Anticipated acquisition by Symington Family Estates of the Cockburn's Port brand

The OFT's decision on reference under section 22(1) given on 7 December 2010. Full text of decision published 17 December 2010.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **Symington Family Estates** (Symington) is a wine company and port wine house in Portugal, owning and operating several vineyards and wineries. Symington subsidiaries and individual Symington family members together own twenty three quintas (estates), as well as leasing another and operating one more as a joint venture, in the Alto Douro region of Portugal. Symington also owns several brands of port, including Dow's, Graham's and Warre's, and Douro DOC wines.

2. Symington is owned by [ ] [which] also hold a 90 per cent interest in **John E. Fells & Sons Ltd**. (Fells), a UK wine importer, which imports Symington ports into the UK, amongst other activities. UK turnover of Symington is estimated to have been [ ] in 2009.

3. **Cockburn's** is a port brand currently owned by **Beam Global Spirits & Wine, Inc.**, the fourth largest premium spirits company globally, with US$2.5 billion in revenue in 2009. Beam is itself a business unit of **Fortune Brands, a leading globa**l consumer brands company with annual revenue exceeding US$8 billion. The Target Business' UK turnover for 2009 was £ [ ] million.

TRANSACTION

4. On 6 October 2010, Symington signed an agreement to acquire the Cockburn's brand and associated goodwill for [ ] million. The transaction does not involve the transfer of any production as Beam currently purchases all of its requirements for port from Symington under a long-term supply agreement. This supply agreement will be internalised through the transaction and will therefore cease. The acquisition is conditional on clearance from the OFT.

JURISDICTION

5. As a result of this transaction Symington and the Cockburn's business will cease to be distinct. As a result of the merger the parties will have a share of supply of port in the UK in excess of 25 per cent. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

RATIONALE

6. [ ].

MARKET DEFINITION

7. The parties overlap in the supply of port. Symington supplies port to the UK from Portugal under the Dow's, Graham's and Warre's brands and also produces own label port (or BOB – Buyer's Own Brand) for various multiple retailers. Beam supplies the Cockburn's brand (although Symington produce the port for Beam through the Supply Agreement). Beam do not produce or supply own label port.

Product market

8. The parties submitted that port forms a distinct market and can be differentiated from wines. The parties further submitted that no distinction should be drawn between (i) different types of port, (ii) the retail channel

through which port is sold, that is whether it is sold in the on or off-trade or (iii) by whether port is branded or own label. The OFT has considered each of these possible distinctions in turn.

Port as a distinct market

9. Port is a fortified wine originating from the Douro Valley in the northern province of Portugal. It is typically sweeter and heavier than most wines and has an alcohol content of 19.5 to 20 per cent. The European Commission in past cases has considered port distinct from other fortified wines, such as sherry, and from other wines more generally.[1] In this case, the parties also submit that port is distinct from other fortified wines, in particular sherry,[2] on the basis that sherry is commonly drunk as an aperitif whereas most port sold in the UK is consumed after dinner and demand for port is very seasonal with a high proportion of sales around Christmas time which is not the case with sherry. The OFT received no evidence to suggest departing from this position and therefore considers port distinct from other fortified wines

10. EU Protected Destination of Origin (PDO) guidelines restrict the use of the label 'Port' or 'Porto' to produce from Portugal. Every bottle of port receives a certificate of quality assurance in the form of an individually numbered IVDP[3] government seal. The European Commission has in past cases noted possible distinctions between different wine products based on origin or appellation.[4] In this case, the parties submit that, although fortified wines in the style of port produced in other countries may exert some degree of competitive constraint, retailers have a preference for port over other port-style wines and any such constraint is limited. Third parties unanimously agreed that port and port-style wines were not close substitutes. The OFT therefore considers that port is distinct from port-style wines for the purposes of its competitive assessment, although it has not needed to conclude on the precise product scope.

