. H P Bulmer also held UK exclusive distribution rights for certain foreign beer brands.

5.41. Brewers who were wholesalers of beer also made sales of other brewers' products—so-called factored sales—as a means of both supplying a full product portfolio to satisfy customer demand and spreading their costs across a wider product range. Interbrew estimated that factored sales represented about 10 per cent of the total on-trade market. Most of this was represented by sales of Guinness and Budweiser. Out of the beers which Bass Brewers factored, about [✂] per cent was represented by beers brewed by regional brewers. Out of the beers which Interbrew UK factored, about [✂] per cent was represented by beers brewed by regional brewers. Interbrew believed that regional brands would continue to play a significant role as brands factored by the merged entity, in the light of continuing customer demand for these niche products. [ *Details omitted. See note on page iv.* ] These volumes could not simply be replaced by own volumes as they were supplied in response to customer demands.

5.42. In terms of developments at the wholesale level, Interbrew considered that the following points should be noted:

*(a)* The so-called independent wholesale sector represented about 7.5 per cent of the on-trade market, and about 15 per cent of the independent sector, that is, outlets (that are not part of a significant retail pub chain). Although this figure had not altered substantially in recent years, independent wholesalers continued to have an important part to play in the market and were increasingly able to invest where new opportunities arose. Matthew Clark and The Beer Seller had received significant financial investment recently through being acquired by a larger concern (see paragraph 5.40). Each of the three major wholesalers (Matthew Clark, The Beer Seller and Tavern—see paragraph 5.40) had significant customer bases and were leading drinks distributors.

*(b)* Pubcos were increasingly acting as independent wholesalers for outlets in their estates, in particular where those estates were leased. The main impact of this had been on the brewers, who had formerly acted as wholesalers to those tied estates. However, this had also impacted on independent wholesalers as the pubcos sought to capture the wholesaling margin for themselves.

*(c)* The major independent pubcos purchased on a centralized basis and were increasingly operating centralized wholesaling systems. For example, Supplyline, owned by Nomura, and Avebury Direct effectively acted as wholesalers for their tied estates, providing single-point order capture,

customer service, telesales and invoicing for their lessees. The pubcos had therefore effectively created a new and powerful independent wholesale function.

*(d)* E-commerce represented an important new opportunity for entry at the wholesale level and there were already at least seven online trade wholesale suppliers. Some e-commerce wholesalers, as well as traditional wholesalers with online ordering facilities, were already enjoying discounts equal to the highest available on the market. For example, Cellaronline.com, one of the online wholesalers funded by venture capital including backing from BT, claimed to have secured discounts of more than £[✄] per barrel even before launch from more than one national brewer and from one regional brewer. This discount was equivalent to that received by medium-sized pub chains with around 500 outlets. Eskye.com, which was the premier US online drinks wholesaler, had recently opened an office in London, headed by a former executive of Diageo plc (Diageo), and bevaccess.com, another international online wholesaler, had opened a UK office in July 2000, launched by the former Chairman of Seagram. H P Bulmer/The Beer Seller had very recently launched pubserve.com as a one-stop shop for pubs with a single buying point for beers, wines, spirits and soft drinks, catering and food service products, and claimed to have already direct-mailed 17,000 outlets nationwide.

*(e)* Interbrew considered that brewers were likely to view such operations as a viable alternative route to market for their products, increasingly so as consumers continued to switch to non-beer products. Booker had announced that it would be launching a business-to-business trading platform in October 2000 focused on the pub and catering sector. It would use its purchasing leverage from its cash-and-carry operations and the Iceland supermarket chain to source the products and would use its 190 depots and logistics expertise to deliver products directly to independent and pub group outlets alike. Interbrew estimated that 50 per cent of on-trade outlets and 75 per cent of national pub chains already had internet access. This provided the opportunity for companies to set themselves up as on-line wholesalers. Buyer power would be dramatically increased by the creation of retailer trading exchanges such as the recently-announced Hospitality Exchange involving Bass, Whitbread, Granada-Compass and Accor, whose sole purpose was to combine their purchasing leverage across and within product sectors and across national borders.

*(f)* In addition, Interbrew believed that at least 20 consumer-focused online drinks operations, for example lastorders.com, alestore.com and theboozebus.com, were also redefining traditional routes to market. If even a proportion of those operations were successful, that would place increased pressure on suppliers.

5.43. As to physical distribution to the on-trade, this broke down into primary and secondary distribution. Primary distribution involved the transport of beer to regional depots, which might belong to brewers, wholesalers, pubcos or retail chains. Secondary distribution involved the transport of beer from the regional depots to individual retail outlets, namely pubs, hotels, clubs and restaurants.

5.44. In relation to the on-trade, Bass Brewers had since 1995 outsourced distribution to Tradeteam, a joint venture with Exel. Tradeteam was managed independently of Bass Brewers. It operated a primary transport fleet for delivery between the Bass breweries and depots or customer warehouses. Tradeteam's secondary fleet undertook delivery from the depot to the individual customer. Interbrew UK undertook primary and secondary distribution itself unless otherwise required by the customer.

5.45. As far as other brewers were concerned, Interbrew said that: S&N split its distribution between a third party, Hays, and its own in-house operations; Carlsberg-Tetley undertook its own distribution, although it also used some regional brewers, such as the St Austell brewery in Cornwall; Anheuser-Busch outsourced its primary distribution to Bibby, with its secondary distribution undertaken by a mix of other brewers and independent wholesalers; Guinness, like Anheuser-Busch, outsourced its primary distribution to TDG, undertaking secondary distribution through other brewers and independent wholesalers; Wolverhampton & Dudley and Greene King undertook most of their own distribution; and, as to the other regional and local brewers, most undertook their own distribution but some outsourced their distribution. Some regional brewers undertook distribution for the national brewers, notably in areas outside the brand owner's core geography.

5.46. Pubcos were increasingly taking control of the distribution chain, frequently appointing one logistics company to undertake distribution to their individual outlets. Most developed UK retail markets

exhibited control by retailers of distribution, and Interbrew expected this to become the norm for the larger pubcos. If a brewer's logistics operation were appointed to provide a secondary distribution service, it would deliver all beer selected for each outlet, regardless of its manufacturer. Interbrew UK did not provide this type of secondary distribution to any of the major pubcos other than to the retail estate of Whitbread.

5.47. Interbrew contended that there was no scope for a brewer-owned logistics operation to discriminate in favour of or promote its own products. The logistics provider was contracting with the pubco and it was the pubco that dictated the terms. By taking over the contracting out of secondary distribution, the pubcos had both enhanced their retail control and successfully weakened the competitive position of the brewers with whom they contracted.

5.48. As to physical distribution to the off-trade, the multiple retailers tended to arrange their own secondary distribution to individual outlets. Primary distribution tended to be arranged by the brewer or subcontracted to a third party.

### *Imports and the international dimension*

5.49. Interbrew submitted that the UK beer market was extremely international, and an open market as far as international brewers were concerned. Four of the top eight global brewers produced beer directly in the UK, namely Anheuser-Busch, S&N, Carlsberg and now Interbrew. Heineken and Miller were also present in the UK market through licence arrangements. Guinness had a 'top ten' brand in the UK.

5.50. Overseas brewers not only had their brands brewed directly in the UK under licence, but also imported their products. This method of entry had traditionally been associated with the off-trade. The growth in the off-trade sector in the UK over recent years had provided increased opportunities for overseas brewers to import their brands in this way. However, the on-trade was now also increasingly adopting the purchasing habits of off-trade retailers, including sourcing products from abroad. These products could be in packaged or draught form. For example, bottled Budweiser Budvar was currently being imported into the UK from the Czech Republic and was widely available through on-trade retailers, while the supply of this brand in draught was currently on trial in the UK through the Punch and Hogshead retail chains.

5.51. In addition to direct imports from overseas brewers, the level of personal imports had grown significantly in the UK in recent years. Such products represented nearly 5 per cent of total UK beer consumption. The high levels of duty in the UK—at 33 p per pint on average over six times the level of duty in France—made it an attractive option to consumers to purchase products for their own personal consumption from outlets on the continent. Tesco had recently opened a superstore outlet in Calais, in order to benefit from the sale of products to UK consumers.

5.52. Independent wholesalers had an important part to play in the sale and distribution of imported brands, as a result of national distribution networks. Certain specialist wholesalers had focused on providing a route to market for imported brands, particularly into the cafe/bar sector.

## Competitive pressures in the UK beer market

5.53. Interbrew submitted that the following key competitive aspects of the UK beer market should be considered: consumer pressure; customer pressure from retailers, both in the on- and off-trade; competitive pressure from brewers, both actual and potential, and pressure from imports. Interbrew stated that the result of these competitive pressures had been a continuing downward fall in the wholesale price of beer (1992: 100; 1998: 90) and that that was the context within which the competitive assessment of the merger should be made.

## *Consumer pressure*

5.54. The consumption pattern of the ultimate consumer necessarily had an effect on Interbrew UK's and Bass's brewing operations, even though they now had no retail estate. Consumption patterns brought the following competitive pressures to bear:

*(a)* The decline of the overall market and in particular of the on-trade placed direct pressure on brewers' operations. Given that the bulk of brewers' fixed costs derived from serving the on-trade, falling volumes placed upward pressure on brewers' unit costs in this still very important part of the market.

*(b)* The shift from draught beer to packaged beer had increased the opportunities for Continental brewers to import into the UK, because it was easier to import packaged rather than draught beer.

*(c)* Customers were now more discerning and ready to try new beers and drinks. Bacardi Breezer had achieved more than 40 per cent share of the FAB market in the space of three years and had achieved a sales volume greater than the total of draught Bass. Wine and cider had also increased their share of the alcoholic beverages market.

*(d)* Female drinkers were on the increase but tended to prefer other alcoholic drinks to beer.

5.55. Interbrew provided survey evidence to show that consumers were less loyal to any particular beer brand than they once were: between 1991 and 1999 the proportion of people who drank cider, wine or spirits in addition to lager and bitter had continued to rise.

## *Customer pressure*

5.56. As to on-trade customer pressure, Interbrew submitted that the result of pubco consolidation had resulted in a considerable increase in buyer power and additional opportunities for customers to renegotiate terms of supply (see paragraph 5.28). Pub companies were sophisticated buyers, with key management aware of the cost structures of brewers from their days in a vertically integrated industry.

5.57. Interbrew said that smaller customers, namely smaller independent pubs, had also benefited from the downward trend in wholesale prices. Interbrew UK's sales to on-trade customers purchasing [ ✂ ] of beer a year indicated an overall reduction in price per barrel in money terms, excluding duty, over the last three years. Bass Brewers' discounts to this sector had increased from £[✂] per barrel to £[✂] per barrel over the last five years. Competition for the business of smaller independent customers was intense despite the fact that they did not order comparable volumes to those ordered by the large multiple pub chains. Factors putting pressure on prices to smaller on-trade customers included:

*(a)* increased awareness of the broad level of discounts, which were published in *The Publican;*

*(b)* the greatly increased range of discounts now given; some of the larger customers obtained discounts of around [✂] per cent off the wholesale list price;

*(c)* brewers had become increasingly dependent on the independent free trade and so competed aggressively;

*(d)* secondary wholesaling (reselling of beer by pubcos to independents) was prevalent;

*(e)* buying consortia exerted additional purchasing pressure;

*(f)* illegal imports added to competitive pressures;

*(g)* online wholesaling operations benefited customers; and

*(h)* small chains with independent outlets could achieve high discount levels.

5.58. As to off-trade customer pressure, almost all Interbrew UK's and Bass Brewers' sales were to chains with substantial purchasing power. Large multiple retailers were fighting for market share with

discounted retail prices. They tended also to fix a ceiling on prices to be paid. Currently retailers were competing on bulk purchases and promotional offers on larger packs were part-funded by brewers.

## *Competitive pressures from brewers*

5.59. Interbrew gave us information about its major UK competitors, namely:

- S&N;
- Carlsberg-Tetley;
- regional brewers;
- Guinness;
- Anheuser-Busch;
- Heineken; and
- imports.

5.60. Interbrew observed that the three largest brewers in the UK, namely itself, S&N and Carlsberg-Tetley, were now each part of major international brewing groups with significant financial resources; these brewers could be expected to compete fiercely with each other in those markets where they operated.

5.61. S&N was a significant competitor, with a market share not far short of Interbrew's and a significant tied retail estate. As to Carlsberg-Tetley, Interbrew did not accept the suggestion that Carlsberg-Tetley might become marginalized, for the following reasons:

*(a)* Carlsberg-Tetley was 100 per cent owned by Carlsberg, one of the largest brewers in the world, which had made clear its commitment to stay in the UK market, and had been itself an unsuccessful bidder for Bass Brewers. Carlsberg had issued a press release after its unsuccessful attempt to purchase the Bass brewing operations, in which it stated that 'Carlsberg is committed to remaining an important player on the British market as Carlsberg-Tetley develops successfully both economically and in the market';

*(b)* Carlsberg-Tetley had strong brands, notably a leading global lager brand, Carlsberg and the number two UK ale, Tetley, along with the resources of a major international group to back it;

*(c)* Carlsberg's integrated marketing campaign as official sponsor of Euro 2000, official supporter of the England football team and broadcast sponsor for all ITV's coverage of the event, had led to a reported increase in overall sales of nearly 50 per cent during the tournament. The Carlsberg-Tetley's Director of Marketing had stated that 'Carlsberg as a brand is considerably bigger now than it was during Euro '96';

*(d)* Carlsberg had an extremely efficient operation in the UK following a successful reorganization over the last three years and the Chief Executive was quoted in the *Financial Times* of 17 June 2000 (very shortly after Interbrew announced its agreement to acquire the Bass brewing interests) as insisting that the business would continue to flourish. He went on to say that 'of course we were disappointed not to buy the Bass brewing business … but we have already restructured the business and reduced our cost base'. In addition Carlsberg had recently re-capitalized its financial structure so as to be able to gain access to external funding and therefore invest in its international operations, of which the UK was the most significant.

*(e)* Carlsberg had a strong national network; its guaranteed supply contract until [✂] with the former Allied-Domecq estate (approximately 3,500 pubs) made it the major supplier to one of the largest national estates as well as supplying large proportions of at least four other major national estates. These pubs were recently sold to Punch and BLR, although the supply agreement remained in force, with both Punch and BLR obliged to purchase significant volumes from Carlsberg-Tetley until [✂].

*(f)* Carlsberg was the primary supplier to the Punch estate, having won significant additional volume in a recent tendering process in competition against all major brewers including S&N, Interbrew UK and Bass Brewers. The estimated total volume it now supplied to the Punch estate was 1.5 million hectolitres.

5.62. In Interbrew's view, Carlsberg's participation in the auction of Bass Brewers did not suggest that Carlsberg-Tetley was not a viable business, any more than its recent mergers in Scandinavia indicated such a weakness. Carlsberg-Tetley was larger than Interbrew UK, and other smaller producers, such as Anheuser-Busch and Guinness, also backed by large international groups, had managed to grow market share, volumes and profits in the UK in recent years. Over the last year, Carlsberg-Tetley had increased its market share in both the on-trade and the off-trade. Carlsberg's participation in the sale process was consistent with activity at the international level where the globalization of the industry meant that all international brewers were generally participating in the sale of any major brewing interests that became available.

5.63. As far as Heineken was concerned, it had been reviewing its UK strategy even before the decision of Whitbread to exit brewing. Interbrew believed that Heineken would use that that decision as a catalyst to refocus its UK operations. Interbrew had no doubt that Heineken, with its significant standing as an internationally recognized brand and its huge financial resources, would be a significant competitive force in the UK market in future.

5.64. As to Anheuser-Busch, Interbrew commented that, following the acquisition of the Mortlake Brewery in 1997, Anheuser-Busch had achieved a situation in which its leading Budweiser brand was one of the major packaged beers in the UK and currently the number two premium lager overall and the number two premium lager in the off-trade.

5.65. As to the position of the regional brewers, Interbrew considered them to be a significant competitive force. They were different in size and scale from the three major national brewers and did not seek to mimic them, nor would it make sense for them to do so. However, that did not make them any less competitive. Supplying a relatively densely-situated regional estate enabled these competitors to keep distribution costs low. Regional brewers were able to build brands through their own estates and achieve wider distribution through supply arrangements with other brewers.

5.66. As to imports, including personal imports, these had become a significant competitive factor in the UK beer market, representing about 14 per cent of beer consumption.

5.67. Interbrew submitted that an important competitive aspect of the UK beer market was the high degree of brand fragmentation. The strength of individual beer brands was very low relative to the strength of leading brands in other fast-moving consumer goods markets. The top three beer brands in the UK accounted for only about 22 per cent of the total market. This was much lower than the share held by the top three brands in other fast-moving UK consumer goods markets. For example, the top three instant coffee brands held about 77 per cent of the instant coffee market, and the top three squash drink brands held about 58 per cent of the squash drinks market.

5.68. Carling was currently the number one brand in the UK but accounted for only about 10 per cent of the total market. The positioning of brands in the UK beer market was not static, as was shown by the change in the top ten brands between 1989 and 1999. Interbrew provided a table showing top ten beer brands in decreasing order for each of those years; this is reproduced in Table 5.1.

TABLE 5.1 **Top ten beer brands in 1989 and 1999**

| *1989* | *1999* |
|---|---|
| Carling | Carling |
| Heineken | Fosters |
| Guinness | Stella Artois |
| Fosters | John Smiths |
| Carlsberg | Guinness |
| Tetley | Carlsberg |
| Tennent's Lager | Heineken |
| Castlemaine XXXX | Tetley |
| Stones | Tennents |
| Skol | Budweiser |

*Source:* Canadean Limited, Bass and Interbrew estimates.

