News Release

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CC BLOCKS SDEL/COORS MERGER

The Competition Commission (CC) has blocked the proposed acquisition by Serviced Dispense Equipment Limited (SDEL) of the technical services function of Coors Brewers Limited (Coors). SDEL is a joint venture company formed in 2004, merging the technical services businesses of Scottish Courage Ltd and Carlsberg UK Ltd.

There are around 149,000 outlets in the UK with technical services equipment for draught beer dispense (TSE) valued at about £350 million. The merger would have increased SDEL's share of TSE and related servicing (TS) to between 55 and 60 per cent leading SDEL to be several times larger than the next largest providers. The CC found that this would have led to less competition, which would be likely to lower standards and raise prices of TSE and related servicing. This confirms the conclusion of the provisional findings report published in January.

After considering alternatives, the CC has concluded that the only effective remedy to address the anti-competitive outcome is to prohibit the merger. It looked carefully at the remedies packages proposed by the parties, but did not think that they would be effective in addressing the SLCs identified in the TSE and related servicing markets.

Professor Paul Geroski, Chairman of the CC and the SDEL/Coors inquiry group, said:

> Our view is that by blocking this merger it is more likely that a fully functioning market for technical services equipment and related servicing will develop. This will be good news for both pub companies and their customers.
>
> Independent suppliers of these services are slowly starting to emerge but competition is currently limited, in particular, by the brewers' strategy of bundling the provision of the equipment and services in with the price of beer, and their ownership and control of this equipment. We have suggested that the Office of Fair Trading consider whether a market investigation into the pricing or supply of beer may be appropriate, with specific reference to these and related market features.

A summary of the CC's report is attached to this news release. The full report will be available on the CC's web site later today:
http://www.competition-commission.org.uk/rep_pub/reports/2005/index.htm.

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Notes for editors

1. There are currently around 149,000 outlets for the supply of draught beer in the UK, the vast majority of which require TSE and TS. TSE, which includes, for example, coolers and lines running from the cellar to the bar in outlets, and related TS, are typically provided by the brewer.

2. SDEL is a joint venture company formed in 2004, merging the technical services businesses of Scottish Courage Ltd and Carlsberg UK Ltd. The proposed addition of the technical services function of Coors to this joint venture was referred to the CC by the Office of Fair Trading (OFT) on 29 September 2004.

3. The Enterprise Act 2002 empowers the OFT to refer to the CC completed or proposed mergers for investigation and report which create or enhance a 25 per cent share of supply in the UK (or a substantial part thereof) or where the UK turnover associated with the enterprise being acquired is over £70 million (see OFT Press Release PN 06/04).

4. The SDEL/Coors inquiry group consists of five members: Professor Paul Geroski (Group Chairman), Diane Coyle, Laurie Elks, Graham Hadley and Professor Stephen Wilks.

5. Enquiries should be directed to Francis Royle on 020 7271 0242 (email francis.royle@competition-commission.gsi.gov.uk) or Rory Taylor on 020 7271 0398 (email rory.taylor@competition-commission.gsi.gov.uk).

The proposed acquisition by Serviced Dispense Equipment Limited of the Technical Services Function of Coors Brewers Limited

Summary

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

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

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

4. The Four Brewers' Initiative (FBI) was set up in 1995, in response to increased brand switching, to reduce waste, recover asset value and minimize customer disruption when generic TSE was installed in an outlet or was transferred between the signatories. The FBI principal supplier (usually the brewer with the most taps on the bar) owns the shared generic TSE, has the responsibility for servicing that TSE, and provides lines to other brewers with taps at that outlet. Must Buy Must Sell (MBMS) arrangements ensure that generic TSE is sold to the incoming principal supplier or new brand owner at a standard price.