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[1] See Case Comp M. Case Comp/ M.5114 – Pernod Ricard/V&S, 17 July 2008, paras. 34, 40, 98-101. The precise product scope was left open.
[2] Sherry, similar to Port is subject to EU Protected Origin of Destination Guidelines and must be produced in a very specific area of Cádiz province in Spain, around the town of Jerez.
[3] The Port and Douro Wines Institute, part of Portugal's Ministry of Agriculture.
[4] See Case Comp/M.2941 CNP / Taittinger, para. 13, 16, October 2002; Case IV/M.400 Allied Lyons / HWE-Pedro Domecq, paras. 13-17, 28 April 1994; and Pernod Ricard / V&S, para. 34 and 36.

(i) Different types of port

11. There are different types and styles of port. There are distinctions between ports aged in a barrel and those aged in a bottle. Of barrel-aged port, there are distinctions in production and ageing methods between ruby, tawny, reserve, rosé, white and modern late bottled vintage port. Of bottle-aged port, there are distinctions between traditional late bottled vintage, crusted and vintage port. There are also distinctions for both barrel- and bottle-aged port between sweet and dry wines.

12. The parties submitted that most sales of port in the UK are of ruby-style wines (including ruby, reserve and modern late bottled vintage), which are sweet dessert wines. The majority of UK port sales are either ruby port (42 per cent of total UK sales) or reserve port (33 per cent). A further 14 per cent of UK sales are traditional late bottled vintage (LBV). Sales of other types, such as tawny, white, rosé, crusted, and vintage ports in the UK are small. Further, the merging parties do not have particularly strong positions in any of these small port categories with the exception of vintage port, which accounts for 2.2 per cent of total UK port sales.[5] The OFT therefore has not considered these categories further.

Demand-side substitution

13. The OFT's market investigation indicated that the majority of customers, believed they could readily switch and that significant switching would occur in the event of a price rise regardless of which type or style of port it related to.[6] Several retailers stated that for those types of port that make up the majority of the market (that is, ruby, reserve and LBV) switching readily occurs but that, as might be expected, there was far more limited switching from port at a lower pricing point to that at a far higher one (and vice versa), for example, between vintage and tawny. In this regard, one customer gave a specific example of its sales of reserve port increasing in response to increasing LBV prices. One retailer did not consider any different styles or types to be substitutable of any style or type of port.

[5] With regard to vintage, the parties submit there are numerous suppliers with 44 port houses on average declaring vintages in the last ten years and the ability to access significant quantities of high quality vintage port from other sources. The OFT has therefore not considered this category further

[6] Some limitations to switching were highlighted but primarily in relation to those types we have dismissed in the previous paragraphs (tawny, vintage, etc.).

Supply-side substitution

14. As the evidence on demand-side substitution was mixed, the OFT has also considered supply-side substitution. The OFT considers that markets are defined primarily on the basis of demand-side substitution. However, the OFT may aggregate several narrow relevant markets into one broader one on the basis of supply-side substitution when:

    (a) production assets can be used by firms to supply a range of different products that are not demand-side substitutes, and the firms have the ability and incentive quickly (generally within a year) to shift supply between these different products depending on demand for each, and

    (b) the same firms compete to supply these different products and the conditions of competition between the firms are the same for each product.[7]

15. With regard to (a), the parties submitted that a port house active in producing one type or style can readily switch to producing another, and that most port houses produce a wide range of types and styles. In the event that a port producer requires 'younger' port (for example ruby port, which is commonly less than two years old), it has the option of purchasing either grapes or port at each harvest from cooperatives and large farmers, or of purchasing stocks of port from other port companies (all of which have significant spare capacity, according to the parties). Around 30 per cent of all port is produced by cooperatives in the Douro region with the aim of selling this immediately to port companies. Where the supplier requires 'older' port, this can generally be purchased from other port houses or from the Casa do Douro, the Douro farmers' union. The Casa do Douro currently holds over 13.4 million litres (equivalent to 1.4 million nine litre cases) of a range of port types for sale to port companies.[8]

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[7] OFT and Competition Commission Joint Assessment Guidelines, September 2010, paragraph 5.2.17.

[8] The parties add that there is a legal requirement in Portugal that port shippers have a stock-to-sales ratio of three-to-one. Thus for every case of port which the port shipper tried to sell but could not, the port shipper is left with four unsold cases (the original unsold case plus the three stock cases, which become free for sales). The parties submit that, while this may restrict a port producer's ability to switch supply capacity between different styles or types, a producer can increase its stocks by making harvest purchases, which in turns increases it shipping rights, enabling it to sell any port, including older port.