5.69. Interbrew said that the merged entity would own only three of the top ten beer brands, namely Carling, Stella Artois and Tennents, all of which were placed in different segments of the beer market:

Carling was a standard lager sold mainly in England and Wales, Stella Artois was a premium lager and Tennents was essentially only sold in Scotland. The merged entity would own only eight of the top 30 beer brands, namely Carling, Stella Artois, Tennent's Lager, Worthington, Boddingtons Bitter/Gold Stones, Caffrey's and Draught Bass (a ninth, Grolsch, was brewed under licence). The position of the top 30 brands changed over time. Since 1989, consumer tastes had led to the discontinuation of some brands, the relaunching of others and the introduction of new brands. The increase in number of microbreweries had also led to an increase in the number of new brands. The *Brewery Manual* for 1999 indicated that 269 new brands (a figure which included brand extension, FABs and brand renaming) came on to the UK market in 1999, a figure which represents 42 per cent of the total number of brands listed in the manual for that year.

5.70. Interbrew said that the top six brands of the merged entity would account for only approximately 20 per cent of the overall beer market. Six different international brewers owned brands in the top ten: Anheuser-Busch, Carlsberg, Guinness, Heineken, Interbrew and S&N. This underlined the openness of the UK market. Moreover, brands outside the top ten had the necessary distribution arrangements in place to achieve significant sales volumes in both the on-trade and the off-trade. These included leading international brands such as Holsten, Beck's and Miller, as well as national and regional brands produced by national and regional brewers. Greene King Abbot Ale had grown by 8 per cent in the last year, Fullers London Pride had grown by 13 per cent in that time and Charles Wells' Bombardier Bitter by 27 per cent.

5.71. Consumer and customer trends had focused negotiations between suppliers and retailers on individual brands and on the price of those individual brands as opposed to a more general negotiation at the supplier level. The result was that overall market share figures overstated the real market power held by a supplier in the light of the degree of brand fragmentation described above.

5.72. The level of brand fragmentation in the UK was in marked contrast to the situation in other EC member states. Interbrew provided a table to show this (Table 5.2).

TABLE 5.2 **Market share of top brand and top three brands in the UK and 12 other EEA countries**

| *Country* | *Market share of leading brand* % | *Market share of top three brands* % |
|---|---|---|
| Belgium | 32.2 | 49.2 |
| Denmark | 36.1 | 61.6 (top two brands) |
| France | 24.7 | 40.0 |
| Germany | 4.3 | 12.1 |
| Greece | 53.2 | 88.2 (top two brands) |
| Ireland | 39.5 | 68.5 |
| Italy | 13.2 | 31.6 |
| Netherlands | 28.5 | 59.3 |
| Norway | 29.4 | 49.4 |
| Portugal | 44.7 | 82.4 |
| Spain | 14.7 | 40.4 |
| Sweden | 18.2 | 41.4 |
| UK | 9.5 | 22.5 |

*Source:* Canadean Limited, Bass and Interbrew estimates.

*Note:* This table relates to brand families rather than separate products.

5.73. Interbrew submitted that the cumulative effect of these competitive pressures had produced a strong downward pressure on wholesale price levels. Average net real wholesale prices for draught beer (excluding duty) had declined by approximately 16 per cent since 1992.

## Public interest issues

5.74. Interbrew stated that, in commenting on the public interest issues, it would confine itself to commenting on competition as reflected in the European Commission's reference back to the UK of the UK aspects of the merger transaction.

5.75. Against that background, Interbrew addressed in turn the following competition issues:

(a) impact of the merger at the brewing level;

(b) impact of the merger at the wholesale and distribution level;

(c) effect on prices; and

(d) effect on consumer choice.

5.76. Interbrew said that the merger had no direct impact at the retail level, but had had a positive indirect impact by severing the vertical links between the retail estate of Bass and Bass Brewers. Interbrew UK did not operate at the retail level.

### *Impact at the brewing level*

5.77. Interbrew submitted that analysis of the impact of the merger at the brewing level required consideration of: the UK market share of the merged entity; the competitive position of other suppliers operating in the market; the degree of countervailing purchasing power; competition from imports; lack of significant entry barriers to potential competition; and the impossibility of duopolistic behaviour between the merged entity and S&N.

5.78. Concerning the UK market share of the merged entity, Interbrew estimated that in 1999, beer produced by Bass Brewers and Interbrew UK under brands owned by, or licensed to them, accounted for approximately 22 and 10 per cent respectively of all UK beer produced for sale. The Interbrew UK figure excluded Whitbread's production, under licence agreements with Heineken, of the latter's Heineken and Murphy's Irish Stout brands (which together accounted for just over 4 per cent of the UK market). Those licences had not been assigned to Interbrew UK. They remained with Whitbread, which continued to be responsible for production, marketing and advertising of those brands. Distribution of the brands in the UK was to be effected mainly through Interbrew UK for the time being. Interbrew considered that, in assessing the market share of the merged entity, it was not appropriate to take account of the share of the market attributed to the Heineken and Murphy's brands. Interbrew UK understood the Heineken licences to be non-assignable, ie production could not be subcontracted by Whitbread. In order to enable Whitbread to sell its brewing business while at the same time complying with its obligations under the Heineken licences, arrangements had been put in place between Whitbread and Interbrew UK (called 'the H&M Arrangements') at the time of the acquisition of WBC. These arrangements were put in place at the insistence of Whitbread and were intended to enable Whitbread to continue to manufacture and market Heineken lager and Murphy's Irish Stout, with distribution being carried out by Interbrew UK. Interbrew understood that the Heineken licence was terminable in [ ✂ ] and that Heineken might already have the right to terminate that licence earlier than that date on grounds of performance and believed it had already exercised that right. Interbrew said that those dates were subject to the parties' right to terminate the Heineken licences earlier by mutual agreement. Interbrew also understood that the Murphy's licence was terminable by either party on notice to the other, the length of notice being calculated by reference to the number of barrels brewed.

5.79. [

*Details omitted. See note on page iv.*

]

5.80. [

*Details omitted. See note on page iv.*

]

[

*Details omitted. See note on page iv.*

]

5.81. [

*Details omitted. See note on page iv.*

]

5.82. [

*Details omitted. See note on page iv.*

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5.83. In support of its views that the H&M Arrangements should not be taken into account in calculating Interbrew's UK market share, Interbrew pointed to the following key factors: Interbrew was not a party to the Heineken licences; Whitbread retained control over marketing and brand positioning of the Heineken and Murphy's brands; the H&M Arrangements were short term, transitional in nature and had been put in place at the request of Whitbread; and Heineken had the right at any time to decide which of a number of viable strategies it wished to pursue in relation to the UK market at which point the H&M Arrangements would fall away.

5.84. Interbrew said that the question might be raised as to whether Interbrew could replace the market share represented by Heineken with Carling (the standard lager in the Bass Brewers portfolio). Interbrew said that this was unlikely. The beer market was a fragmented market in which the leading brands did not have the same share as in other fast-moving consumer goods markets. It was not a market

where solus supply occurred and therefore other producers of standard lager brands would continue to have the opportunity to tender to supply their products to customers, who would also purchase other products supplied by the merged entity—as they did now. Moreover, approximately [✄] per cent of Heineken volume was supplied to the off-trade, where the route to market was extremely open. There was no reason to suggest that customers and consumers would change their behaviour as a result of the merger and cease to purchase Heineken's products. The arrangements entered into in relation to Heineken were a means of enabling Whitbread to honour its commitments to Heineken, whilst at the same time exiting brewing. These arrangements enabled Heineken to consider which options it wanted to pursue. The arrangements had not been entered into in order to enable Interbrew UK to substitute other standard lager products for Heineken and if Heineken formed the view that this was taking place, Interbrew had no doubt that it would act quickly to ensure that its position was protected.

5.85. A related question which arose was whether Interbrew could use the minimum purchase obligation under the supply agreement which it had entered into with Whitbread to substitute Carling for Heineken, in circumstances where the Heineken licences, and therefore the H&M Arrangements, terminated prior to the end of the supply agreement, and whether on that basis the market share of Heineken should be attributed to Interbrew. Interbrew considered that this would not be appropriate for the following reasons:

*(a)* Inclusion of the Heineken and Murphy's volumes in the Interbrew market share would assume that the supply agreement with Whitbread constituted the entire Heineken and Murphy's sales volumes in the UK. That was not the case. In the year to February 2000, the Whitbread retail estate represented only about [✄] per cent of Heineken and Murphy's UK sales volumes; the off-trade alone represented about [✄] per cent of Heineken and Murphy's UK sales volume.

*(b)* Based on those figures, the share of the total UK market represented by Heineken and Murphy's volumes as supplied to the Whitbread retail estate was only just over [✄] per cent. In addition, the supply agreement with Whitbread was only for [✄] years, after which there were no minimum purchase commitments, and therefore no scope for Interbrew to replace Heineken or Murphy's with other brands other than at the request of the customer, responding to consumer demand.

5.86. In summary, therefore, Interbrew considered that the market share accounted for by the Heineken and Murphy's brands should not be attributed to Interbrew for the purpose of analysis of the merger. In addition, it would, in Interbrew's opinion, be inappropriate to calculate the likely market share of the merged entity simply by aggregating the market shares of Interbrew UK and Bass Brewers. Approximately [✄] per cent of the aggregate beer volume supplied by them in 1999 (representing [✄] per cent of the total UK market or [✄] per cent of the on-trade sector) was accounted for by Whitbread and Bass, at that time captive customers. Those customers would be wholly free to source beer from any brewer at the end of the [✄]-year supply agreements into which they had each entered. Indeed, Bass would be free to purchase [*Details omitted. See note on page iv.*] from any brewer by [*Details omitted. See note on page iv.*].

5.87. As to the market share of the merged entity in an international context, Interbrew submitted that this would be small by comparison with other beer markets in the EC. Apart from Germany, there would be no EC member state in which the market share of the largest supplier would be as low as Interbrew's share of the UK market. In Germany, the beer market had its own unique regional characteristics; about 70 per cent of the on-trade was tied to brewers and/or wholesalers, the majority being tied by loan, but with increasing consolidation also between brewers.

5.88. As to the position of other competitors, Interbrew estimated the 1999 share of the UK market of its competitors as shown in Table 5.3.

TABLE 5.3 **Interbrew estimate of market shares**

| | *Market share* % |
|---|---|
| S&N | 25.6 |
| Carlsberg-Tetley | 11.7 |
| Guinness | 5.5 |
| Wolverhampton & Dudley | 2.5 |
| Anheuser-Busch | 2.2 |
| Greene King | 1.1 |
| Others | 19.1 |

*Source:* A C Nielsen.

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5.89. As to the competitive pressures exerted by other brewers (see paragraphs 5.59 to 5.73), Interbrew stated that the following particular points should be noted in the context of the public interest analysis:

*(a)* S&N was a formidable competitor, bolstered by a sizeable retail estate and with a significant international presence following its acquisition of the European beer interests of Danone (Kronenbourg, Peroni and San Miguel) and the recently announced joint venture with Central de Cervejas in Portugal.

*(b)* Carlsberg-Tetley was also a significant competitive force with the significant financial backing from its parent, Carlsberg, one of the largest brewers in the world, and any suggestion that it would become a marginalized player should be dismissed for the reasons set out in paragraphs 5.61 and 5.62.

*(c)* Apart from Interbrew, five of the world's largest brewers (Anheuser-Busch, Heineken, Carlsberg, S&N and Guinness) were present in the UK market, between them owning seven of the top ten UK beer brands.

*(d)* There was every reason to believe that Heineken would take the opportunity presented by Whitbread's decision to exit brewing to establish its own independent presence on the UK market. It had the consumer franchise and the global reputation from which to do this: Heineken was widely available in the UK and accounted for approximately 4 per cent of the UK beer market; Murphy's Irish Stout was the number two stout behind the market leader Guinness. With a capitalization of approximately £20 billion, Heineken clearly had the resources to pursue a successful strategy in the UK.

*(e)* The regional brewers were a significant competitive force. Their ability to remain vertically integrated, within the parameters set by the Beer Orders, provided them with a significant competitive advantage. The fact that they supplied densely grouped estates enabled them to keep their distribution costs low and gave them a secure platform for their products.

*(f)* The level of imports into the UK at about 14 per cent of consumption was high in comparison with other countries.

5.90. As to purchasing power, Interbrew said that the significant purchasing power operating in the off-trade was well documented and was noted by the then MMC in the 1997 report. Since that time, the purchasing power of the off-trade had grown. In 1999 the major US discount retailer Wal-Mart had entered the UK market when it acquired Asda. The major cash-and-carry wholesaler, Booker PLC (Booker), had recently merged with Iceland. Iceland had since been selling a number of Booker's drinks products, and Booker planned to exploit Iceland's internet sales opportunities to boost overall sales. Nomura, the second largest on-trade group in the UK, has very recently announced the purchase of First Quench, the largest specialist off-trade group, with 2,450 off-licences. Furthermore, the on-trade was now increasingly displaying the characteristics of the off-trade. The purchasing power wielded by the large pubcos—pubcos comprising more than 30 pubs now accounted for approximately 50 per cent of beer supplied to the on-trade—was formidable.

5.91. Interbrew noted the impact of imports on the UK market (see paragraph 5.89*(f)*). It said that imports represented a considerable competitive force which not only impacted on the off-trade but also on the on-trade.

5.92. Interbrew drew attention to the lack of significant entry barriers and said that there were a number of viable strategies for entry into the UK beer market. These existed at a variety of levels, including expansion of the activities of existing competitors; regional brewers expanding their activities outside their traditional heartlands through organic growth or through acquisition; or international brewers entering the market at a national level through a variety of routes. The principal factors which a new entrant to the UK market must consider were: access to production; access to distribution brands and market; retail customer preference; and consumer preference.

5.93. There were a number of possible ways of gaining access to production and the most appropriate route would depend to a certain extent on the scale at which the new entrant wished to participate in the market. Ease of entry on a relatively small scale was demonstrated by the growth of microbreweries, such as the Freedom brewing company. These niche breweries found a route to market by selling their own brands through associated retail premises, particularly pubs, and/or to a limited local free trade base. The number of licensed breweries (excluding national or regional brewing companies) had increased from 279 to 498 over the last ten years.

5.94. A larger new entrant to the UK market might gain access to production capacity by acquiring an existing brewery or by subcontracting brewing. For example, Thomas Hardy (formerly part of Eldridge Pope) was formed as a contract brewing and packaging business in 1996 and now owned two breweries with a combined capacity of approximately 700,000 hectolitres. It owned no retail estate through which to sell its products, but had established itself as a specialist contract brewer and packager of third party brands. Faxe, a Danish brewer, had purchased the Robert Cain brewery in Liverpool, at which it brewed its own lager brands, such as Scandia, as well as carrying out contract production for other brewers. The existence of such contract brewers also provided international brewers entering the UK with ready access to production capacity without having to establish such capacity themselves. In addition, existing capacity could be enlarged or converted for minimal capital expenditure.

5.95. Alternative means of gaining access to production capacity in the UK for an international brewer included licensing of brands to an existing UK brewer, national or regional, and indeed this was the way in which Interbrew first sought to enter the UK market. Anheuser-Busch originally entered the UK market by licensing its Budweiser brand to Grand Metropolitan. It had since acquired its own brewing capacity at the Stag brewery in Mortlake and was now one of only two beer brands which approached 'must stock' status in the UK (the other being Guinness). Wolverhampton & Dudley currently brewed Heineken under licence.

5.96. For a brewer with an existing brand, in particular the international brewers, the emergence of the pubcos as a powerful purchasing force had presented new routes to market. By securing a contract to supply a pub chain, an international brewer could achieve sufficient volumes to have its brands brewed under licence or pursuant to a contract brewing agreement, or indeed to justify importing direct into the UK. Punch had indicated publicly that it believed this to be a viable source of supply. This was a strategy that had been used for a number of years by Beck's, which supplied all markets in which it was present by direct export from Bremen. Although this approach had previously been more commonly associated with packaged products, recent examples of importation of draught beer into the UK included import of Budvar, Beck's, Staropramen, Warsteiner and Hoegaarden.

5.97. Differences in packaging of beer products, such as the prevalence of returnable bottles in Belgium or industry standard size bottles in Germany and the Netherlands, could impede imports of beer into these countries. However, imports of beer into the UK beer market were not impeded in this way: returnable bottles were not a feature of the UK market; cans and non-returnable bottles (including plastic bottles) were used more frequently than in other countries and restrictions on bottle sizes did not apply. Therefore packaging did not constitute a barrier to entry to the UK market by import, and entrants were not required to put in place the necessary support network to deal with returned bottles.

5.98. For any brewer entering the market, there were a number of routes to market at the distribution level. These included using existing wholesalers or other brewers or using independent distribution companies such as Wincanton, Tradeteam or Hays. Companies such as The Beer Seller and Matthew Clark, which distributed wines, ciders and spirits as well as beer, provided a further distribution option to

new entrants. One consequence of pubcos taking control of secondary distribution to their outlets was that an entrant need only supply one central depot in order for its products to reach an entire estate.

5.99. At the wholesaling and distribution levels of the market, a variety of entry strategies could therefore be seen. In addition, e-commerce had provided new opportunities for wholesaling of a range of beverages (see paragraph 5.42).

5.100. For any entrant to the market, the most important issue was to have a brand that customers and consumers wanted to buy. International brewers could take advantage of the international reputation of their brand in order to enter a new geographic market. However, geographic expansion could also be seen at the level of the regional brewers. The emergence of a number of 'supra-regional' brewers such as Wolverhampton & Dudley and Greene King, through a combination of organic growth and acquisition, had seen local or regional brands becoming more widely available. These companies were able to secure volumes through their regional tied estates and, by successful marketing, had succeeded in building Pedigree and Old Speckled Hen into national ale brands.