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

6. SDEL and Coors (the parties) told us that the supply of TSE and TS was an important but non-core activity for brewers. Brewers' primary focus is competition in beer brands. They have therefore been looking to cut costs and take some assets off their balance sheets, in part through outsourcing non-core activities to specialist service providers. This has already taken place in the provision of kegs and, to a

more limited extent, in distribution. The proposed merger sees the addition of Coors's TSE and TS business to SDEL. The parties told us that it was expected to generate efficiencies and consequential cost savings for the SDEL brewers and Coors, which, we were told, would be to the ultimate benefit of the consumer.

7. We concluded that arrangements were in progress which, if carried into effect, would result in the creation of a relevant merger situation.

8. We included all outlets in our definition of the markets for TSE and TS. Beer was defined to include all draught ale, lager and cider, and to include both keg and cask beer. We concluded that the markets primarily affected by the proposed merger were two separate but interdependent markets for the supply of TSE and the supply of TS in Great Britain.

9. We found that before the proposed merger SDEL had much the largest share of both the TSE and TS markets (30 to 40 per cent). Coors, the next largest TSE and TS provider before the proposed merger, would increase SDEL's market share by around 15 percentage points for TS, and 25 to 30 percentage points for TSE, leaving SDEL several times larger than the next largest TS and TSE providers.

10. We noted that the markets for independent supply of both TSE and TS are very much in their infancy, particularly in the case of TSE. We believed that competition in both TSE and TS was currently limited by several features of the market—the bundling of prices of TSE and TS with beer; the interdependency of TSE and TS coupled with brewer ownership and control of TSE; switching costs and difficulties in valuing TSE; and customer inertia—although a market for TS in particular was slowly starting to emerge.

11. Price unbundling is critical to the likely success of any alternative arrangements that the retailers might wish to make for the separate provision of TSE or TS. Such arrangements would depend on the ability of the retailer to obtain a cost-reflective discount off the price of a barrel of beer from the brewers that was broadly sufficient to meet the cost of an alternative TSE or TS provider. We considered it likely that as pubcos look more carefully at their costs, they would continue to press for unbundled prices provided there were credible alternative providers of TSE and TS.

12. Repair or replace decisions that need to be taken daily inevitably create tensions when ownership and servicing of TSE are in different hands. Given the continuing ownership of TSE by SDEL or the national brewers, this in principle creates difficulties for an independent TS provider.

13. We noted that there were significant switching costs associated with replacing generic TSE. In addition, aspects of the way that TSE was valued by the national brewers might militate against an active and well-functioning market for TSE coming into existence. Finally, we noted the relatively high level of retailer inertia in the markets for TSE and TS.

14. We considered that there were both direct and indirect mechanisms through which retailers could choose their TSE and TS provider. The indirect mechanism occurs through the retailer influencing which brewer is principal supplier and hence supplies the shared generic TSE and provides associated TS in its outlet or outlets. This could occur either through a change in beer brands leading to a change in the supplier of shared generic TSE and associated TS or through the outlet opting to switch the brewer designated as principal supplier despite not having changed beer brands.

15. Since Coors and Interbrew UK Limited (Interbrew) both told us that they would only provide TSE and TS associated with the supply of beer, direct competition in the TS market today and in the near future was effectively limited to independent TS providers. Few, if any, third parties other than City Refrigeration Services (City) could claim to be truly independent of the national brewers, since the vast majority of third party contractors' business was performed under subcontracts to the national brewers. In the TSE market, we have seen less evidence of direct competition than in the TS market. Retailers could seek to buy their TSE assets from SDEL or the brewers, or install their own or leased TSE assets. Entry into the supply of generic TSE could also occur in conjunction with the provision of TS.

16. We found that the indirect mechanism for competition was relatively weak in both the TSE and TS markets. There was little direct competition in the TSE market, but more history of direct competition from third party providers in the TS market. However, as these two markets emerge and develop, and despite the existing features of the market, we would have expected levels of competition to increase in the future in the absence of the proposed merger, particularly in the TS market.