16. Consistent with this, the majority of third parties indicated that ample supply can be obtained from the Casa do Douro which has significant stocks of port that they readily sell. One port house suggested that there may be limits on the quality of ports available from the Casa do Douro, but the parties provided significant evidence to show this was not the case, including details of purchases by the major port houses from the Casa do Douro within the last three years; a quality audit undertaken on the stock, showing the vast majority of the stock to be of in a good and saleable condition;[9] and Symington's own experience in sourcing from the Casa do Douro.

17. Competitors also indicated that, for younger ports, they can easily source different types elsewhere sufficient to switch sales capacity, including purchasing at harvest time to expand production, and would do so in the event of a price increase of five to 10 per cent in one type.

18. Set against this, the OFT's market investigation revealed some evidence that purchases from other port houses can sometimes be difficult and may be insufficient to allow switching in the short-term.[10] Without the ability to buy from other parties switching capacity would otherwise require a long-term shift in the focus of production.

19. With regard to (b), all the major port houses produce a wide range of types and styles and competition between producers is the same for each type as has already been discussed above in the section relating to 'Different Types of Port'.

20. On this basis, the OFT's assessment is that supply-side substitution in relation to all the styles and types of ports is possible and likely to be

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[9] The quality audit was undertaken on behalf of one the banks which provide credit to the Casa do Douro secured on the stocks themselves. Indications of quality were provided to the parties by the IVDP.

[10] The reasons for the limitations to switching relates to the shipping capacity of port houses. Shipping capacity provides an upper limit on the amount that can be sold. When a port producer sells to another port producer, the seller will use up some of its shipping capacity, which is based on the opening seasonal stocks of a company. Sourcing from other port producers would mean the selling producer would also be selling shipping rights.
More generally, sales capacity in a particular type of port can be increased within a year by increasing purchases in the annual harvest. The purchases give additional sales capacity the following year and, in particular, provide the purchaser with additional shipping rights capacity, which can be used for any port type.

profitable in response to a small price increase. Indeed, supply-side substitution already takes place.

Conclusion on Different Types of Port

21. Evidence on demand-side substitution is mixed. However, evidence on the supply-side points to a single relevant market: capacity can be used by port suppliers to rapidly shift supply between port products of different types, dependent on demand, and where this is not the case, purchases can easily be made of other types, without incurring significant investment or significant risk. Furthermore, the same firms compete to supply these types and competition between producers is the same for each type. The OFT therefore considers all types of port together for the purposes of the assessment.

(ii) On and off-trade retail channels

22. The OFT has considered whether the market can be subdivided between on-trade[11] and off-trade[12] distribution channels.

23. The European Commission has in the past distinguished between each channel on the basis of separate sales forces and customer requirements,[13] although they have in the majority of other relevant cases rejected such a distinction.[14] The OFT has also made a distinction between distribution channels in the past.[15] In Interbrew/Bass, the CC found that at the retailing level, the on-trade and the off-trade can be considered to be different markets.[16] In its AB/InBev decision,[17] the OFT did not conclude on whether

[11] This refers to pubs, bars and restaurants where consumers drink on the premises.
[12] This refers to supermarkets, off-licences and other outlets where consumers purchase alcohol for consumption off the premises, typically at home.
[13] See *Pernod Ricard/V&S* paras. 15 and 16. Although we note the main factor suggesting such a distinction in the *Pernod Ricard/V&S* case was the predominance of state monopolies in retail sales of strong alcohols in Scandinavia. Such a distinction has not been the position of the Commission in the majority of other cases involving alcohol sales.
[14] See Case IV/M.938 *Guiness/Grand Met*, para. 21, 15 October 1997; Comp/M.2268 *Pernod Ricard / Diageo / Seagram*, para. 15, 8 May 2001; and Comp/M.3779 *Pernod Ricard / Allied Domecq*, para. 13, 24 June 2005.
[15] See, for example, *Completed acquisition by C&C Group of the business and associated trading assets of Constellation Europe*, 8 April 2010, although this did not relate to wine.
[16] Paragraph 4.25.
[17] Anticipated acquisition by InBev NV/SA of Anheuser-Busch Companies Inc, decision of 18 November 2008, although, again, this did not relate to wine and spirits.

the on and off-trade constituted separate markets, however, it did examine the merger separately in each of these retail channels.