5.101. All these factors indicated that barriers to entry or expansion in the UK beer industry were relatively low and that new entrants, or those companies wishing to expand their geographic reach, had a number of options available to them. The dramatic expansion over a short period of time of Bacardi Breezer (a FAB product) was a good example of the ability of new entrants to access all areas of the market.

5.102. As to the question of a possible duopoly, Interbrew said that this had been raised when the UK authorities had obtained jurisdiction from the EC over the transaction. Interbrew therefore wished to comment.

5.103. Interbrew said that the headline market shares of the top two or top three participants provided no basis for drawing any conclusion regarding possible coordinated behaviour or parallelism. It was necessary to consider the competitive dynamics of the market under review. Interbrew considered that there was no basis for concluding that the merger presented potential for coordinated behaviour.

5.104. S&N and the merged entity would account between them for less than 60 per cent of the UK beer market, lower than the aggregate market share of the top two brewers in most major beer markets. In the UK, where there was higher than average on-trade concentration, the complexity of supply agreement terms and the multiplicity of factors affecting the prices charged to the pubcos meant that there was no 'market price' that could be used as a basis for coordination. The intense competition present in the UK beer market was such that it would be impossible for S&N and Interbrew to act in parallel, even were they to seek to do so, for the following reasons:

*(a)* Four other of the world's largest brewers (Anheuser-Busch, Heineken, Carlsberg and Guinness) were present on the UK market, between them owning five of the UK's top ten brands. Carlsberg in particular had a strong national distribution network, a guaranteed supply contract which ran until [✂] with large parts of two of the largest national estates, and was now one of the primary suppliers to the Punch estate, the largest independent retail group in the country, having won significant additional volume to be supplied in a recent tendering process.

*(b)* The regional brewers (about 50 of them) provided strong competitive offerings in the regions or localities where they operated, reinforced by tied estates which provided secure outlets for their products. These brewers, which collectively owned over 9,000 pubs (15 per cent of the UK total), also provided routes to market for other international brewers, by brewing and/or distributing their lagers under licence.

*(c)* The severance of the vertical ownership links between the brewing and retailing activities of Bass following the severance of the ownership links between the brewing and retailing interests of Whitbread, opened up significant new opportunities to other brewers. Interbrew had no doubt that those brewers would be quick to seek to exploit those opportunities, and indeed that the independent Whitbread and Bass retail estates would encourage them to do so. The agreements contained declining volume commitments with the result that there would be vigorous competition for the freed-up volumes during the time of the agreements; and at the end of [✂] years, the [✂] per cent of the on-trade market represented by these agreements would be subject to full competition.

*(d)* The high level of imports into the UK market (14 per cent of consumption) was a further factor which undermined any potential for coordinated behaviour.

*(e)* Barriers to entry in the UK market were falling fast. Excess capacity in the hands of competitors would act as a competitive constraint and could be used to counteract any co-ordinated rise in prices. Further, brand-switching behaviour by consumers meant that the market was too dynamic to enable coordinated behaviour to succeed.

*(f)* Beer was a highly portable product, which was also highly substitutable. This was particularly true in the UK, where beer brands were weak compared with other European beer markets and other fast-moving consumer goods sectors. This was borne out by the willingness of the pubcos in the on-trade to change suppliers of beer as they retendered their supply contracts, either on termination of existing agreements or following retail consolidation, and in the off-trade by the very broad brand choice on offer by the larger off-licence retailers. The complex nature of supply agreements in the on-trade and the number of factors influencing the price offered meant that there was no 'market price' against which coordinated behaviour could be measured.

*(g)* The commercial power and acumen of multiple grocers to control their suppliers by sourcing from overseas and through their knowledge of own-label suppliers would prevent parallel behaviour occurring.

5.105. There was no scope for any collusion between the merged entity and S&N at the distribution level. Alternative access to on-trade retailers was provided by Carlsberg-Tetley, Wolverhampton & Dudley and Greene King; three major independent national wholesalers two of whom, The Beer Seller and Matthew Clark, have been significantly financially strengthened recently through mergers; and numerous regional wholesalers. Many of the larger on-trade customers now effectively acted as wholesalers, negotiating direct centrally with the brewers and reselling products to their lessees or supplying them to their managed estates. At the logistics level there were a number of specialist distribution companies not owned by brewers in the UK, many with national coverage, who did or could undertake contract distribution. In addition many major on-trade customers now directly arranged all their secondary distribution requirements with a single logistics provider, even if they purchased beer and other beverages from a number of suppliers.

5.106. The lack of any scope for coordinated behaviour was further underlined by the dynamism of the market from a brand perspective. This was shown by:

*(a)* the continuing launch of new brands;

*(b)* the rise and fall of different brands;

*(c)* the presence in the market of a number of major international beer brands (for example, Budweiser, Beck's, Holsten and Miller);

*(d)* the continuing shift in the market from the on-trade to the off-trade (product branding was more important in the latter) and the accompanying shift from draught to packaged products; and

*(e)* the fact that negotiation with major retailers in the on-trade and the off-trade was at a brand level rather than a company level.

5.107. The structure of the UK market was not such as to afford Interbrew and S&N the possibility of coordinating their behaviour. The two companies were likely to have very different commercial strategies, as Interbrew would not be a retailer of beer and would be focused exclusively on its brewing business. S&N will inevitably have a different commercial strategy, because it was both a brewer and a retailer. The fact that S&N had a substantial retail estate, whereas Interbrew did not, pointed to a clear lack of symmetry between the two companies. The economic interests and incentives of the two companies would therefore by definition be different.

## *Impact at the wholesale and distribution level*

5.108. Interbrew did not consider that the merger would in any way impede the route to market for the products of other brewers. As far as the on-trade was concerned, there would continue to be: a large variety of wholesale routes to market: the major brewers; the independent national wholesalers, a sector of the market which had been strengthened in the last 12 months; the wholesale operations of regional brewers; local wholesalers and e-commerce wholesalers. The merged entity would need to continue to satisfy its customers with products for all drinking occasions, as both Interbrew UK and Bass Brewers did at present, in order to retain its customer base. In the year to August 2000, Interbrew UK sold about [ ✂ ] hectolitres of factored beers, of which about [ ✂ ] hectolitres were Budweiser; [ ✂ ] hectolitres were Guinness; [ ✂ ] hectolitres were other national and regional brewers' ale and stout and the remainder was other brewers' lager. In the year ending September 1999, Bass Brewers' sales of factored beers were [✂] million hectolitres, of which [ ✂ ] hectolitres were Guinness; [ ✂ ] hectolitres were Budweiser; [ ✂ ] hectolitres were other brewers' lagers; and [ ✂ ] hectolitres were other brewers' ales, of which [ ✂ ] hectolitres were regional brands.

5.109. Interbrew said that in relation to physical distribution, the most notable development in the market in recent years had been the taking of control of the distribution chain by the major pubcos. The merger would not change Bass Brewers' relationship with Tradeteam, which operated as an independent contractor to which other beer suppliers and retailers could gain access on very competitive terms. Tradeteam already carried out distribution for many other suppliers and for a number of pubcos.

5.110. As far as the independent free trade sector was concerned, other brewers would continue to have a number of routes to market. The outlets in the free-trade sector were served through a variety of routes: the major brewers; the regional brewers; independent wholesalers and cash-and-carry outlets. That situation would not be changed by the merger and those outlets would remain free to source their requirements in the manner best suited to their individual circumstances. Where the landlord chose to source requirements from a national brewer, the outlet would have access to factored brands. Likewise, regional brewers provided national brands on a factored basis. Alternatively, the landlord might decide to source requirements from an independent wholesaler or a buying consortium. The landlord might choose to source from a number of brewers to satisfy requirements for particular brands or to acquire beer on a 'spot basis' from supermarkets and/or cash-and-carry outlets. Each of these sources of supply was open to a number of brewers, including regional brewers. Nearly [✂] per cent of the volume of beer factored by Bass in the year to September 1999 was attributable to regional brands.

## *Effect on prices*

5.111. As to the effect of the merger on retail prices, Interbrew had no retail operations. The effect of the merger was to combine two brewing businesses and the only effect on prices to which it could potentially give rise was at the wholesale level. The lack of correlation between wholesale and retail prices was shown by the fact that in the last seven years wholesale prices, excluding duty, had fallen, in total, by approximately 15 per cent in real terms, whereas on-trade retail prices had risen by over 20 per cent in real terms. The retail price was determined by the retailer in accordance with its own retail strategy. The wholesale price accounted for a relatively small proportion of the retail price, on average about 30 per cent inclusive of duty or 15 per cent exclusive of duty, and the factors which in reality determined the retail price were whether the retailer was operating on a volume or margin basis to create profits and the strength of consumer demand for its offer. In this regard, the factors that determined the retail price were: location; whether the outlet offered food; and whether it was a special occasion venue or a local pub. In many instances volume discounts were paid retrospectively at the end of the trading year and therefore wholesale pricing was not used in making operational pricing decisions but was rather relevant to the profit stream of the pubco or independent retailer.

5.112. As to wholesale prices, there was no reason to believe that the merger would affect the downward trend in wholesale prices. The merged business, while gaining improved margins from the synergies obtainable from the merger, would be obliged to set its prices, in the face of continuing and growing competitive pressures, at levels which reflected this continuing downward trend. The increasing power of national accounts and the existence of major on-trade and off-trade retail groups would ensure that the competitive pressures on the merged group would be fierce. [

*Details omitted. See note on page iv.*

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### *Effect on consumer choice*

5.113. As to the effect of the merger on consumer choice, Interbrew submitted that the brand portfolios of Interbrew UK and Bass Brewers fitted well together. In relation to ale, each of Boddingtons, Stones and Worthington were strongly associated with their regional heartlands and with differing strengths in the on- and off-trades and Interbrew would therefore have every reason to sustain and develop these brands. Interbrew had not foreseen any need for brand rationalization in its business plan.

5.114. The commitment of Interbrew to brand diversity was a key philosophical backcloth against which to assess this merger from the perspective of consumer choice. Unlike other potential purchasers of Bass Brewers, Interbrew would seek to continue the commitment to brand diversity which Bass had shown over recent years, and indicated its willingness to undertake to maintain the current level of brand diversity and not to close brewing capacity for a period of two years. The export potential which Bass saw for some of those brands, and which Interbrew would be keen to develop in keeping with its activities elsewhere in the world, underlined this commitment.

## Public interest benefits

5.115. Interbrew believed that a number of public interest benefits would flow from the merger and that the CC should take these into account. Bass Brewers and the trade unions had reacted to the acquisition with enthusiasm. The strategic decision by Bass to exit brewing might be seen as a consequence of the rejection in 1997 by the then Secretary of State of Bass's proposed acquisition of the brewing business of Carlsberg-Tetley. Interbrew's acquisition removed uncertainty for Bass as it created a merged group which could focus on brewing and was not hampered in regulatory terms by a retained retail estate. The devolved way in which Interbrew operated, empowering local management, gave Bass Brewers every opportunity to be at the heart of Interbrew's strategic decision making in the years ahead.

5.116. Interbrew said that it had identified cost savings which could be achieved through operational integration of Interbrew UK and Bass Brewers. It estimated the total of these to be about £[✄] million after [✄] or [✄] years, representing some [✄] per cent of the current combined cost-base of the two businesses. The operational synergies fell into the following categories:

[

*Details omitted. See note on page iv.*

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There was also an expectation of creating value through a fuller development of the export potential of the Interbrew UK and Bass brands, by utilizing the global Interbrew export network. These synergies would enable Interbrew to continue to invest in brand diversity, thereby preserving consumer choice, despite the anticipated continued downward pressure on wholesale prices. No other potential purchaser of Bass Brewers would have been able to deliver synergies on that scale or have the same commitment to preserving brand diversity.

5.117. As to consumer choice, the acquisition held out the real prospect of broadening consumer choice, given Interbrew's commitment to brand diversity. Interbrew's priority was to develop local strengths, brands and customer networks. It had a wide portfolio of brands and invariably mixed national and international brands in each new market that it entered. In mature markets, national brands were long-established products.

5.118. Concerning export opportunities, Interbrew said that it had its origins in Belgium which was famous for its beer but owed its current strength to the position built up in mature markets—notably

Canada but also France, the Netherlands, the UK and the USA. Those countries accounted for over [✂] per cent of Interbrew's volume. Interbrew had production plants in 15 countries, licensing agreements in a number of other countries and exports to over 80 countries.

5.119. Interbrew said that Bass had been relatively successful in exporting its brands through Bass Brewers World-wide; Interbrew planned to build on that success through its operations around the world. Those operations offered greater export potential than had been possible under the ownership of Bass. Brands such as Bass, Boddingtons, Caffrey's, Carling and Tennents could successfully be exported to countries around the world. The potential for increased exports by the merged entity would improve the long-term security of Interbrew's UK business in the face of the continuing decline in domestic consumption.

## Response to the issues and remedies letter

### *Issues*

5.120. Interbrew responded to our issues and remedies letter, which is summarized in the Issues and Remedies Statement (see Appendix 2.2).

5.121. Generally, Interbrew submitted that the description of the UK market put to the CC by others significantly understated its dynamic and competitive nature and overstated the degree of market power which Interbrew would be in a position to exercise as a result of the merger. The UK beer market had changed since the 1997 report: the UK was increasingly part of a global beer market and beer sales had continued to decline as consumers demanded a wider portfolio of drinks for different occasions; concentration at the retailing level had grown substantially and would continue to grow in both the on- and off-trade (see paragraph 5.2).

5.122. The merger was the result of decisions by Whitbread and Bass to exit brewing. WBC had found itself in a weak position, dependent for two-thirds of its output on brands licensed from other brewers. The only way that WBC could create a sustainable future for its brewing interests was by acquisition by a specialized brewer such as Interbrew. Bass, with good brands of its own, had maintained the profitability of its brewing interests through increased efficiency, but efficiency gains had been taken as far as they could in Bass's pre-merger structure and had been eroded by the pricing pressure of the retailers; hence the need to seek further synergies through the current merger. Interbrew would bring public interest benefits as the owner of Bass's brewing interests, particularly in its commitment to brand diversity, which would not be offered by any of the alternative bidders.

5.123. As to the effects of the merger on brewing, Interbrew said that generally competition in the brewing of beer would continue to be vigorous (see paragraphs 5.59 to 5.73). Interbrew would face strong direct competition from a wide range of brewers pursuing varied strategies: niche regional brewers, large international brewers pursuing focused brand strategies in the UK, and vertically-integrated companies. There was no single correct strategy and it certainly was not necessary to be a brewer-wholesaler in order to succeed. As Interbrew had a market share of only 32 per cent and faced a range of powerful competitors, it would not be in a dominant position. The risk of collusion, tacit or otherwise, between Interbrew and S&N was illusory. S&N's substantial retail estate meant that the incentives of the two companies were fundamentally misaligned (see paragraph 5.107). In any case, collusion would be impossible in practice because of non-transparent market conditions, fierce competition from other brewers, low barriers to entry, significant excess capacity and substantial and growing buyer power. Interbrew had no 'must stock' brands and no ability to use its portfolio of brands anti-competitively. Competition took place at the level of individual brands, not between portfolios of brands. If Interbrew sought to raise wholesale prices, it would lose market share as its competitors would increase production or increase imports.

5.124. The factors affecting marketing expenditure would not be altered by the merger. Advertising spending was subject to rapidly diminishing returns and expensive advertising was not necessary to launch or grow new brands.

5.125. The significant power of pubcos was likely to increase as the retail sector became more concentrated. For example, if Nomura were to be successful in acquiring even 50 per cent of the pubs to be disposed of by the Bass and Whitbread estates, it would control about 12 per cent of all UK pubs. Recent

comments by Punch, threatening to delist Stella Artois, indicated that brewers had no ability to force pubcos to stock particular brands. In the off-trade, the power of retailers continued to grow (see paragraph 5.90).

5.126. As to the effects on wholesaling and distribution, Interbrew submitted that the merger would not reduce competition (see paragraphs 5.108 to 5.110). Multiple retailers in both the on- and off-trade increasingly controlled the supply chain from manufacturer to retail outlet. Competitors would continue to have a number of alternative routes to market through national and regional brewers, specialist wholesalers, independent logistics providers and new e-commerce entrants. No barriers to entry would be created by the merger.

5.127. Interbrew said that it would still have a strong incentive to supply independent wholesalers with its full range of products and factored beers. Otherwise, it would lose custom. Interbrew said that the transfer of power to the retailers, and the very thin margins this had produced, left no scope for cross-subsidization of different products in a brewer's wholesale portfolio. [ *Details omitted. See note on page iv.* ] Customers made their purchasing decisions brand by brand and cross-subsidization in the brewing industry made no commercial sense since attempts at cross-subsidy would simply reduce the brewer's margins on lines where it reduced prices, without increasing sales of other lines in compensation.

5.128. Interbrew said the merger would have no impact on distribution. Interbrew UK had very limited third party on-trade distribution business. Tradeteam provided no third party distribution to the off-trade and Interbrew UK supplied only one off-trade customer, namely First Quench. As Tradeteam was controlled and managed by Exel, Interbrew could not influence the conduct of Tradeteam to give less favourable terms to other brewers. Interbrew's stake in Tradeteam did not give it access to any commercially sensitive information about its competitors' products and prices and therefore it could not target price cuts to particular retailers on the basis of knowledge about its competitors' offerings.