17. We thought that, in the absence of the proposed merger, SDEL/Innserve would continue to operate with SDEL as a JV between the two SDEL brewers. We also assumed that the national brewers would continue to participate in the FBI. We adopted the assumption that, in the absence of the proposed merger, Coors would retain all or part of its TSE and TS business in the short to medium term.

18. The major concerns that were put to us focused on the increased ability of the SDEL brewers/Coors and SDEL/Innserve to act independently and exploit their market power as a result of the large increase in SDEL's market share following the proposed merger. We looked at the possible effects of the proposed merger in each of the three markets—the supply of TS, TSE and beer. Given the size of SDEL's market share following the proposed merger, our analysis focused on unilateral effects.

19. In the absence of the proposed merger, the SDEL brewers would be using the SDEL/Innserve arrangements to provide TS to retailers, while Coors and Interbrew would be organizing their own TS. All would be provided through a mix of in-house staff and subcontractors. However, if the proposed merger were to proceed, Coors would also use SDEL/Innserve as its exclusive contractor to deliver TS. SDEL has contracted with Innserve for ten years to be the exclusive provider of TS to three out of the four national brewers.

20. We believed that competition for the provision of TS in the absence of the proposed merger was relatively limited, largely because of the features of the market specified in paragraph 10. We considered that the proposed merger would reduce the likelihood of an existing smaller-scale third party TS provider expanding to provide more direct competition for the provision of TS on a larger scale. SDEL/Innserve's increased market power as a result of the proposed merger would give Innserve a strong negotiating position with subcontractors. Innserve could demand substantially improved terms from the subcontractors, which would be highly dependent on Innserve for business. We considered that SDEL/Innserve would have the ability and incentive to organize its TS subcontracting strategically to ensure that no subcontractor developed a sufficiently strong presence to become a major competitor.

21. Given that credible third party TS providers with a significant capability would be less likely to develop and would struggle to compete on level terms with SDEL/Innserve, retailers' incentives and ability to find alternatives to their existing TS provider would

be much reduced compared with the counterfactual. We did not believe that it would be in the interests of the brewers to offer unbundled prices unless they were asked to do so by the retailers. We believed that, given the lack of credible alternatives for TS provision to retailers, the proposed merger would reduce the prospect of cost-reflective discounts being offered at a level which would allow viable competing bids for independent TS provision.

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

23. Overall we considered that there would be a reduction in competition as a result of the proposed merger. We considered possible adverse effects on service quality and on price. We believed that the incentives to standardize at a lower level of service—one which was 'adequate'—were high. We also believed that the size of SDEL/Innserve and the relative lack of competitive constraints could lead to rising prices, at least over the longer term.

24. We considered whether the increase in SDEL's market share as a result of the proposed merger would lead to a reduction in competition in the TSE market compared with the counterfactual. At present the majority of retailers could be supplied with generic TSE owned by SDEL (for the two SDEL brewers), by Coors, or by Interbrew. There is no well-developed independent provision of TSE. As a result of the proposed merger, the TSE required by Coors would also be provided to Coors by SDEL. SDEL would therefore provide TSE to three out of the four national brewers.

25. We believed that incentives for retailers to seek alternatives to their existing generic TSE owner (including taking ownership themselves) would be reduced as a result of the proposed merger. Although our conservative counterfactual assumes no substantial change in ownership of Coors's assets in the short to medium term, the proposed merger would constrain further the likelihood of entry, particularly with respect to retailers seeking to own the generic TSE in their outlets.

26. We therefore found that there would be a reduction in competition as a result of the proposed merger. In the case of the TSE market this was largely due to the increased market share of SDEL/Innserve which would lead to a reduction in the competitive threat and hence reduced constraints on SDEL's future behaviour. We believed that there were likely to be adverse effects on the quality and/or price of generic TSE.

27. We also considered the longer-term future of the FBI as a result of the proposed merger. On the evidence available, we were unable to form a view as to whether the FBI arrangements would cease to operate or would be substantially changed as a result of the proposed merger.