24. On the demand-side, any distinction between the two channels is blurred by interactions between them.[18] For example, wholesale customers of the parties supply to both on off- and on-trade customers: Matthew Clarke and Waverley Vintners have in the past supplied both the on- and off-trade, for instance.

25. Notwithstanding this, around 90 per cent of port sales are in the off-trade, the vast majority of which are through the largest supermarkets (around 78 per cent of total UK port sales[19]) with the remainder through the on-trade. Save for wholesalers, port producers therefore face little direct demand-side substitution between the on- and off-trade. Some third parties told the OFT that some end consumers may switch from the on- to the off-trade. This may therefore impose some small, indirect constraint on port producers from the off-trade to the on-trade.

26. On the supply-side, some (though not all) port producers indicate they have separate sales forces and sales to each group are different due to the different scale, distribution requirements and pricing mechanisms (such as promotional funding in the off-trade).

27. In light of the above, the OFT has assessed the impact of the transaction considering the on and off-trade channels separately, although considering them together has no material impact on the competitive assessment, given the relative sizes of the off- and on-trades.

(iii) Branded and own label port

28. Port is sold as both a branded product (displaying the producer's brand clearly on the bottle, for example Cockburn's, Graham's, Croft) and as an own label product (also known as 'buyer's own brand', or BOB). Symington produce and supply port under their own brands and for BOBs. Cockburn's supply their own branded port (which is produced by Symington through

[18] Note that in assessing the demand-side substitution, both here and throughout this decision, the OFT considers it appropriate to focus more on substitution at the upstream level (sales to the retailer or wholesaler) where the parties are active, rather than the downstream retail level (sales to the end-customer) unless evidence suggests these two can be considered simultaneously.
[19] For these purposes the largest seven supermarkets are Asda, Co-op/Somerfield, Marks and Spencer, Morrison's, Sainsbury's, Tesco, and Waitrose.

the supply agreement) but are not active in supplying any BOBs. Some ports are also known as 'high/low' brands, a hybrid between port producers' brands and BOBs.

29. The parties submit that BOBs and branded products (both producer and high/low) form a single frame of reference, based on the strong and increasing presence of BOBs in total port sales, the long-term and ongoing trend of weakening brands (as a consequence of high/low brands), and because the underlying port in each case is almost identical. Evidence was provided showing secular trends in demand away from sales of branded products and towards sales of BOBs at both the retail and wholesale levels. As a result, BOBs now account for a high proportion, around two-fifths, of total UK port supply.

30. In previous decisions, the OFT has generally been cautious about the constraint that own label products are able to place on branded products,[20] although it has accepted the existence of such a constraint in some cases.[21] In this case, the OFT has been provided with a significant amount of evidence on the degree of competitive constraint and the competitive interaction between BOBs and branded (producer and high/low) port.

Overall shift from branded to own label

31. The parties submitted evidence showing a significant shift from branded to own label since 2004. However, the OFT notes that this offset an equal shift from own label to branded prior to this, from 1999 to 2004. The parties submitted that the decline in the own label share from 1999 to 2004 occurred because of very heavy discounting by Symington and its main competitor, the Fladgate Partnership, of their branded port, narrowing the price differential between branded and BOBs. The parties submitted that this narrowing of the price differential and decline in the share of BOBs is evidence of the competitive constraint between branded and BOBs. In this respect, the OFT notes that—helpful though such long-term trends may be in 'scene setting'—only evidence on customers shifting in the short-term in response to price changes is probative of market definition.

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[21] Completed acquisition by Dr Oetker (UK) Limited of the business and assets of Schwan's Consumer Brands (UK) Limited, OFT decision of 5th May 2009.