5.129. Interbrew acknowledged that differences in the costs of serving different types of customer and the volumes supplied to them meant that there was a differential in the discounts offered to pubcos and to the independent on-trade and this differential was likely to persist. However, that was not the result of the merger. Indeed the synergies which the merger would generate for Interbrew would enable it to continue to price very competitively across all channels, including the independent free trade channel.

5.130. As to the general effects on retailing, Interbrew said that the supply agreements with the Bass and Whitbread estates were a necessary part of the separation of previously vertically-integrated operations. However, they increased competition by allowing for the opening up of the estates to Interbrew's competitors over the next [✂] years (see paragraphs 5.2*(i)*, 5.2*(k)* and 5.34). Carlsberg-Tetley's agreement to supply the former Allied-Domecq estate until [✂], and the substantial tied estates of S&N and the regional brewers, all conferred substantially greater advantages than Interbrew's supply agreements (see paragraph 5.2*(e)*, *(h)* and *(k)*). Interbrew stated that it would not be able to cross-subsidize sales to other customers from its sales to the Bass and Whitbread estates.

5.131. Interbrew further submitted that consolidation in the on-trade continued apace; and that pricing power would continue to be exercised by retailers rather than brewers. Independent outlets were becoming increasingly sophisticated and had benefited from the continuing decline in wholesale prices. This was in contrast to the constraints placed by pubcos on their tenants, as the pubcos sought to capture for themselves most of the discounts negotiated from brewers. The merger would have no adverse effects on either pubcos or the independent free trade.

## *Effects of the merger on the public interest*

5.132. As to effects on the public interest, Interbrew submitted that generally it had a well-established and well-documented commitment to brewing and to the beer markets in which it was present. It considered that it was the best of all the possible owners of both the Interbrew UK and Bass Brewers businesses.

5.133. Interbrew submitted that the merger would not affect retail prices. Interbrew would not be able to use its market share or enlarged portfolio to increase wholesale prices because of the strong bargaining positions of both on- and off-trade retailers and the ease with which products could be

substituted, together with the significant overcapacity across the industry. Differences in prices to different segments of the retail market were likely to persist, but the structure of the retail on-trade would continue to change with the sale of independent pubs to pubcos and the growth of bidding consortia through which independent outlets aggregated their purchases.

5.134. Interbrew submitted that the merger would not lead to a reduction in brand diversity or product innovation. By contrast with other potential purchasers of Bass Brewers (such as Heineken, Carlsberg, Anheuser-Busch and South African Breweries), Interbrew's philosophy and practice were founded on protecting brand diversity and meeting consumers' varied needs through introducing new products.

5.135. Interbrew believed that a number of public interest benefits would flow from the merger (see paragraphs 5.115 to 5.119). These were:

*(a)* Interbrew had identified substantial cost savings flowing from the integration of the two businesses from which its customers would benefit directly. Without those synergies, the stand-alone business would be forced to continue to reduce its workforce, cut costs by reducing its range of brands and close production capacity. Alternative purchasers of Bass Brewers would not be able to generate the same level of synergies, if any at all.

*(b)* Interbrew would add to brand diversity and consumer choice through the introduction of new brands. This contrasted with the focused or single-brand approach of the possible alternative purchasers of Bass Brewers.

*(c)* Interbrew would use its global operations and international expertise to build on Bass Brewers' success in exporting its brands.

## *Effects of the merger on brewing*

5.136. Interbrew took issue with statements made by the CC in the issues letter: to the effect that the merger would reduce from four to three the number of national UK brewers; the suggestion that Interbrew was now a dominant firm; and the remark that, aside from Interbrew, S&N and Carlsberg-Tetley, the remaining brewers had much smaller market shares and narrower portfolios. That summary did not reflect the highly dynamic and competitive nature of the UK brewing industry. Interbrew's view of the UK market was that there were currently six powerful national brewing operations, namely S&N, Bass Brewers, Carlsberg-Tetley, Interbrew UK, Anheuser-Busch and Guinness; that number was reduced to five by the merger. Heineken was likely to emerge as an additional powerful national brewer in the near future.

5.137. Interbrew stated that the CC appeared to be defining the term 'national brewer' to mean a brewer with a large national brewing business, with its own wholesaling and distribution and with or without a tied estate (in contrast to the definition used in the Bass/Carlsberg-Tetley MMC report which used the term to refer to brewers with tied estates or a specified site, as defined in the Beer Orders). However, that categorization was not sound, as Bass Brewers had outsourced its distribution to Tradeteam, which came under the day-to-day management control of Exel. In Interbrew's view, the six brewers mentioned in paragraph 5.136 were those which had truly national reach, leaving aside regional brewers which had products sold on a national basis.

5.138. Brewers operating in the UK pursued a variety of strategies. S&N offered a broad portfolio of products on a national basis, supported by a retail estate, which gave it guaranteed access to some 5 per cent of the on-trade and enabled it to share in the total industry profit pool at both the brewing and retail level and support its brands. Its Chief Executive had recently been reported as saying that retail assets gave immediate access to customers and brands that could only be created in pubs. Carlsberg-Tetley operated nationally with an integrated wholesale and distribution operation focusing on a core portfolio of key brands and a commercially attractive supply agreement with the former Allied-Domecq estate. Both Guinness and Anheuser-Busch operated on a national basis, each focusing on brewing and marketing of key brands, in keeping with their respective worldwide strategies, which allowed them to benefit from worldwide synergies in marketing and brand management. The major regional brewers operated fully-integrated brewing, wholesaling and retailing operations which were geographically concentrated but with national reach in respect of their premium ale brands, with guaranteed access to

some 12 per cent of the on-trade market. Major continental brewers such as Beck's and Holsten competed successfully by exporting beer, taking advantage in particular of the growth in popularity of packaged beers and the growth of the off-trade. To all these must now be added Heineken, a major international brewer with an existing UK market share of close to 5 per cent and with a variety of alternative strategies now available to it to develop its UK business on its own terms, and take a bigger proportion of the margin pool than the royalty payments currently made under the Whitbread licence agreements.

5.139. Interbrew said it did not accept the assertion that it had a market share of up to 37 per cent, depending on the allocation of the Heineken and Murphy's brands. As set out in paragraphs 5.78 to 5.86, it was not appropriate to allocate the Heineken market share to Interbrew and its market share was therefore 32 per cent rather than 37 per cent. Given the variety of effective competitive forces faced by Interbrew, it could not be considered to be dominant in UK brewing.

5.140. On the question of whether the merger would reduce competition in the brewing of beer, Interbrew responded that competition would not be reduced by the merger owing to the many competitors with varied effective strategies and the purchasing power in both the on- and off-trade. Interbrew said that competition would continue to be vigorous and that the merged entity would face strong and effective competition from a range of sources, namely S&N, Anheuser-Busch, Heineken, Carlsberg-Tetley, Guinness, regional brewers, and imports (see paragraphs 5.59 to 5.66). Interbrew provided statements from certain regional brewers (Youngs, Jennings, Shepherd Neame and Fullers) indicating growth in turnover and operating profits.

5.141. Interbrew said that the purchasing power of retailers was clearly demonstrated by the ongoing decline in wholesale beer prices and the rise of retail on-trade beer prices (see paragraph 5.111). Interbrew showed that, on a pint of beer, brewers made just 4p a pint. The shift in the margin pool from brewers to retailers had forced some UK brewers to focus on particular segments where they were strongest, such as stout, specialist ales or premium products, and had forced all UK brewers to become more efficient and to compete vigorously. Price competition would therefore continue to be vigorous, driven by the large number of brewers pursuing a variety of different strategies; the demands of pubcos and off-trade retailers and their ability to play brewers off against one another in a declining market with excess capacity; and fierce competition from FABs such as Bacardi Breezer (see paragraph 5.2*(g)*), which now had annual sales of about [ ✂ ] hectolitres, more than those of many beer brands, including draught Bass and with higher comparable unit sales value.

5.142. On the question of whether the merger would have the effect of making market conditions more conducive to a reduction in price competition, escalation in non-price competition and reduction in product innovation on the part of Interbrew and S&N, Interbrew submitted that this suggestion was misguided and argued that it would be impossible for collusion to occur. Interbrew pointed out that its business plan, which it had submitted to the CC, clearly indicated an expectation that price competition would continue to be fierce. Interbrew did not accept that there were a number of characteristics of the UK beer market which made the market susceptible to collusion between Interbrew and S&N.

5.143. These characteristics, as identified in the issues letter sent by the CC to Interbrew, had been: the homogeneous nature of the products; the limited scope for innovation and the similarity of the product ranges of Interbrew and S&N; their broadly symmetrical market shares and cost structures; the stable and inelastic demand for beer; high entry barriers and the absence of recent entry into national brewing and distribution, other than through acquisition; excess capacity in brewing, which would deter cheating on a collusive outcome; fragmented buyer power; and a transparent market. Interbrew commented on these alleged characteristics in turn.

5.144. On homogeneity, Interbrew submitted that, although there was substitution between beer brands, beer types and between beer and other alcoholic beverages, nevertheless beer was not a completely homogeneous product. Brewers made extensive use of tasting panels for existing and new beers. Different beers catered for different consumers on different occasions. UK brewers sought to differentiate their products through developing brands with distinctive consumer appeal and through quality of products and services. Consumers in the 18 to 24 age group were the largest consumer group for UK brewers and were increasingly responsive to innovation.

5.145. On innovation, Interbrew said that there were pressures in the UK beer market to innovate in order to mitigate against declining beer consumption and attract consumers, particularly aged 18 to 24. Examples of innovation included 'Ice' and 'Lite' beers; nitrokeg beers; and 'smooth' beers, many being

extensions of cask products. Interbrew said that Bass Brewers trialled a number of new products or brand extensions and packaging formats each year and provided statements from regional brewers showing an emphasis placed upon innovation. Movement into and out of and within the top ten brewers (see paragraph 5.2*(f)*) also pointed to ongoing product innovation in the market.

5.146. On alleged similarity of product ranges, Interbrew submitted that it was unsurprising to see a similarity between the portfolios of S&N and Interbrew, given that they had chosen to compete on the basis of broad brand portfolios. This was a result of normal competitive pressure: for example, the launch by S&N of John Smiths' Extra Smooth to compete with Caffrey's. That behaviour was evidence of a competitive market, not of potential for collusion. However, the product ranges of S&N and Interbrew were not identical, as S&N, unlike Interbrew, owned stout-, wine- and spirits-related operations in addition to its beer portfolio. Interbrew said that its own distinctive background would bring an additional dimension, offering the possibility of introducing new product types into the Bass Brewers portfolio in order to meet consumer demand.

5.147. As to the alleged broad symmetry between Interbrew and S&N, in fact there was a lack of symmetry. Interbrew and S&N were fundamentally different in strategy and cost structure (see paragraph 5.107). Over 50 per cent of S&N's profits derived from its retailing and leisure operations, with the result that it had a very different focus from that of Interbrew. The S&N tied estate meant that S&N would gain no benefit from colluding on wholesale prices, since those were irrelevant to S&N's tied business. All that mattered to S&N was the marginal cost of production. However, in any event, the S&N tied estate would make it difficult to detect 'cheating' since that could take the form of cutting retail prices in the tied estate rather than cutting wholesale prices. It should also be remembered that S&N's portfolio management included commitments to other brand owners, for example Fosters and Millers, for whom it brewed under licence. S&N's perspective was bound to be with the retail price of beer, whereas Interbrew's perspective was wholly with the wholesale price. In these circumstances a mutually agreeable collusive solution was unlikely. Interbrew could not monitor S&N's wholesale price to its tied estate. Nor could it punish S&N for any deviation from any supposed tacit agreement.

5.148. On the alleged stable and inelastic demand for beer, Interbrew submitted that although total demand for beer was declining, there was significant growth in demand in some segments of the market and some brands had grown noticeably, even in declining segments. The mainstream lager sector showed modest growth in the second half of the last decade (a compound annual growth rate, CAGR, of 1.1 per cent from 1995 to 1999), while the premium lager sector grew more rapidly (CAGR of 4 per cent over the same period). Fullers' London Pride and Old Speckled Hen, both produced by regional brewers, had achieved annual growth rates of 7 and 5 per cent respectively in recent years, despite the decline in demand in the ale segment. Demand for beer products could also increase significantly for short periods of time, as witnessed during the Euro 2000 competition and the significant price reductions by Carlsberg-Tetley during that period, when overall demand increased and Carlsberg-Tetley took significant sales away from rivals. Moreover, demand at a wholesale level was extremely elastic, as evidenced by the readiness of pubcos and off-trade multiples to switch suppliers and brands (see paragraph 5.125).

5.149. On entry barriers, it was not true that the only recent entry into national brewing and distribution had been through acquisition. Anheuser-Busch initially grew through importing and then a joint venture before buying its own brewing capacity. Tradeteam was an example of entry into the distribution market at national level and this option was available to other new entrants. There were a number of new entrants in wholesaling, such as bevaccess.com and eskeye.com, taking advantage of new technology and increased access to relatively inexpensive software packages to develop e-commerce wholesaling activities. There were also new entrants at microbrewery level and for packaged products. The lack of recent entry at brewing level on a national scale was not surprising given that most leading international brewers were already present in the UK market and given the decline in consumption of beer and in brewers' margins. These facts did not indicate high entry barriers but the already highly competitive nature of the market. Methods of entry for brand owners were many and varied. International brewers could enter through importing, subcontracting brewing or licensing before moving directly to brewing in the UK and had a number of wholesale routes to market (see paragraphs 5.95 to 5.98).

5.150. On the question of excess capacity, Interbrew said that it understood the CC concern that, as a matter of economic theory, the presence of excess capacity could in certain contexts enable punishment to take place and therefore enable collusion to be policed and maintained. However, the presence of spare capacity could equally undermine the scope for collusion. In particular, excess capacity among the competitive fringe was usually thought to make tacit collusion unsustainable. The excess capacity in the

UK and in Continental Europe meant that, if S&N and Interbrew were to seek to engage in any form of tacit collusion with a view to increasing wholesale prices, their competitors would have no difficulty in increasing their output to satisfy demand, thereby defeating such attempted collusion. Interbrew provided cost figures showing, in its view, that the marginal cost of importing beer from the continent to a depot in England was about the same as the delivered to depot price demanded by pubcos. This demonstrated, Interbrew said, that Continental production and imports were a viable alternative. Furthermore, that surplus capacity also meant that competitors would be able to meet demand without increasing fixed costs and could therefore justify utilizing marginal pricing to take advantage of any such collusion. In addition, only marginal capital expenditure would be required to expand or convert existing capacity providing a further competitive constraint. Interbrew therefore considered that collusion would be hampered by the presence of excess capacity.

5.151. On buyer power, Interbrew considered it wholly inaccurate to suggest that there was fragmented buyer power. On the contrary, buyer power in both the off-trade and the on-trade was increasingly concentrated, with the retailers showing significant sophistication and knowledge of brewers' cost structures, and would undermine any attempted collusion. It should be noted that the pubcos made six times more profit than the brewing industry; pubcos sold over two out of every five pints drunk in British pubs; the total volume of beer purchased by Nomura alone represented 15 per cent of the volume that the merged entity would produce; Punch and Nomura together controlled nearly 11,000 pubs, ie nearly 20 per cent of all pubs; the recently announced disposals by Whitbread and Bass of a number of pubs were likely to lead to even larger pubcos (Alchemy had been quoted recently as suggesting that 15 to 20 per cent of the UK's 60,000 pubs were either for sale or about to come on the market); the six largest pubcos purchased nearly 30 per cent of total UK pub volume; Punch's total annual volume was about 1.2 million barrels, two and a half times the capacity of an average brewery; and off-trade multiple retailers accounted for about 25 per cent of total UK beer consumption. In the 1997 report, the MMC had recognized that even in 1996 brewers' and wholesalers' margins were declining as a result in the growth in buying power of the on- and off-trade retail chains. That buying power had grown very considerably in the intervening four years and Interbrew therefore failed to see how it could be suggested that buyer power was fragmented. The CC in its issues letter had contrasted the combined market share of on-trade beer sales of the two leading pubcos (13 per cent) with the market share accounted for by Interbrew and S&N respectively. Interbrew rejected this comparison as being an inappropriate means of establishing relative bargaining positions. Interbrew argued that pubcos had a wide choice of suppliers from whom to source products but that the loss of volume upon delisting by a pubco had significant effects on brewers who either had to suffer a loss of volume or compete aggressively to make that volume up elsewhere. The market share of the pubcos was therefore irrelevant.

5.152. Interbrew added that pubcos exerted their power in many different ways, with the primary intention of achieving significant discounts. Interbrew provided examples of pubcos removing beer from their pubs when negotiations had not been satisfactorily concluded.

5.153. On alleged price transparency, Interbrew submitted that, even if all the other factors suggesting collusion existed, which they did not, the lack of price transparency made tacit collusion impossible. Interbrew firmly rejected the suggestion that the market for the supply of beer was transparent as to prices and other terms. Negotiations with retailers were highly confidential and the discounts and other terms of agreements with retailers were not known by other companies, as was indicated by the disparity between prices to different pubcos. The pubcos kept the terms of their supply agreements secret as a means of playing brewers off against one another. This was clearly shown by press reports of Stella Artois prices per barrel being [*Details omitted. See note on page iv.*]. The existence of retrospective discounts in many supply agreements also added to the lack of transparency of prices. The severing of vertical links between Bass Brewers and WBC and their former retail operations meant that these two brewers no longer had knowledge as retail customers, unlike S&N and the regional brewers. In further support of its view that there was lack of price transparency in the market, Interbrew provided evidence showing widespread price dispersion in the market, pointing out that there were no simple or predictable relationships between prices, volumes and other service characteristics. Specifically, there were no local points to which price could be coordinated in this highly opaque market.