28. We concluded that the increment in market share resulting from the proposed merger was significant enough to constitute a substantial lessening of competition (SLC) in the TS market. We expected that the increased market share of SDEL/Innserve would lead to a reduction in the level of competition compared with the counterfactual. SDEL would provide TS via Innserve for three out of the four national brewers. Credible large-scale third party TS providers would be less likely to emerge

and compete on level terms with SDEL/Innserve. Retailers would therefore have less incentive and ability to find alternatives to their existing TS provider, in part because the proposed merger would reduce the prospect of discounts being offered which would allow viable competing bids for TS provision. It is likely that there would be adverse effects from the SLC on service quality and/or price of TS provision.

29. We further concluded that the increment in market share resulting from the proposed merger was significant enough to constitute an SLC in the generic TSE market. We expected that the increased market share of SDEL/Innserve would lead to a reduction in the level of competition compared with the counterfactual. SDEL would provide TSE to three out of the four national brewers. The retailers would have less incentive to seek alternatives to their existing TSE owner. It is likely that there would be adverse effects from the SLC on the quality and/or price of generic TSE.

30. The increased market share of SDEL/Innserve would also lead to a reduced platform for entry which would leave insufficient headroom for a potential new entrant. Given our counterfactual, this is particularly relevant to entry into the TS market in the short to medium term.

31. Finally, we concluded that the arguments we had received did not carry enough weight to lead us to form an expectation of an SLC in the beer market.

32. We considered two remedies options aimed at addressing the expected SLCs and any resulting adverse effects—a prohibition of the proposed merger, and a package of remedies. The parties responded initially to our notice of possible remedies on 19 January 2005, and put forward three sets of revisions subsequently. We consulted third parties on our notice of possible remedies, and on the parties' initial and final submissions.

33. We could not form an expectation that any of the parties' proposed remedies packages, including their final proposed remedies package, would be effective in addressing the SLCs. We had three key concerns that were not resolved by any of the parties' proposals:

    (a) SDEL would continue to enjoy market power due to its ownerhip of around two-thirds of the generic TSE, and could therefore extend that power into the TS market;

    (b) SDEL would remain responsible for a large proportion of TS subcontracting in the TS market because of its ownership of TSE. SDEL/Innserve would have the same amount of work to subcontract which Innserve would have had in the absence of the proposed merger, giving SDEL influence to shape the emerging TS market; and

    (c) the proposed package of remedies would be complex, would lack transparency, be difficult to set up, and hard to monitor. Particularly given the different incentives of the participants, the effectiveness of the proposed remedies package would be dependent to some extent on the goodwill of market participants, since the proposed protocols could not cover all eventualities. We were concerned that the parties would not have the incentive and ability to promote the effectiveness of these remedies in practice. The proposed remedies package would impose an ongoing regulatory burden which could be unattractive to potential entrants.

34. We concluded that prohibiting the proposed merger would be an effective remedy. No other remedies proposed could be expected to be effective.

35. We did not expect there to be relevant customer benefits as defined under the Act. We therefore did not consider whether to modify the remedy that we would otherwise put in place.

36. We concluded that the action that should be taken for the purpose of remedying, mitigating or preventing the SLC was the prohibition of the proposed merger. This would prevent the expected SLCs, and hence there was no need for us to consider recommending any action to be taken by others.

37. Having reached a conclusion on the expected effect of the proposed merger on competition and on the appropriate remedy, there remained one outstanding issue. We noted, in particular, that the prices for the supply of TSE and TS were almost always bundled with the price of a barrel of beer. We believed that bundled pricing might lead to potential distortions in the markets for the supply of beer, TS and TSE. We therefore suggested that the OFT considers whether a market investigation into the pricing or supply of beer, with specific reference to the features of the market set out in paragraph 10, might be appropriate.