Consumer loyalty to branded port

32. For some retailers own brand represents a larger proportion of the port category than for others. For example, Marks & Spencer, Lidl and Aldi only stock BOBs and do not stock any branded port. In other retailers, BOBs account for up to a half of their total port sales by volume. Stocking of BOBs is widespread among a range of customer sizes, including major supermarkets, smaller retail fascias and independent wine merchants, and on-trade wholesalers. The majority of customers who responded to the OFT indicated that customers were continuing to switch to BOBs from branded port and that they expected this trend to continue.

33. Third parties also provided evidence showing that BOBs can also achieve significant brand presence. For example, one large retailer, which provides a wide range of types of BOB, considered consumer loyalty to its BOBs to be as high as to producer brands. Similarly, a supermarket provided brand loyalty figures (the proportion of consumers' total expenditure within a category spent on a single product) which showed that its BOBs achieve comparable (and in some cases higher) loyalty than do producer brands.

34. The stocking of brands therefore appears to be less important than it has been in the past. Indeed, the majority of supermarket chains now offer BOBs across the range of port sub-segments identified by the parties, enabling them to sell a similar offering to that of branded port producers.

Pricing

35. The evidence available to the OFT shows that BOBs are, on average, cheaper than branded port and that the price premium for branded port has risen over the past five years. However, taking into account all available brands and individual products, there appears to be a continuous chain of prices across branded and BOBs with no significant pricing gaps. There are a number of cheaper branded ports that third parties consider to compete closely with BOBs.

36. Further, the price differential between BOBs and producer brands narrows during the high sales volume Christmas period (when around 45 per cent of UK sales of port are made) when the price of many high/low brands is reduced. Pricing data indicates that any significant price gap almost disappears at Christmas and retailers said that consumers switch away

from BOBs to producer brands during this period. The retailers have facilitated the emergence of high/low brands in the Christmas period to leverage the producer brand's value and eliminate the price differential with BOBs. Prices of BOBs, during this period, for the most part, are higher than high/low branded products.

Competitive response of BOBs to brands and vice versa

37. The parties provided significant evidence of customer switching between BOBs and branded port, including where the de-listing or promotional activity of one had affected sales of the other. A number of examples were given where the customer had directly substituted one for the other with little or no affect on total port sales, or had altered promotional activity on one in response to another.

38. Consistent with the parties' arguments, the OFT's market investigation also supported the existence a competitive constraint between BOBs and producer brands. Most of the larger retailers stated that there is switching between BOBs and branded port by both end consumer and, consequently, retailers. For the end consumer this occurs when producer brands are on promotion and the price differential narrows. Supermarkets, on the whole, commented that they did not feel brand was a strong factor in dictating consumer choice.

39. Sales figures for one multiple retailer were provided to the OFT, for example, showing that its port sales had increased by around 10 per cent in the last five years. Sales of its branded port had reduced by around a third over this period while sales of its BOBs had grown a similar amount over the same period, which the retailer said occurred because of significant switching between BOBs and producer brands.

40. From the above, the OFT believes that BOBs provide a constraint on producer-branded port (i) as their price and quality are comparable, (ii) because promotions of branded ports increase their sales at the expense of BOBs and (iii) on the basis of customer and other third party views. On this basis, for the purposes of the competitive assessment we consider traditional producer brands and BOBs to form part of the same market.

Move towards high/low brands

41. High/low brands are brands that are sold by the retailer or wholesaler for a period at high prices, in order to be subsequently sold at lower prices, principally in the run up to the high volume Christmas period.[22] Generally, new brands (which are often exclusive to each retailer) are created for these high/low contracts but high/low brands continue to use, and benefit from, the producer's name. For example, 'Cockburn's Acclaimed' is sold exclusively in Morrison's, and Fladgate created 'Croft Indulgence' to be sold exclusively in Tesco and 'Croft Platinum' in Sainsbury's. Each high/low brand may be sold alongside traditional brands of Cockburn's and Croft.

42. All but one of the major supermarkets has a high/low brand and some have up to three. These brands are generally supplied under an annual tendering process. If a supplier loses an annual contract, then sales of that specific high/low brand are likely to be zero and the brand is likely to be withdrawn from the market. As with BOBs, the parties have submitted evidence showing significant secular shifts in away from sales of traditional producer-branded products towards sales of high/low brands, which now make up around 40 per cent of total port sales.