5.154. In short, Interbrew concluded that the conditions which were said to be necessary for there to be collusion in the UK beer market did not exist. Interbrew instanced some further factors inconsistent with collusion. S&N and the merged entity accounted for less than 60 per cent of the UK beer market. The intense competitive activity was such that it would be impossible for S&N and Interbrew successfully to act in parallel (see paragraphs 5.89, 5.104 and 5.123).

5.155. As to the question of whether the merger would increase barriers to entry or expansion in brewing, Interbrew submitted that it would not do so but, rather, that additional volume would be opened to full competition over a [✂]-year period as a result of the ending of the supply agreements with the Bass and Whitbread estates. There was no reason why the merger should affect the current trends in relation to imports. The plentiful spare capacity available across the country meant that brewers were able to produce products relatively easily and with low marketing spend.

5.156. As to whether the merger would create a position of market dominance for Interbrew based on leading brands, Interbrew denied that it was in a position of market dominance. It argued that individual brands competed with other individual brands and did not consider that leading brands could put a brewer in a position of market dominance. The reality of the UK beer market was that there was no such thing as a 'must stock' brand. Although Interbrew's brand portfolio was strong, it did not give Interbrew a dominant position in the UK market (see paragraph 5.2*(f)*). The merged entity would control only three of the top ten beer brands—Carling, Stella Artois and Tennent's Lager. Carling and draught Stella Artois were only stocked in [*Details omitted. See note on page iv.*]. The closest any UK brand came to being a 'must stock' brand was Guinness. Carling was a standard lager sold mainly in England and Wales; Stella was a premium lager sold mainly in England and Wales; and Tennent's Lager was a standard lager sold mainly in Scotland (see paragraph 5.59). Many brands outside the top ten had the necessary distribution arrangements to facilitate large sales volumes, for example leading international brands such as Holsten, Beck's and Miller (see paragraph 5.70). In contrast, had the merger between Bass and Carlsberg-Tetley been approved, the merged entity would have combined two of the leading standard lagers in its portfolio, Carling and Carlsberg, and also the number two and three ales at the time of the 1997 report on the merger. The top six brands of the merged entity (Carling, Stella Artois, Tennent's Lager, Worthington's, Boddingtons and Stones) would account for only about 23 per cent of the overall beer market. Furthermore, the proportion of on-trade outlets stocking Interbrew's leading brands was relatively low compared with that of other leading brands. Interbrew provided data from A C Nielsen showing the following percentages of on-trade outlets in Great Britain carrying leading beer brands in 2000: Budweiser 69 per cent, Holsten 63 per cent, Guinness 59 per cent, Beck's 58 per cent, Stella Artois 29 per cent, Carling 27 per cent, Fosters 26 per cent, and Carlsberg 21 per cent. (The figures for Budweiser, Beck's and Holsten included bottles and cans; the other figures related to draught beer.)

5.157. Interbrew said that neither Stella Artois nor Carling carried the price premium that would be expected of a 'must stock' brand. The price of both Stella and Carling had been falling in real terms. Furthermore, consumer perceptions of the leading beer brands were very similar, as could be seen in the similarity of the ratios of consumers who said they liked a brand to those expressing a view either way. Interbrew provided data from its market research to support these statements. Customers did not choose pubs on the basis of the beer brands stocked and success of one brand in a portfolio did not produce success for the entire portfolio of brands, as was demonstrated by the fact that the success of Stella Artois and Carling had not lifted sales of other beers in their respective portfolios. Moreover, Interbrew had a strong incentive not to put the position of Carling and Stella Artois at risk by trying to use them to force weaker brands on reluctant retailers.

5.158. On the question of whether S&N and Carlsberg-Tetley had brand portfolios, and the necessary financial resources to support them, that would enable them to compete effectively with Interbrew, Interbrew said that a broad portfolio of brands was not necessary in order to compete effectively. However, S&N's portfolio included the number one ale in the UK (John Smiths), the number two standard lager in the UK (Fosters), and it had recently acquired ownership of the international premium lager brand, Kronenbourg. S&N's brewing business was underpinned by virtue of the guaranteed sale of its products through its tied estate. Carlsberg-Tetley had the financial backing of Carlsberg (see paragraphs 5.61 and 5.62). Recent changes to the ownership structure of Carlsberg meant that it was now better placed to raise additional funding. On 3 November it had announced the acquisition of a major Swiss brewer. The UK represented about 13 per cent of Carlsberg's total EBITDA and 20 per cent of operating profits.

5.159. On the question of whether other competitors, including Anheuser-Busch, Guinness, Heineken and the regional and local brewers, had brand portfolios, and the necessary financial resources to support them, such that they would be able to compete effectively with Interbrew, Interbrew responded that a broad portfolio of brands was not a prerequisite to competing successfully and that its competitors at all levels, from regional to international, had the financial resources to compete with Interbrew on their own terms. Interbrew provided data to support this. It said that both Anheuser-Busch and Guinness had chosen a single brand strategy in the UK in keeping with their strategies across the

world. Anheuser-Busch's Budweiser brand and Guinness were both extremely successful brands in the UK, achieving nearly 70 per cent distribution in the on-trade in the case of Budweiser (see paragraph 5.156) and 60 per cent distribution in the on-trade in the case of draught Guinness; these levels were far in excess of the stocking levels achieved by any Interbrew brand. Anheuser-Busch was the largest brewer in the world and Guinness had the backing of one of the world's largest alcoholic drinks companies, Diageo. Both these companies could draw on enormous financial resources and would continue to be significant competitive forces in the sectors of the UK beer market in which they had chosen to compete.

5.160. Heineken had a range of options available for developing its brands in the UK (see paragraph 5.81), and with a market capitalization of some £14 billion, clearly had the financial resources to be able to compete in the UK market. In the USA, Heineken had achieved a 25 per cent contribution to profit with only a 2 per cent market share.

5.161. As to regional brewers, they had demonstrated their capacity to grow and prosper and to provide intense competition (see paragraphs 5.2*(e)* and 5.35 to 5.38).

5.162. As to the question of what scope there would be for competitors to respond to price increases by increasing output or importing beer, Interbrew responded that there was significant scope for competitors to do this. The high fixed costs involved in brewing meant that brewers would be likely to offer their spare capacity to potential new entrants or existing companies in order to recover fixed costs. There was about 20 per cent overcapacity in the UK and 5 million hectolitres spare capacity in the hands of regional brewers. In north-western Continental Europe, there were about 30 million hectolitres of spare capacity available and that could easily be accessed by a UK brewer. Interbrew estimated that the delivered duty-paid price of draught beer exported from Continental Europe to a UK central depot would be around £[✂] per hectolitre. That compared with an average price received by Bass Brewers from pubcos for supply and delivery of [*Details omitted. See note on page iv.*].

5.163. On the question of whether the merger would lead to higher levels of overall marketing spend, Interbrew submitted that advertising in the beer industry was marked by diminishing returns rather than scale economies. Brand awareness could be gained with little or no advertising expenditure. Interbrew argued that the merger would not lead to an excessive increase in marketing spend likely to raise barriers to entry. By contrast with other major international brewers which had a focused or single-brand strategy, Interbrew would ensure continued investment in supporting a broad range of brands.

5.164. In Interbrew's view, the forces affecting marketing expenditure would not be affected by the merger. The diversity of consumer tastes and inclinations meant that it was impossible to create 'must stock' brands (see paragraph 5.156). Price promotions benefited the consumer directly and marketing benefits such as sports sponsorship benefited the consumer indirectly. Generally, marketing had helped to stem the loss of beer sales overall. There was no incentive to increase marketing expenditure beyond a certain point, which was about £8 million for a beer brand in the UK. Brand awareness in the beer industry clearly showed the effect of diminishing returns. Carlsberg and Budweiser with expenditure of well over £10 million both had spontaneous awareness levels (ie the ability of consumers to name a brand without being prompted) of less than 40 per cent. No brand had a spontaneous awareness level of more than 50 per cent. Brands with current awareness levels of more than 35 per cent had little incentive to increase advertising expenditure since the returns would be marginal. A number of brands had succeeded in gaining awareness levels of around 10 per cent without significant advertising spend, for example Skol, McEwan's and Harp. Interbrew's planned increase in marketing spend for Stella Artois and Carling, totalling £[✂] million over the planning period, reflected the likely significant increases in the cost of sponsorship deals with premier league football and tennis. It did not imply any intention simply to push up media spend, although some additional spending would be necessary following the inevitable loss of market share after the breaking of the tie with the Bass and Whitbread estates.

5.165. Interbrew said that an increase in marketing spend would not raise barriers to entry. New brands or companies could enter the market and gain up to 10 per cent brand awareness without spending significant amounts on advertising. They could grow their brands further by heavier spending, but beer brands with higher market share like Stella Artois and Carling would have nothing to gain by increasing spending on marketing. There were an increasing number of ways to grow brands other than through high media spend. Regional brewers had grown ale brands with less than £450,000 advertising expenditure. Low-cost promotions included: sponsorship of local clubs and charity events (Shepherd Neame); promotions on bottles and through web sites (Fullers); web-site features (Tanglefoot); pub trails

(King & Barnes). San Miguel had doubled its share of the premium lager segment during the period 1995 to 1999 despite spending nothing on advertising during 1995 to 1998 and only £100,000 in 1999.

5.166. Interbrew submitted that the level of marketing spend by the major UK brewers in recent years had not had any exclusionary effect on other brewers. Marketing spend by the five largest brewers increased by 8.6 per cent compound annual growth rate from 1995 to 1999, while marketing spend by Greene King, Morlands, Wolverhampton & Dudley, Mansfield and Marstons collectively declined by 8.5 per cent over the same period. In spite of this, the combined market share of the five major brewers fell from 80.3 per cent to 78.4 per cent in those years. It was therefore reasonable to conclude that marketing spend would not increase significantly, as there came a point when no advantage was gained by such expenditure; and that new brands and suppliers could and would enter the market and achieve growth of market share with relatively low marketing spend.

5.167. As to the question of whether Interbrew would have an incentive to rationalize the Whitbread and Bass portfolios, Interbrew submitted that the beer market was a dynamic market in which changing product categories, places of consumption and leisure occasions caused some products to grow and others to decline. Beer was a living product in which shelf life and rate of sale determined product quality. Some beers withdrew themselves as consumers switched to drinking other beers and new products were introduced. It was not in Interbrew's interests to delist a brand where sales levels were being maintained. Interbrew had a total of 180 brands in its portfolio worldwide and had a proven track record of preserving brand diversity, unlike Carlsberg and Heineken which had been the two other European bidders for Bass Brewers. There would also be scope for Interbrew to introduce new brand concepts. [ *Details omitted. See note on page iv.* ]

5.168. As to the effects of the merger on exports of beer from the UK, Interbrew said it was committed to developing the export potential of the merged entity. It had an excellent track record of growing exports of its national brands, particularly in the USA. As an owner of UK beer brands, Interbrew would have every incentive to develop British exports through its international network.

5.169. In the issues letter sent to Interbrew, the CC asked about Interbrew's acknowledgement, reported in the press, that in prior years it had taken actions which were incompatible with the competition rules of the EC; and its statement, also reported in the press, that it was now compliant with the competition rules prohibiting restrictive agreements and concerted practices and was committed to ensuring that its business practices were now fully compliant with the regulations in the market where it operated. We asked Interbrew whether it would nevertheless be reasonable to infer an expectation that such conduct would occur following the merger. Interbrew provided us with its own and with Bass's code of conduct and with the Interbrew guidance manual on its code. It said it would not be reasonable to form an expectation that anti-competitive conduct would recur. Interbrew's attitude to anti-competitive behaviour had been heavily influenced by the arrival of Mr Powell as Chief Executive Officer. Mr Powell's previous experience in the USA and Canada where any collusion with competitors was a criminal offence with responsible officers subject to jail sentences, had had a significant effect upon the way in which such conduct was viewed within the Interbrew group. Interbrew was cooperating fully with the European Commission authorities in their investigation and had demonstrated that it took these issues very seriously. It had sent a clear message to all its staff that it would not tolerate any repetition of this type of conduct.

5.170. Interbrew said that its own policy on these issues simply served to reinforce a stance which had already existed in Bass Brewers. Interbrew added that its code of conduct was being rolled out throughout the organization on a country-by-country basis, with the code of conduct customized to take account of the specific requirements of national competition legislation. The UK code would need to take account of the Beer Orders and, to the extent that these were covered in the Bass code, the Interbrew code to be implemented in the UK would draw upon elements of the existing Bass Brewers' competition law compliance code. WBC had not had any competition compliance programme when it was part of Whitbread and Interbrew's compliance programme would apply to it.

5.171. Interbrew said that while it deeply regretted the past conduct which had been the subject of the European Commission's investigation, the reality was that the discovery of that conduct and the decisive way in which Interbrew had responded to it made it less rather than more likely that there would be any repetition in the future.

5.172. On the question of whether Interbrew had a financial incentive to increase wholesale prices as a result of the price it paid to acquire Bass Brewers, Interbrew responded that that question appeared to

disregard all the competitive pressures in the UK market which would make it difficult for Interbrew to increase wholesale prices. Interbrew, like any other business, sought to maximize its profits. Attempts to increase wholesale prices would not achieve this as market share would be lost. Interbrew needed a high-volume and low-margin strategy to cover its overheads and, because of competitive pressures and high fixed costs, the strategy of attempting to increase wholesale prices would be unattractive.

5.173. In any event, Interbrew submitted that it did not have a financial incentive to increase wholesale prices in order to justify the price it paid to acquire Bass Brewers. The synergies it expected more than justified the price paid. [ *Details omitted. See note on page iv.* ] The price paid to acquire Bass Brewers was justified by the expected synergies and was based on a combination of a discounted cash-flow evaluation and a comparison of the price paid on recent comparable brewing transactions. [ *Details omitted. See note on page iv.* ]

## *Effects of the merger on beer wholesaling and distribution*

5.174. Interbrew considered that wholesaling and distribution were fundamentally different and that different issues arose in relation to each of those functions. The link between the brewing and wholesaling of beer had its roots in the historical structure of the UK beer industry. Since the 1989 Beer Orders, vertical integration had gradually been dismantled. However, wholesaling had tended to remain associated with production activities. Because of the emergence of large pubcos, the structure of the on-trade was increasingly evolving along lines similar to the off-trade, where the emergence of large retail operators had led to alternative methods of distribution. Over time, large retailers in both the on- and the off-trade had taken control of the supply chain, dealing directly with manufacturers and taking control of distribution, and in some cases wholesaling. This had led to fundamental change in the nature of distribution services operated by brewers, and to the emergence of a market for contract distribution services. Customers were increasingly taking control of various aspects such as sales and order collection, secondary distribution, invoicing and payment collection. It was increasingly common for pubcos to arrange for secondary distribution from main depots to managed or tenanted estates by one distributor who would deliver a range of beers supplied by a number of brewers. Several retail groups collated orders from individual outlets. Brewers employed a range of distribution arrangements and distributed a significant volume of products manufactured by competitors.

5.175. On the question of whether the merger would reduce competition in the wholesaling and distribution of beer, Interbrew submitted that the merger would not have this effect. By 'wholesaling', Interbrew referred to order capture, invoicing and cash collection. By 'secondary distribution', it referred to delivery to outlet. Traditional wholesaling had involved a combination of these two activities. By 'primary distribution' Interbrew referred to delivery from the brewery to either the retailer's or the wholesaler's nominated depot, and this was included in the price of the product. Interbrew provided a market map showing the varying routes to market for brand owners according to the trade channel.

5.176. As to competition in wholesaling, Interbrew said that national brewers and independent wholesalers had a strong incentive to wholesale other brewers' products where these were demanded by customers. Bass Brewers currently factored over 150 beer brands and Interbrew UK factored more than 70. No UK brewer had sufficiently strong brands to be able to satisfy customer demand completely. If the merged entity were to refuse to supply beers desired by the pubcos, other brewers would willingly supply them. Increased efficiency was crucial to maintaining margins in supplying pubcos, although dedicated niche operators could survive.

5.177. As to competition in distribution, Interbrew submitted that it would not be able to influence the conduct of Tradeteam, which was managed by Exel. To the extent that Bass Brewers obtained a dividend generated as a result of revenues from third party distribution, it had a commercial incentive to encourage Tradeteam to carry out third party distribution. At present distribution for Bass Brewers accounted for about [✄] per cent by volume of Tradeteam's business but this proportion was expected to decrease as the amount of third party distribution carried out by Tradeteam rose. Interbrew UK's logistics activity, formerly Whitbread Drinks Logistics, had been separated from its manufacturing activity in operational terms [*Details omitted. See note on page iv.*]. In general, Interbrew UK did not carry out third party distribution. However, as part of the acquisition of WBC, separate agreements relating to the provision of beer supply and secondary distribution services had been put in place.

Whitbread Drinks Logistics did tender for third party secondary distribution contracts but not on a marginal basis and it had not yet been successful in winning third party business. Its contract distribution activities were limited to its former affiliated companies, namely Whitbread and First Quench. The proposed sale of the Whitbread retail estate placed the secondary distribution contract for that estate under considerable uncertainty since, if the estate were purchased by a pubco, that pubco might seek to bring secondary distribution into line with the arrangements for the rest of its estate.

5.178. Interbrew concluded that the merger would have no significant impact on competition in the distribution of beer, given that Bass Brewers was not active in distribution other than through its equity stake in Tradeteam and that Interbrew UK had only very limited third party distribution services.

5.179. Therefore competition in the wholesaling and distribution of beer would remain strong following the merger. The existing options for wholesaling and secondary distribution would continue, ensuring that brands had a number of available routes to market. In addition to Bass Brewers for wholesaling, Tradeteam for secondary distribution and Interbrew UK, brewers and retailers would have available to them the wholesaling and distribution services of S&N, Carlsberg-Tetley and a range of regional brewers as well as independent wholesalers such as The Beer Seller and Matthew Clark, and independent logistics providers such as Hays and Wincanton.

5.180. As to whether the merger would increase barriers to entry or expansion in wholesaling or distribution, Interbrew submitted that it would not do so. Pubcos had themselves entered the wholesaling market and had subcontracted certain elements of this activity. Entry to wholesaling activities did not need to be on a large scale. Even entry on a relatively large scale was not subject to significant barriers. National Drinks Distribution was an example of small independent wholesalers being able to create an entity to compete with the major independent wholesalers (see paragraph 5.40); this was a consortium of 27 wholesalers with sales of £140 million and 16,000 customers. Opportunities had also been opened up by virtue of e-commerce (see paragraph 5.42) which Interbrew said was likely to grow significantly in importance.

5.181. As to entry into distribution, the contracting out of distribution activities also provided opportunity for entry and many pubcos had sufficient scale to be able to set up their own in-house distribution operations or partnerships with a logistics provider should they wish to do so.

5.182. The fixed outlays required in relation to distribution were not significant and were not sunk costs. The capital requirements consisted of general-purpose warehouses for temporary storage and a fleet of vehicles to distribute products. Those off-the-shelf assets could be leased, thereby reducing the initial outlay and the financial risk in entering the market or expanding existing operations. IT capital requirements and working capital requirements were modest. The merger would not alter any of these aspects of the industry. Although so far there had been few examples of independent logistics providers entering the market, this was evidence not of barriers to entry but of intense competition for the business, particularly from S&N and Carlsberg-Tetley, which were each able to offer logistics services on a marginal cost basis.

5.183. As to what impact, if any, the merger would have on Carlsberg-Tetley's position in the wholesaling and distribution of beer, Interbrew believed that the merger would have no material impact on Carlsberg-Tetley's position, and that Carlsberg-Tetley would continue to be a significant competitive force (see paragraphs 5.61 and 5.62). Carlsberg-Tetley would continue to have available to it a range of brands and this would not be affected by the merger. Interbrew would continue to have an incentive to offer its brands on competitive terms to Carlsberg-Tetley in order to increase coverage of its products. Nor would the merger affect opportunities for Carlsberg-Tetley to provide distribution services on a contracted-out basis. Carlsberg-Tetley had been able to justify marginal costing of its distribution services in order to recover overheads and this had been a successful strategy for the company. Interbrew provided information about the supply arrangements for a number of retailers.

5.184. On the question of whether Interbrew would be able to use its expanded brand portfolio to deny leading brands to competing brewers and wholesalers on terms that would enable them to compete effectively for the business of retail outlets, Interbrew submitted that the nature of competition would continue to be on a brand-by-brand basis. Interbrew had no commercial incentive to refuse to supply other brewers and indeed this would be unlawful under the terms of the Beer Orders. Pubcos were powerful retail customers which dictated the brands that would be supplied to their estate and in general

agreed terms directly with brewers. Interbrew would have a specific incentive to continue to make its brands available to brewers with tied estates, since those estates were otherwise closed to it.

5.185. Interbrew did not agree with the suggestion made to the CC that independent wholesalers primarily serviced independent free trade outlets and did not have access to the pubcos because they were unable to source beers at competitive prices. Interbrew said that the prices demanded by the pubcos reflected their strong buyer power. Brewers' margins on sales to this channel were being eroded but this had to be balanced against the brand coverage offered. Since pubcos were able to demand very keen prices from brewers, they were reluctant to pay the wholesalers' margin. Similarly, larger free trade outlets could 'cut out the middle man' by going straight to the brewer.

5.186. On the question of whether Interbrew would be in a position to require wholesalers or retailers to take its complete product range (full-line forcing), Interbrew said that purchasers would generally 'cherry pick' the brands they wanted from a number of suppliers in order to satisfy the wide-ranging demands of their consumers. There was no scope for Interbrew to use strong brands to leverage other weaker brands in its portfolio. The only way in which secondary brands could be tied to the sale of brands would be through offering loss-leading prices but, in view of the remorseless passing of the margin pool from brewing to retailing, that was not a viable or profitable strategy.

5.187. On the question whether the differences in the net prices charged to different buyers by Bass and Whitbread were cost justified, and what effect the merger would have on these net price differentials, Interbrew said that the costs incurred in serving different channels varied considerably and this largely determined the differences between the net prices charged to different channels. Net prices charged took account of differences in the direct cost of supply, the need to recoup overheads, spillover benefits from certain trade channels, and volume. Brewers had different levels of capital invested in the different channels on which they needed to obtain a return and that was a factor in determining prices. However, the levels of discount offered to independent free trade outlets were such that those customers paid on average about £[✂] per barrel less than a pubco tenant paid when purchasing beer from the pubco. Further, it was clear from the overall levels of profitability of Interbrew UK, Bass Brewers and UK brewers in general that this was not an industry with excess profits.

5.188. Interbrew stated that the nature of services offered to different channels in the on-trade were such that competition took place on a number of levels, in particular in relation to the independent free trade. As a result of the continuing pressures placed on brewers by pubcos, where brewers' margins had been significantly eroded, the incentive to compete vigorously for independent free trade volumes had increased, and this channel had benefited from a substantial increase in the discounts available over the last five years in particular. In addition, brewers had sought to increase the range of services offered to this channel including providing strategic advice and other promotions that were relevant to the particular outlet.

5.189. The commercial strategy of pubcos had focused competition on price. This was due in large part to the fact that the majority of pubcos' profits were derived from the margin they earned on sales of beer to their tenanted estates. Punch had been quoted in the press as saying it wanted to buy beer cheap and sell it dear. Pubcos had driven down net wholesale prices to the extent that these covered the direct cost of sales but were not margin enhancing. However, brewers had an incentive to continue to compete on price for sales to pubcos because they did not wish to lose large volumes of sales which would result in a reduction in contribution to fixed costs.

5.190. Interbrew said that effective competition to supply each class of customer ensured that net prices fully reflected cost, including costs of capital, and demand and scale efficiencies. This would continue to be the case for the merged entity. The synergies generated as a result of the merger would enable Interbrew to continue to offer competitive pricing to all channels without further erosion of already tight margins.

5.191. Interbrew expected the downward pressure on net wholesale prices to continue. Although brewers' margins were already extremely tight, in the longer term this downward trend could be expected to level off. In the meantime, the synergies generated by the merger would enable Interbrew to continue to compete vigorously on price and at the same time maintain its chosen commercial strategy as a broad portfolio brewer, thereby enhancing consumer choice.

5.192. On the question of whether Interbrew's increased portfolio would enable it to spread distribution costs across multiple brands, cross-subsidize prices and offer high promotional support or discounts on specific brands within its portfolio, to the disadvantage of its competitors, Interbrew responded that its portfolio philosophy meant that it did benefit from economies of scope. However, that did not mean that it could penalize customers which did not take multiple brands. Rather, this strategy and philosophy enabled it to ensure that smaller brands were maintained, to the extent that there was consumer demand for these products. Although there would be certain brands where Interbrew would be able to spread distribution costs on a national basis, local brands would continue to benefit from support in areas of customer demand. Cross-subsidization of prices would not make commercial sense because customers demanded brands rather than portfolios. Any attempt at cross-subsidization would lead to customers demanding more of the subsidized product but would not benefit Interbrew, as customers would not buy the expensive product. Interbrew might still offer promotional support or discounts on particular brands, as Carlsberg-Tetley had done during the Euro 2000 football competition.

5.193. On the question of whether Interbrew would have a financial incentive to promote brands from its enhanced portfolio at the expense of competing brands, Interbrew responded that the nature of competition was such that it would obviously wish to promote its own products ahead of those of its competitors. It was in Interbrew's interests to offer customers the range of products that they wanted. Both Bass Brewers and Interbrew UK provided factored beer promotions, for example: point-of-sale kit such as glasses for Guinness; 'buy one get one free' in relation to Holsten, for customers currently stocking Holsten Pils; and special price offers on Budweiser for customers not currently purchasing Budweiser from Bass Brewers. If Interbrew failed to provide factored beers on competitive terms, customers would merely source those brands from elsewhere and indeed would be likely to punish Interbrew by delisting its own brands. This position would not change as a result of the merger.

5.194. On the question of whether Interbrew would be able to lower the price of its own brands, or artificially increase the price of competing brands, in order to encourage sales of its own brands to retail outlets and disadvantage its competitors, Interbrew responded that it would not be able to discriminate against competing brands in order to encourage sales of its own brands to retail outlets. As the result of their ability to play one brewer off against another, retailers were able to obtain very competitive prices. If Interbrew were to offer deep discounts for its own brands, that would undermine the profitability and efficiency of Interbrew's own operations. Prices for factored brands were extremely competitive because they were available from all wholesalers trading in the market and, in the case of packaged products, from cash-and-carry outlets.

5.195. Interbrew said that the theoretical decision whether to promote a competitor's brand or an own brand rarely arose, because customers needed and wanted all brands in order to fully satisfy consumer demand. Bass currently wholesaled a great deal more Bacardi Breezer than it did of its own competing brand, Hooch, along with a wide variety of other competing products such as Martini Metz and Smirnoff Ice. Similarly with bottled premium beer, Bass had launched two new entrants, Mojo and Cru, into the on-trade market, while continuing to wholesale a wide variety of direct competitors, particularly Budvar and Beck's.

5.196. The margins made by Bass Brewers on factored brands, [

*Details omitted. See note on page iv.*

]. This included an element of brewing margin for Bass brands as well as wholesale margin which, in the case of factored brands, was captured separately by the brand-owners. In the UK this was usually estimated at [✂] £[✂] to £[✂] per hectolitre based on contract brewing margins, and therefore the direct equivalent comparison might be £[✂] per hectolitre margin for factored brands and £[✂] per hectolitre margin for owned brands; [*Details omitted. See note on page iv.*].

5.197. On the question of whether Interbrew would have greater access to information about its competitors' sales to retail outlets, and whether this would give Interbrew the ability to compete selectively to secure sales to those outlets, Interbrew responded that it was simply not the case that it had the ability to compete selectively. Tradeteam had been structured in such a way that Bass Brewers did not and could not receive confidential information about competitors' sales to retail outlets. Interbrew UK's contract distribution activities were limited to distribution to the Whitbread estate and to First Quench off-trade outlets; and it did not have access to information regarding products supplied by its competitors to these customers by virtue of these agreements.

5.198. Interbrew said that the rapid consolidation in the retail sector had led to increasing churn in accounts. When a pubco acquired a number of formerly independent pub chains that had been supplied

by a particular brewer, it would examine the terms of all the supply agreements to the various parts of its estate and would choose the most favourable terms to apply across its estate. Interbrew had no more control over this aspect of the industry than had any other brewer and even if had information about competitors' sales, which it did not, selective discounting would ultimately have a damaging impact upon its business. Interbrew noted that no such barriers to confidential information being passed from distribution operator to wholesaler were in place in relation to S&N and Carlsberg-Tetley's operations. Any perceived lack of neutrality on the part of those companies had not prevented them both from establishing successful third party distribution businesses.

5.199. On the question of whether Interbrew would be able to control the route to market, especially to the on-trade, for competing brewers, or potential entrants to the market who lacked their own wholesaling and distribution functions and were thereby placed at a competitive disadvantage, Interbrew responded that there were many routes to market and that it would not be able to control those routes or place competitors or potential entrants at a competitive disadvantage. At the time when brewers' sales had been predominantly through their tied estates, control over route to market had been an issue. Now the beer industry was a dynamic market where brand owners communicated directly with retail customers and consumers. There were a number of viable routes to market for brewers who lacked their own distribution function. Both Anheuser-Busch and Guinness had succeeded in establishing very strong positions in the UK without having their own wholesaling and distribution operations (see paragraph 5.156). A number of regional brewers' brands were wholesaled by others outside those brewers' regions; for example, Tradeteam carried out distribution for Wolverhampton & Dudley in London and the South-East. Prices of factored beers were at levels which enabled them to be competitive with brewer-wholesalers' own brands. Brewers without their own wholesaling and distribution functions could negotiate directly with pubcos and the increasing tendency towards outsourcing distribution meant that access to logistical services did not pose a barrier to entry or expansion.

5.200. Some pubcos controlled their own distribution, organizing order capture, invoicing and delivery; others received outlet-delivered product from brewers. Brewers without dedicated wholesaling or distribution operations tended to negotiate supply agreements with regional brewers and with the national brewer-wholesalers and/or independent wholesalers. Delivery to the off-trade was usually to a single central depot. E-commerce operations provided an additional route to market.

5.201. On the question of whether the merger would have any adverse effects on the wholesaling and distribution of beer to the off-trade, Interbrew responded that it would not. The off-trade was a very open market, with numerous routes to market for brewers. Typical off-trade retailers would offer over 100 stock-keeping units, or about 35 beer brands. Prices were extremely competitive and margins were tight. The continuing shift from the on-trade to the off-trade would continue to place considerable pressure on brewers to price competitively. Those trends would not be affected by the merger. The synergies arising as a result of the merger would enable Interbrew to continue to invest in a wide range of brands in accordance with its chosen strategy but without having to increase prices in order to do so. The synergies generated would offset further erosion in margins.

5.202. Interbrew said the purchasing power of multiple retailers was shown by their demands for substantial discounts and also their requirement to pay 'listing fees' (that is, payment for the right to supply). Brand owners dealt direct with multiple retailers and cash-and-carry operators; neither Bass Brewers nor Interbrew UK undertook either a wholesaling or distribution function for third party beer brands to the off-trade (with the sole exception of distribution by Interbrew UK to First Quench outlets which covered all drinks not limited to beer and included third party brands) as off-trade customers dealt directly with brand owners.

5.203. On the question of whether the synergies justified the purchase price for the merger, and what percentage of those synergies would be passed to consumers of beer, Interbrew said that it regarded the price it paid in the light of the synergies, having regard to other deals in the brewing sector in the last two years, as fully justified and value creating for its shareholders. Further detail on the synergies expected to arise from the merger are in paragraphs 3.65 to 3.69.

5.204. Interbrew said that it expected the downward pressure on wholesale prices to continue, [
*Details omitted. See note on page iv.*
]. The margin earned by brewers in the UK was a mere 4p per pint compared with 53p per pint earned by retailers. In Interbrew's view, if synergies were not available and wholesale prices continued to decline, then the pre-tax industry profitability of 4p per pint would surely slip to a lower

number. This figure was an estimated decline in real terms of 20 per cent since the 1997 report. Eventually, continuing downward pressure would erode margins to the point where brewers would be forced to cut back on discretionary spend, ie marketing costs. Although Interbrew believed that, in time, the downward trend must level off if the industry were to survive, the synergies generated by the merger would enable Interbrew to continue to invest in products and maintain a full range of large and small beers, in line with its strategy as a broad portfolio brewer, without having to increase wholesale prices or reduce consumer choice. Thus consumers would benefit directly from the synergies by virtue of continued brand choice.

5.205. Interbrew said that, as demonstrated by the widening gap in real terms between declining net wholesale prices and increasing retail prices, the benefit of the decline in wholesale prices had in general been retained by on-trade retailers rather than being passed on to consumers. Off-trade retailers generally passed on more of the benefit of declining wholesale prices, which had led to a fall in off-trade retail prices in recent years. There were a few notable exceptions in the on-trade, such as Wetherspoon and Yates, who had chosen to pass on the benefit of lower wholesale prices to their customers; and Interbrew expected that those retailers would make available to their customers a proportion, if not all, of the savings made through the increasing reduction in wholesale prices that the synergies generated by the merger would be able to sustain. The fact that consumers were price sensitive, depending upon the occasion, was demonstrated by the continuing shift in volumes from the on-trade to the off-trade, and by the fact that the outlets that suffered most were those that had high prices but did not satisfy a particular consumer leisure demand that would offset those prices. Bass Brewers also referred to the success of the BLR Goose & Granite pubs which had significantly increased volumes by pursuing a low price strategy.

## *Effects of the merger on the retailing of beer*

5.206. Interbrew submitted that the merger would not have any adverse effects on the retailing of beer. If anything, the effect would be positive because the severing of two major sets of vertical links had opened the way to full competition over the next [✂] years to supply beer to the Bass and Whitbread estates, which amounted to over [✂] per cent of the total of the UK on-trade beer volume. The power and sophistication of both the pubcos and the independent free trade continued to increase. Both Bass and Whitbread could be expected to exercise their new-found independence and bargaining power to the full.

5.207. On the question of whether the long-term supply agreements which Interbrew had entered into with the retained estates of Bass and Whitbread effectively foreclosed those estates to competitors for the duration of the agreements and beyond, Interbrew said that the severing of the ownership links between the brewing and retailing businesses of Bass and Whitbread had been a major change for both the brewing and retail operations concerned. The Bass retail estate accounted for about [✂] per cent of the on-trade volumes supplied by Bass Brewers and the Whitbread estate accounted for about [✂] per cent of the volume supplied by Interbrew UK. Both the retail and brewing divisions of the former integrated businesses needed time to adapt, and Interbrew regarded the supply agreements as a reasonable means of effecting an extremely significant structural change. Interbrew noted that both agreements were shorter than the extended Carlsberg-Tetley supply agreement with the former Allied-Domecq estate, which now ran until [✂] (see paragraph 5.2*(e)*).