43. Symington supplies more [ ]. Cockburn's share of supply is more reliant on [ ]. Post-merger the parties would have [ ] proportions of sales of high/low brands and producer brands [ ].

44. The parties suggested that the traditional brand name drives sales of high/low brands and, for this reason, producer brands constrain high/low brands. The OFT's market investigation supports this proposition, with broad recognition that from the consumer's perspective, the two types of brand are indistinguishable and would likely be perceived simply as additional products within one brand.

45. Price differences between high/low brands and BOBs and depend on the time of year, with the Christmas period resulting in high/low prices cheaper than BOB prices. High/low brands therefore make any difference between BOBs and producer brands even less distinct.

[22] Over 45 per cent of UK port sales are made in the final eight weeks of the year.

46. The OFT also considers the supply-side arguments outlined above in relation to BOBs also apply to high/low brands. On this basis, for the purposes of the competitive assessment we consider traditional producer brands and high/low brands to form part of the same market.

Conclusion

47. On the basis of the above, for the purposes of its competitive assessment of the merger, the OFT considers traditional producer brands, high/low brands and BOBs to form part of the same product market.

Geographic market

48. The parties submitted that there is a UK market for the sale of port given different customer preferences and regulatory and duty systems. The OFT received no evidence that the geographic market was sub-national. The European Commission has in past cases found the geographic scope for the production and distribution of wines and spirits to be national,[23] based mainly on national preferences and patterns of consumption. The OFT notes that port sales to the UK are also predominantly of British brands. There appears no reason to depart from this analysis here and as a result the appropriate geographic market is considered to be the UK.

COMPETITIVE ASSESSMENT

HORIZONTAL ISSUES

Shares of supply

49. The parties overlap in the supply of branded port in the UK, in which the OFT cautiously estimates their combined share of supply to be around 39 per cent based on volume and around 52 per cent based on value with an

[23] See, for example, *Guiness/Grand Met*; *Pernod Ricard/Diageo/Seagram*; *Pernod Ricard/Allied Domecq; Pernod Ricard/V&S* in relation to the Commission. The OFT has in the past considered the effects of an alcoholic drink transaction on GB and Northern Ireland separately. However, these cases have involved primarily beer and cider, rather than wines and spirits. We do not consider such a distinction appropriate in this case.

increment from Cockburn's of around 19 per cent in either case (see table below).[24]

UK share of supply data, 2009 (off-trade only)[25]

[ ]

50. The parties submitted that shares of BOBs and high/low brands should be allocated to the retailer, rather than the producer.[26] The parties state the retailer controls the brand and can readily switch supplier given the significant spare capacity in port production. According to the parties, the key issue in determining allocation of sales for the purposes of calculating shares of supply is not whether the product features the producer's name but which company controls the sales in seeking to exercise market power. The test to be used, according to the parties, is whether retailers would be able to seek alternative suppliers for post-merger.[27] On this basis, the parties submit that BOBs and high/low brands are generally created specifically and exclusively for the retailer—the retailer can readily switch and if the retailer de-lists the BOB or high/low brand, then the product disappears.

51. The OFT agrees with the parties that BOB is correctly attributable to its customer: contracts for the supply of BOB rarely exist; all promotional activity relating to BOB is undertaken by the retailer; it is the retailer that generates business and sets the terms of trade; and if the retailers were to reduce BOB output, the port houses would not be able to sell the same volume elsewhere.

52. However, on a cautious basis, the share estimates given above include high/low brands as part of the sales of their producer rather than the retailer they are produced on behalf of.

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[24] As a result of contracts lost subsequent to this data, the parties submit that Cockburn's share of supply has fallen to 14.4 per cent and the parties' combined share to 47.3 per cent.
[25] Table based on total (ex-cellar) port shipments to the UK of around eight million litres with a value of €41.6 million. Figures provided by the parties based on Nielson data. The on-trade represents an additional 0.9 million litres. While data is not available for this sector, the OFT's market investigation indicated there was no reason to suggest that the parties' and Fladgate's shares of supply in the on-trade were dissimilar to those in the off-trade. In the on-trade, although there are no BOBs, there are far more other producer brands.
[26] Doing so would reduce the parties' combined share of supply to 34 per cent, with an increment of 19 per cent, according to the parties.
[27] This assertion is based on Case Iv/M.623 Kimberley-Clark/Scott, which states 'The essential be attributable to the retailers.