5.208. Interbrew submitted that the supply agreements with the Bass and Whitbread estates would extend rather than reduce competition by effecting a move away from the vertical integration that had previously existed. Interbrew failed to see how the agreements could foreclose access. On the contrary, they represented the first stage in freeing the estates up to full competition. The two estates, whether they remained owned by Bass and Whitbread or whether they were acquired by pubcos, could be expected to seek to achieve the lowest possible prices for their beer. If existing large pubcos acquired some of the outlets, their purchasing power would increase still further. As the minimum purchase requirements from Bass Brewers and Interbrew UK reduced, the estates would almost certainly go out to tender for the supply of the extra volume. The bidding process would undoubtedly be highly competitive.

5.209. In the case of the Bass retail estate, [*Details omitted. See note on page iv.*] that estate's volumes would not be subject to minimum purchase obligations in the supply agreement with Bass Brewers. The level of churn of supply to retailers of all sizes undermined any notion that retailers' purchasing was driven by inertia. Interbrew gave examples of products which had been delisted as a result of purchasing negotiations.

5.210. On the question of whether the supply agreements would enable Interbrew to compete more aggressively for other business, Interbrew responded that it would be in a weaker position than either Bass Brewers or WBC had been when they had been part of vertically-integrated groups. Bass Brewers and Interbrew UK would not make any excess profits on their contracts which they could use to cross-subsidize other sales. Interbrew would not therefore be in any better position in this respect than any of its competitors. In addition, the proposed sale of the Whitbread retail estate and part of the Bass retail estate would put increased pressures on these volumes and would add to the uncertainty faced by Interbrew during the transitional period.

5.211. On the question whether the pubcos had sufficient buying power to enable them to withstand the increased market power of Interbrew, Interbrew said that power in negotiations rested with the pubcos which could and did renegotiate supply contracts (see paragraph 5.104*(f)*). Pubcos had a very firm degree of control over their estates and were able to control to a large extent what was served in their outlets, even when they had tenanted rather than managed estates. Pubcos tended to buy beers at a large discount to the list price; the pubco kept the discount but required the tenant to pay the full list price or close to it. Pubcos' strategies would develop and Interbrew expected them to develop own-label products or look to suppliers for promotional support. Interbrew would be more dependent on business with the pubcos and the independent free trade than Bass Brewers and WBC had been when they were vertically integrated, and Interbrew expected the retailers to take full advantage of this.

5.212. On the question whether the merger would have an adverse effect on the free trade, Interbrew said that it would become more dependent on business with the free trade (see paragraph 5.211). Interbrew provided a graph showing the decline in real ex-duty wholesale prices for Bass Brewers' products to the independent free trade. Prices had declined from £[✂] a barrel in 1991/92 to £[✂] a barrel in 1999 to 2000 (in real terms). The disparity between prices to pubcos and prices to independent free trade customers could be explained in part by the volumes and the difference in the cost of serving them but were primarily driven by the very considerable purchasing power of the pubcos. In contrast, pubcos had taken a number of measures to monitor and control the supply of beer to their tenants, who were charged higher prices by the pubcos than were available from other wholesalers. The discounts per barrel given by Bass Brewers to independent free trade customers for volumes of [ ✂ ] barrels were between £[✂] and £[✂] per barrel. This compared with an estimated wholesale list price discount of £5 per barrel given by pubcos to their tenants or lessees.

5.213. Interbrew said that it would need to continue to compete fiercely on price and service if it were to maintain its share of the independent free trade market, as the independent free trade would continue to source its products according to its requirements from a number of different suppliers.

## *Possible adverse effects on the public interest*

5.214. Interbrew rejected the suggestion that the merger might lead to higher wholesale prices and eventually higher retail prices in the on-trade than would otherwise be the case. It said that the effect of wholesale prices on retail prices should be put to the pubcos rather than the brewers. In the light of the power that lay in the hands of the retailers and the fact that Interbrew, because it did not have any captive retail estate, would be dependent on retailers able and willing to exert their buyer power, Interbrew said the merger would not lead to an increase in wholesale prices. The relatively low strength of individual beer brands was such that there could not be said to be any 'must stock' brands and having relatively strong brands did not mean that the entire portfolio of brands would enjoy success. Interbrew therefore rejected the suggestion that the market share of the merged entity and its enlarged portfolio would enable it to increase wholesale prices in the face of retailers with such strong bargaining positions and with such easily substitutable products available on the market.

5.215. However, Interbrew did not expect the trend in wholesale prices to continue indefinitely. The decline in real wholesale prices seen in recent years would need to level off at some point if brewers were to be able to continue to invest in innovation and offer customers a breadth of choice, although Interbrew had envisaged wholesale prices continuing to decline [*Details omitted. See note on page iv.*]. It was impossible to predict when the decline in prices would cease but it was clear that the merger would have no impact on the process.

5.216. Interbrew said that any such slowing in the decline of wholesale prices should not lead to an increase in retail prices for the consumer. The rise in retail prices and the decline in wholesale prices

were not linked, although they had occurred in the same period. Retailers' margins were typically six times larger than brewers' margins, and any flattening out of wholesale prices in due course should not have a significant bearing on retailers' strategies in relation to the prices charged to consumers.

5.217. Interbrew rejected the suggestion that the merger might lead to increased price discrimination between buyers, leading to adverse effects on the structure of the retail market and on independent wholesalers. Interbrew said that the differences in prices charged to different types and sizes of retailers could be explained by volume; the cost to serve the different retailers, including relevant capital costs; and strategic or marketing benefits. Independent outlets were likely increasingly to join buying consortia and the market share held by independent wholesalers would depend on the changes to the independent free trade sector. It was notable that the market share of the independent wholesalers had remained stable despite the pubcos increasing their wholesaling functions.

5.218. Interbrew rejected the suggestion that the merger might lead to reduced choice of brands for retailers and consumers and a reduced rate of new product innovation. Its philosophy was founded on brand diversity and catering for consumer choice. Product innovation would be maintained and increased through Interbrew's investment in Bass Brewers. Interbrew considered that it was a more suitable purchaser of the Bass Brewers business, in terms of protecting brand diversity and therefore consumer choice, than any of the other bidders for the business.

5.219. Interbrew rejected the suggestion that the merger might lead to an escalation of marketing expenditure, leading to increases in entry barriers to brewing. It said that marketing expenditure beyond a certain point produced diminishing returns, and it did not consider that the CC should view the merger as likely to increase marketing expenditure to an extent likely to raise the barriers to entry into the UK beer market. By contrast with other potential purchasers of Bass Brewers, Interbrew would continue to invest in supporting a broad range of brands, by virtue of the synergies realized by the merger and in accordance with its chosen strategy as a broad portfolio brewer.

## *Further points on public interest benefits*

5.220. In addition to the points in paragraphs 5.115 to 5.119, Interbrew asked the CC to bear in mind that a return to the status quo ante, that is, the vertically-integrated Bass, was not an option. Bass had decided to sell its brewing interests and the sale to Interbrew had removed uncertainty and been welcomed by the trade unions. Interbrew's acquisition of Bass Brewers and WBC had brought the following benefits:

*(a)* the severing of the vertical links between Bass Brewers and Interbrew UK and the retail estates of their former parent companies. Either of these companies on a stand-alone basis would be weaker than previously and the synergies generated by the merger would help to off-set this weakening and enable the merged entity to continue to compete vigorously;

*(b)* the potential entry on to the market of Heineken as a stand-alone competitive force; and

*(c)* the entry on to the UK market of Interbrew, a company committed to brewing and to brand diversity.

5.221. In addition, Interbrew asked the CC to take account of the following public interest benefits.

5.222. As to synergies, Interbrew had identified substantial cost savings which it believed would be achieved through the integration of Interbrew UK and Bass Brewers into the global Interbrew group. The total of these cost savings was estimated at about £[ ✄ ], representing some [✄] per cent of the current combined cost base of the two businesses. These synergies would enable Interbrew to maintain a wide portfolio of products while at the same time operating in a market in which there would be a continued decline in wholesale prices. In the off-trade, the benefit could be expected to be passed on to the consumer. In the on-trade, Interbrew had no means of guaranteeing that those benefits would be passed on by its customers to the ultimate consumer, but it would not be fair for it to be penalized on this account. If that were indeed the reality of the marketplace as it operated, that was a matter which should be investigated separately by the regulatory authorities rather than neutralizing the benefits which would flow from the merger.

5.223. As to consumer choice, far from leading to a reduction of choice and brand innovation, the merger could be expected to lead to an increase in choice and innovation. Interbrew, unlike its competitors, such as Anheuser-Busch, Carlsberg and Heineken, believed in a broad brand portfolio. This was not to say that its approach was better or worse than that of its competitors; it was simply different. As a major new participant in UK brewing, Interbrew could introduce new brands from its global portfolio and new products launched else where in the world. Interbrew expressed its willingness to undertake not to rationalize any brands in the combined portfolio and not to close any breweries for a period of two years in order to preserve brand diversity and employment in the UK brewing industry.

5.224. As to export opportunities, Interbrew believed it could build on the export success of Bass Brewers by providing access to its operations around the world (see paragraph 5.118) and this would improve the long-term security of Interbrew UK's business as well as providing potential new job opportunities in this industry.

## *Comparison with the 1997 proposed Bass/Carlsberg-Tetley merger*

5.225. We asked Interbrew if it wished to comment on the Bass/Carlsberg-Tetley merger considered by the MMC in 1997. Interbrew made the following points:

*(a)* There had been a continuation and acceleration of the trends which Bass had identified in its evidence to the MMC on the Carlsberg-Tetley case. These trends were: a continued decline in overall beer consumption; a continued shift from on-trade to off-trade consumption; a continued decline in draught beer; continued pressure from imports, both legal and illegal; continued pressure from other beverages such as FABs which were in direct competition with beer; continuing decline in wholesale margins and continuing divergence of wholesale and retail prices; and significant scaling-back of brewers' loan books.

*(b)* These factors had served to intensify competitive pressures on brewers. Other developments in the competitive environment had been: the consolidation of Carlsberg in Scandinavia; S&N's becoming a major international brewer and holding 40 per cent of the French beer market; and Heineken's reassessment of its strategy in the light of Whitbread's sale of WBC to Interbrew.

*(c)* There had also been continued consolidation at the retail level. In 1997, independent chains with more than 30 pubs accounted for about 19,000 pubs in all. That figure was now about 30,000, about 50 per cent of all pubs in the UK. Purchasing power at the retail level had increased and consolidation of pubcos would continue; it had been suggested that about 20 per cent of pubs were for sale or about to come on the market, including some from the Bass and Whitbread estates.

*(d)* Interbrew had noted the strength of feeling against the merger which seemed to emanate from the independent pubcos. As their size and purchasing power had grown in the last three or four years, so had their ability to mobilize themselves against any merger which they saw as threatening their purchasing power. Margins were being eroded even more than four years ago by the power of the on-trade chains although very few of these pubcos were passing on their increased margins to their consumers.

*(e)* At the wholesale level, pubcos were increasingly acting as wholesalers. In Interbrew's view, it was not appropriate to treat the share of the market accounted for by independent wholesalers as a litmus test of the competitiveness of the market at the wholesale level, any more than it would be appropriate to consider the share of the off-trade accounted for by wholesalers as being the litmus test of competitiveness in the off-trade. The true test of the competitiveness of the market was what was happening to the industry margin pool and the increase in retail prices as against declining wholesale prices over the last ten years. However, independent wholesalers continued to play an important and distinctive role, two of whom were themselves major brand owners in their own right and both of whom were now part of major drinks organizations. E-commerce had emerged as a new competitive factor.

*(f)* Since the MMC had considered the proposed Bass/Carlsberg Tetley merger in 1997, Bass and Whitbread had sold their brewing interests. This had fundamentally altered the shape of the industry and indeed Bass and Whitbread were intending to dispose of much of their retail estates.

Any suggestion that the supply agreements with Bass and Whitbread were vertical integration by another name was wholly unjustified.

*(g)* The share of UK beer production attributable in 1996 to Bass and Carlsberg-Tetley combined would have been about 38 per cent, with Bass remaining vertically integrated. That compared with a share of 32 per cent attributable to the merged entity, of which [✄] per cent was represented by the Bass and Whitbread retail estates and would therefore become progressively subject to competition from other brewers over the next [✄] years.

*(h)* Average wholesale prices had continued to decline, as had the prices of so-called power brands such as Carling and Stella Artois.

*(i)* Bass Brewers and Interbrew UK combined had fewer brands in the top ten, the top twenty and the top thirty lists of brands than did Bass and Carlsberg-Tetley in 1996, and the same was true of the top lager brands. There was no significant overlap between Bass Brewers and Interbrew UK in the fastest-growing segment of the beer market, namely premium lager.

*(j)* A feature of this merger was Interbrew's commitment to brand diversity and product innovation.

## *Possible remedies*

5.226. Interbrew commented on the possible remedies set out in the Issues and Remedies Statement (see Appendix 2.2). We asked Interbrew to complete a regulatory impact assessment and its response is at Appendix 5.1. Interbrew commented that, in order to provide the CC with estimates of the costs of the hypothetical remedies, a number of simplifying assumptions had been used. Where appropriate, the main details of these assumptions had been stated. However, to validate the detailed accuracy of the estimates, considerable further work would be required, and the estimates were therefore illustrative in nature. In particular, considerably more work would need to be done in order to verify the estimates of costs to third parties as a result of the hypothetical remedies, and so these costs had not, in large measure, been estimated. Furthermore, as set out in this document, several remedies resulted in very substantial costs to either Interbrew or third parties, which were not easily quantifiable as they depended on events outside Interbrew's control and hence no specific figures had been set against them. It had not been possible to complete the regulatory impact assessment form in respect of the three possible behavioural remedies. Interbrew did not believe that such remedies could be meaningfully costed.

5.227. As to the two possible remedies *(a)* divesting Bass Brewers in its entirety or possibly without its activities in Scotland and Northern Ireland; and *(b)* divesting WBC, with or without the rights to Stella Artois, Interbrew made the following points concerning both these remedies:

*(a)* Both these drastic remedies would be detrimental to the public interest. They were likely to lead to a reduction in consumer choice, a reduction in the diversity of the British brewing industry and great harm to the communities linked to Bass and Whitbread. Bass Brewers had been purchased on the basis of significant synergies that could be realized from combining the two businesses and integrating them into the wider Interbrew group. Both Bass and Whitbread had disposed of their brewing assets in the context of broader vertical disintegration in the beer market and in anticipation that these would be brought together with brewing assets to increase their competitiveness and profitability. It followed that reverting to the status quo ante was not possible. In the interests of consumer choice and the British beer industry, Interbrew was the best owner of Bass Brewers and WBC. Other possible trade buyers would either create similar (or greater) competitive concerns or be likely to rationalize the brand portfolios (or both); a financial buyer would simply 'milk' existing brands as part of a rationalization process. If the merger were to be unwound, that would create a harmful level of disruption and uncertainty in the industry and in the communities linked to those brewing operations.

*(b)* Without the benefit of vertical integration and the synergies arising out of the merger with WBC, Bass Brewers would be likely to need to implement heavy brand rationalization. Interbrew hoped to preserve the largest possible number of brands and continue its contributions to product innovation and development. Interbrew estimated that it could save about £[✄] million a year through synergies and the application of best practices throughout the organization. None of Interbrew's competitors would be able to extract as many synergies to benefit from a

combination with Bass Brewers or WBC. Interbrew was the best owner of Bass Brewers' assets, with its unmatched commitment to brand diversity and ability to provide significant export opportunities. The beer industry had declining profits and had been punctuated recently by a series of industry exits, including those of Bass and Whitbread, the number of possible buyers of Bass Brewers or WBC was therefore small.

*(c)* A forced sale would create significant uncertainty in the market and would be likely to lead to loss of top personnel, atrophy of the brands and corporate strategies and general disruption in the Bass Brewers and WBC communities.

*(d)* A sale to a venture capital firm would be only a temporary measure, and would amount to no more than a value-destroying delay of the eventual sale (within two to three years) to another brewer and would not prevent the consolidation of British brewing. Furthermore, a venture capital firm with higher leverage and no operational synergy opportunities would probably rationalize the product portfolio, substantially reduce spend on marketing and product innovation and sell off assets piecemeal. That would drive up short-term profitability but lead to loss of brand diversity and brewery closures in the long term.

*(e)* As to the possibility of a sale to a trade buyer which had brewing expertise and was able to obtain significant synergies, the prospect of regulatory intervention was likely to make such buyers very cautious. Furthermore, other major brewers were less likely than Interbrew to protect brand diversity or pursue innovation. Anheuser-Busch, Carlsberg and Heineken all tended to pursue narrow brand strategies. South African Breweries, which had previously shown interest in bidding for Bass brewers, had limited experience of OECD markets or of brand management, historically had a strategy built on small brand portfolios and would bring no synergies through its acquisition of the business. A sale to Carlsberg-Tetley, Heineken or S&N would lead to very high concentration in the standard lager category, which had no recent new brand entry, and would be likely to lead to a loss of brand diversity in the ale and larger segments.

*(f)* If Interbrew were forced to divest itself of Bass Brewers or WBC, those two organizations would be weakened when eventually resold, and with no access to synergies if they remained as stand-alone businesses, they would be forced to rationalize brand portfolios, reduce capacity and cut employment.

5.228. More specifically on the possible remedy of divesting Bass Brewers in its entirety, Interbrew submitted that that remedy would leave a weakened, although still viable WBC. WBC would be left on its own without its retail arm or the support that could have been provided from the integration with Bass Brewers. As a result, WBC would be unable to support its portfolio of many smaller, largely ale, brands. The significant losses to Interbrew as a result of a forced sale of Bass Brewers would force it to follow a single-brand strategy focusing on Stella Artois to the detriment of other WBC brands. It might also have to consider re-establishing links between WBC and a retail estate. In the event of a requirement to dispose of Bass Brewers, Interbrew anticipated at least a further nine months of uncertainty during the sale process. [ *Details omitted. See note on page iv.* ] It would not be feasible to be investing in the future of the business while it was in limbo. The stewardship of brands and brand management was likely to be weakened during this period. Product innovation, another form of investment in the future, would be inevitably curtailed during the process. In the longer term, Bass Brewers, as a stand-alone company without the benefit of the synergies generated by the merger and without vertical links to a retail estate, would be forced to rationalize brands and breweries. There would be reduced export opportunities as a result of the company's reduced financial capacity. The skills base in the company would be weakened, breweries would close and unemployment levels would rise. Eventually, a further round of consolidation would follow.

5.229. On the possible remedy of divesting Bass Brewers without its activities in Scotland and Northern Ireland, Interbrew commented that it understood this possible remedy to mean that it would be required to sell off assets that formerly belonged to Bass Brewers except those in Scotland and Northern Ireland. The sale of those assets would be detrimental to the public interest. While such a move would have no impact on the market shares in Scotland and Northern Ireland, it would have several harmful effects. It was likely to lead to a decrease in brand diversity and a serious disruption of the regional businesses of Bass Brewers. In practice, a business that would sustain profits could not be created by dividing up the former Bass assets in this way.

5.230. Interbrew added that this remedy appeared to be at odds with the CC's stated approach to market definition of the beer industry; and that as beer was increasingly international in nature, it made little sense to fragment such a business on a subregional basis. Furthermore, to split the former Bass assets in the way suggested would not be feasible from a business point of view, as there was significant cross-border dependence among both assets and brands. [

*Details omitted. See note on page iv.*

] Bass Brewers was a national concern and it benefited from longer production runs in response to changes in demand for particular products and types of packaging. If those assets were divided, the resulting organizations, ie the divested business and the retained business, would be weakened and much less profitable. The result would be less efficient utilization and reduced flexibility in the operation of the six breweries that had belonged to Bass Brewers before the merger. In this context, it should be noted that WBC operated only two breweries. A third was currently leased by it to Whitbread so that Whitbread could continue its production of Heineken and Murphy's and fulfil its obligations to Heineken under the Heineken and Murphy's licences.

5.231. Interbrew went on to say that if it were required to divest Bass Brewers without the Bass Brewers businesses in Scotland and Northern Ireland, that would amount to splitting the business of the former Bass Brewers into at least two companies. Each of the two companies would suffer from a general increase in overhead costs, because of the requirement for duplication, which would reduce their profitability. If Interbrew were permitted to retain only WBC and Bass Brewers' Scotland and Northern Ireland assets, the Bass Brewers' remaining assets would essentially become an independent business and therefore the synergies expected from the merger would be considerably reduced. It was hard to see how the merged entity could be profitable if it were permitted to retain only Bass Brewers' assets in Scotland and Northern Ireland, given the resulting large burden of overhead costs and the higher logistics costs associated with operating in Northern Ireland spread across a much narrower asset and revenue base.

5.232. Interbrew submitted that a remedy which split the assets in the way suggested was contrary to the optimal economics of the beer industry. Brands such as Tennents and Caffreys brewed in Scotland and Northern Ireland were recognized brands in England and Wales and were also significant export brands. If the Scotland and Northern Ireland breweries were separated without retaining the benefit of Bass Brewers' extensive national distribution network, it would be more difficult and more expensive to bring these brands to broader markets; and as a result these brands could be marginalized.

5.233. Interbrew stated that such a remedy could force it to consider the sale or closure of the Northern Ireland operation, as its profitability on a stand-alone basis was questionable. That would have significant implications for Northern Ireland. Guinness already held 60 per cent of the Northern Ireland market, and Bass Brewers was its sole competitor; so if Bass Brewers' Northern Ireland operations were weakened, Bass Brewers would become a weaker competitor. Interbrew had no evidence that any international brewer was prepared to take on the economic, political and security risks of operating in Northern Ireland. The economic and social impact of a brewery closure in County Antrim, where there was high unemployment and social unrest, would be catastrophic.

5.234. As regards the hypothetical remedy of divesting WBC including the rights to Stella Artois, Interbrew said that this would represent such an extreme penalty that it would be forced to reassess entirely its investment and strategy in the British market. The success of Stella Artois had contributed to the growth of the entire premium lager category in an otherwise declining beer market. Interbrew was both the best owner of the Stella Artois rights and of WBC, and best placed to protect the public interest. A forced sale of WBC with rights to Stella Artois would send a dramatically negative signal to international brewers considering long-term investment in the British market. One of the main drivers behind Interbrew's acquisition of WBC had been to regain control of its main international brand, Interbrew seriously valued the strategic and financial benefits of reuniting the UK rights to Stella Artois with those in the rest of the world. Interbrew was the purchaser best able to strengthen the weakened assets of WBC; other potential owners of the Stella Artois brand would not have the same incentives to support it and some might have the incentive to weaken it. A stand-alone WBC would not be able to realize the bulk of the synergies calculated for the merger with Bass Brewers and therefore the remaining Interbrew/Bass business would be less profitable than it would have been had the merger been allowed to stand. A stand-alone WBC, with no tie to an estate and without the licences for Heineken and Murphy's, would be forced to rationalize brands and close breweries.

5.235. As regards the hypothetical remedy of divesting WBC without the rights to Stella Artois, the result would depend on the eventual buyer of the operations. Such a divestment could lead to a decline in consumer choice and would definitely be financially harmful to Interbrew, although less so than divestment of Bass Brewers or divestment of WBC including the rights to Stella Artois. WBC with neither the Stella Artois nor the Heineken brands did not constitute a viable stand-alone business. Private equity companies would be likely to degrade the assets and merely delay an eventual sale to a trade buyer or a break-up and sale of the brand portfolio to the highest bidder. A sale to larger international brewers such as Heineken or Anheuser-Busch would be financially viable but brand rationalization would be likely given the single brand approach of these companies and their lack of experience in relation to ales. Smaller regional brewers might be natural purchasers but might not have the financial or business ability to purchase and support the business.

5.236. As to the hypothetical remedy of divesting such brands and associated brewing and wholesaling capacity as would enable the creation of a fourth brewer/wholesaler, for example, divesting Carling, Tennents and either Boddingtons or Worthington, Interbrew made the following points:

*(a)* The concept of a 'competitive fourth brewer/wholesaler' was misconstrued, as the British brewing market was already extremely competitive, with a number (at least six) of strong companies pursuing a variety of strategies. Regional brewers could stay small and enjoy the advantages of vertical integration. Single brand companies were able to be highly competitive by focusing on what they did best. Heineken might become an independent force and had the ability to become so.

*(b)* Interbrew argued that the sale of such a package was not feasible from both a financial and operational point of view, and would be tantamount to the sale of Bass Brewers in its entirety. Even if it were possible, such a sale would harm the public interest. There was no 'wholesaling capacity' that could be sold off. Splitting the assets would not be feasible as there was significant interdependence among them. Specifically, the sale of Carling was not practicable as it was inextricably bound to other Bass Brewers' operations. Such a sale would be tantamount to requiring the sale of Bass Brewers, reducing Interbrew to a 22 per cent market share (without any vertical ties) and causing major operational disruption. The remaining assets would be unlikely to remain profitable. The sale of Carling to any national competitor would create a high degree of concentration in the standard lager category and further cannibalization of brands in this sector.

*(c)* Divestment of Tennents could lead to local disruptions and possibly brewery closure. This proposed remedy seemed unjustified as the merger would have no effect on the position of Tennents or the Scottish market.

*(d)* The sale of both Boddingtons and Worthington would leave the merged entity without a major ale brand, making its overall portfolio unbalanced and making Interbrew's traditional strategy more difficult to implement. Divestments of either of these brands might also weaken the brand divested as the purchaser might have less interest than Interbrew in supporting a diverse brand portfolio. Nor was it certain that a purchaser would want brewing assets, leading to closures and unemployment.

*(e)* Interbrew submitted that there could be no realistic buyers of such a group of assets. Smaller companies would be ill prepared to manage such an acquisition financially or organizationally and would have to rationalize their own brand portfolios to support such an acquisition. Larger companies would face regulatory difficulties. Financial purchasers would merely delay a sale. Any divestment would result in two weakened organizations, namely the weakened merged entity and the divested parts of it.

5.237. As regards the hypothetical remedy of divesting the wholesaling and distribution businesses of Bass Brewers and/or WBC, Interbrew submitted that if wholesaling activities were divested entirely, that would be tantamount to outsourcing not only product distribution but also the full sales function; this was not practicable. However, the distribution function alone could be outsourced and Bass Brewers had already divested its distribution function through its arrangement with Tradeteam.

5.238. Interbrew submitted, further, that wholesaling was a collection of integrated business functions and not a single separable business; as a result, the proposed remedy was not practicable. Moreover Interbrew's wholesaling activities promoted public interest in a way that similar activities of independent

wholesalers could not do. Scale economies in wholesaling activities enabled Bass Brewers and WBC to bring around 150 independent third party brands to market. If Interbrew were to be required to supply all its volume through third parties, that would result in unduly strengthening market power of pubcos and so depressing brewers' prices further. Both Bass Brewers and Interbrew UK/WBC already used a number of routes to market, including independent wholesalers, other brewers and pubcos, and it was unclear what benefit would accrue from disposing of the combined wholesaling activity.

5.239. Interbrew intended to [ ✄ ], as this would increase asset utilization and reduce unit distribution costs. That would create an opportunity to renegotiate the arm's length supply agreement with Tradeteam [ ✄ ].

5.240. As to the possible remedy of Interbrew divesting its interest in Tradeteam and renegotiating its contract on an arm's length and non-preferential basis, Interbrew said that the Bass Brewers' contract already fulfilled these conditions. The equity investment in Tradeteam was a financial investment in a business known and understood by Bass Brewers. It was a means of ensuring that its customers received acceptable distribution service levels, while ensuring lower overall costs.

5.241. We put to Interbrew evidence received that Bass Brewers had discouraged retailers from contracting separately for distribution by linking the price reductions for unbundling distribution from beer supply with the award of the distribution contract to Tradeteam. Interbrew responded that the pricing policy was not intended to discriminate against Tradeteam's competitors in this way, but the terms of the contract between Bass Brewers and Tradeteam in certain circumstances unintentionally had this effect. Changes had been made to the contract to attempt to address this issue and discussions were continuing between Bass Brewers and Tradeteam on this issue.

5.242. Interbrew said that Tradeteam had been structured to ensure its viable independence. It was designed to credibly develop third party business, which now made up 15 per cent of its total volume. The Bass Brewers representation on the Tradeteam board was designed to influence the level of service to customers. Its stake in Tradeteam benefited Exel as it could share market risk. Bass Brewers did not have access to information about Tradeteam's agreements with other parties.

5.243. If Interbrew were forced to divest Tradeteam, it would be deprived of the dividend stream and [ *Details omitted. See note on page iv.* ]. If Bass Brewers were not able to negotiate a satisfactory supply agreement with a divested Tradeteam, Tradeteam might lose Bass Brewers' volumes and that would weaken Tradeteam as a competitive force in distribution.

5.244. At a hearing, Interbrew restated its view that it saw no competition problem at the distribution level. [ *Details omitted. See note on page iv.* ] WBC's distribution. Its contracts with Tradeteam, although not ideal, were arm's length and non-preferential. However, it was ready to look at changes to the contractual arrangements if the CC, upon hearing evidence from third parties, came to different conclusions. While Interbrew believed that any adverse conclusions could be addressed through contractual changes alone, it accepted that a disposal of its stake in Tradeteam would be feasible but costly to Interbrew, as it would be unlikely to recover its initial investment and it would lose its share of the downstream profit pool. One way to reduce such a financial loss would be to sell the stake to other industry participants.

5.245. As to the hypothetical remedy of terminating the supply agreements with the retained estates of Bass and/or Whitbread, Interbrew submitted that it was contributing to the public interest by purchasing the brewing interests of Bass and Whitbread and thereby separating these from the retail estates. Interbrew gave us a detailed description of the supply agreements. [

*Details omitted. See note on page iv.*

] Interbrew said that such a transaction represented a major structural change and stability would be needed during the transitional period. Termination of the agreements would be a disproportionate penalty and could lead to brewery closures. This would expose Interbrew to a potential loss of [✄] per cent of its total sales by volume, ie up to [✄] million barrels. Even assuming that it were able to retain a 'natural market share' of [✄] per

cent of those volumes, that would mean an overall market share loss of [✂] per cent. Moreover, as Bass and Whitbread continued to sell their retail estates, existing relationships with Bass Brewers and WBC would weaken.

5.246. Interbrew said that the supply agreements with the Bass and Whitbread estates brought benefits by reducing volatility over the transitional [✂]-year period and allowing investment to continue. There would be no long-term effect on competition. Significant shortening of the agreements would almost certainly reduce the value of the Bass Brewers and WBC acquisitions. This proposed remedy would disadvantage Interbrew at a critical time against competitors [*Details omitted. See note on page iv.*] who either continued to benefit from tied estates or enjoyed significantly longer supply agreements than those resulting from the Interbrew/Bass transaction.

5.247. As to the hypothetical remedy not to price discriminate at the brewing level, ie to avoid differentials not justified by cost differences between sales to wholesalers and direct sales to retailers, Interbrew stated that cost differences accounted for the majority of any price differential, except in relation to sales to pubcos where the considerable purchasing power enjoyed by these customers forced brewers to provide ever greater discounts. Market forces were the main driver of price. Volume-related sales were also a source of discounts and pricing differentials. All these were normal business practices, especially in businesses with large fixed-cost operations, and they would be unaffected by the merger. Interbrew considered that the suggested remedy would result in perverse and unintended consequences.

5.248. Interbrew said that the main drivers of pricing differentials were cost differentials in serving customers and delivering volumes purchased. Many other indirect costs went into the real cost of serving customers, but the simple fact of customer power to negotiate prices could not be ignored. In most sales agreements there were non-price-related expenses incurred in serving customers such as on-premise marketing promotion, and technical tap servicing. In some cases these intangibles benefited Interbrew; for example, Interbrew might gain more visibility and marketing exposure by selling to a pubco than by selling to a single outlet.

5.249. Interbrew added that volume-related discounts were another significant factor in pricing policy. This was a widespread practice in the wholesaling of most consumer goods as it reflected the economies of a large fixed-cost base of a national distribution network. Typically discounts resulted in greater consumer demand. Pricing was also related to the degree of control exercised by a customer. Tenanted pubcos commanded better prices than individual outlets because they controlled access to large estates through listing of brands available to tenants in their estates. Similarly, managed retailers typically enjoyed better prices than tenanted groups because they had complete control over stocking policies within the outlet, whereas tenanted groups had only partial control. Wholesalers, on the other hand, had little control over distribution or penetration. These policies would not significantly change as a result of the merger.

5.250. Brewers were price takers and could not prevent the trend towards retail consolidation. The proposed remedy was not practicable and it was hard to see how it could be monitored. It might have the effects of bringing prices down to an unprofitable level or alternatively it could force Interbrew to push wholesale prices up to an uncompetitive level

5.251. As to the possible remedy not to price discriminate at the wholesaling level, ie to avoid differentials not justified by cost differences between sales of Interbrew beers and sales of competitors' beers, Interbrew said that it did not discriminate at the wholesaling level in this way. It traded by negotiating a buying price with the supplier, and it attempted to sell to customers at what might be called market prices for competitors' beers, although Interbrew said that there was no such thing as an overall 'market price' for brewers' own brands because the terms of customer contracts were many, complex and secret.

5.252. Because a wide range of brands were stocked and available, customers were very price aware and [ *Details omitted. See note on page iv.* ]. The proposed remedy would be difficult to impose and would be likely to result in a perverse and unintended effect. It was unclear how such a remedy would be policed and the remedy might lead to price rises for factored beers.

5.253. As to the possible remedy not to engage in full-line forcing at both the brewing and wholesaling level, Interbrew said that it did not force its full portfolio of products and could not do so given the

increasing buying power and sophistication of its customers. Any anti-competitive behaviour would be captured by the Competition Act 1998. Nevertheless Interbrew said it would be willing to reinforce its code of conduct accordingly. Preventing customers from buying as they wished or preventing them from enjoying volume-related discounts, would be an unnecessary interference with normal commercial forces.

5.254. At a hearing, Interbrew suggested other remedies which might be appropriate if the CC judged it necessary to protect brand diversity and maintain brewery employment in the public interest. Interbrew offered to undertake not to close any breweries before 2003, if any closures were necessary at all. It would also be prepared to commit itself to maintaining its wide and varied brand portfolio until 2003; and meanwhile would work to grow export and domestic volumes.

5.255. At the same hearing Interbrew reiterated its view that major structural remedies at the brewing level would be wholly disproportionate to any possible public interest harm that they would be intended to address and that such remedies would themselves be harmful from a public interest perspective. At the same time, and whilst not accepting the need for remedial action, Interbrew expressed a pragmatism about less draconian remedial measures which the CC might see fit to recommend. In this regard it explained that, whilst major brand carve-outs would not be practicable or proportionate, it might be possible to structure selective and lesser brand disposals. Whilst it did not believe its equity stake in Tradeteam gave rise to competition issues, it recognized that there was scope for the terms of the contract between Bass Brewers and Tradeteam to be renegotiated or for the equity stake to be held in such a way that it would provide an equal playing field for all. Interbrew explained that whilst it viewed the supply agreements with Whitbread and Bass as an important transitional measure, in particular during the initial post-merger restructuring period, it was willing to discuss any concerns that the CC might have in relation to the duration or extent of the minimum purchase obligations.