53. The OFT notes that the supply arrangements for high/low brands are different to BOBs: in particular, there is a greater tendency towards longer-term (one- to two-year) supply arrangements (although some third parties indicated no contract was signed). Similarly, the responsibility for promotional activity for high/low brands lies with the supplier and not the retailer: in particular, the parties submitted data which showed that the port producer provided a larger amount (and proportion) of promotional support to high/low products than to traditional producer-branded products.

54. Further, and notwithstanding the fact that brand loyalty in port is not high according to some third parties, high/low brands benefit from any promotional activity of the port producer's underlying brand and port producers appear to consider the high/low brand to be an extension of the underlying brand.

55. Lastly, it is the producer that bears both the brand risk[28] and benefits from any enhanced brand value, neither of which is the case with BOBs.

56. On this basis, the OFT considers it more appropriate to allocate high/low brands to the producer than to the retailer. In doing so, however, the OFT recognises that this is likely to overstate the competitive impact of the merger.

Unilateral effects

57. The parties argue that the transaction does not lead to a substantial lessening of competition since:

- the parties will continue to be constrained by BOBs and by the Fladgate Group
- the parties brands do not compete closely
- switching is commonplace
- there is excess capacity in the market, and
- the parties are constrained by significant buyer power on the part of the multiple retailers.

58. Each is considered below.

[28] [ ]

(i) Competitors

59. The parties submitted that they will continue to face competition, particularly from the Fladgate Group which has around a 20 per share of the UK port market and holds three well known brands (Taylor's, Croft and Fonseca), as well as from other smaller suppliers. The parties also said that they face increasing competition from BOBs which have been significantly increasing their share of the port market in recent years and which currently hold over one third of the market by volume.

60. In addition to Symington and the Fladgate Group the parties submitted that there are three major port houses – La Martiniquaise/Gran Cruz Port, Sograpе and Sogevinus (as well as some others) – that are currently active in the UK but have a disproportionately small share of UK supply, given their global size. Barriers to their expansion are low according to the parties, given the scale of the major port houses, the strength of their brands and their presence in other wines and spirits production. In addition to the five major global port houses the parties also highlighted numerous other port producers with significant reputations and some presence in the UK.

61. The OFT's market investigation also suggested that customers looked to a wider range of alternative suppliers than merely the parties and Fladgate. There was less evidence on the specific constraint provided by the smaller port houses, although the OFT notes that some of these have been able to compete for and supply UK customers.

(ii) Closeness of competition between parties' brands

62. The parties submitted that port brands compete across a range of characteristics, types, quality and price. In assessing mergers where products are differentiated in this way, the OFT consider that the greater the degree of substitutability between the merging firms' products, generally, the more likely are unilateral effects to result from the merger.[29]

63. In this regard, the OFT notes that the substitution patterns of interest in assessing the closeness of competition between Symington's brands and

[29] See Merger Assessment Guidelines, paragraph 5.4.6.

Cockburn's are those of customers, not necessarily those of consumers (although, of course, the two will be related). Here, customers unanimously said that the parties' brands were not close competitors. Tesco, for example, indicated that Cockburn's is a 'medium entry level port' while Symington's brand are of higher quality. Waitrose stated that it only stocked Symington's brand (as opposed to Cockburn's) as the brands are 'better aligned to its customer base'.

64. Further evidence provided by the parties supported the brands as not being close competitors [ ]. The price positioning of the brands also does not suggest that Symington's and Cockburn's are close competitors.

65. Set against this, some examples were given where specific products were substitutes. For example, [ ] told the OFT that Symington's Graham's Reserve would be a substitute for Cockburn's Special Reserve and [ ]'s said that Cockburn's 10yr old Tawny would be a substitute for a Symington 10yr old Tawny. However, in each case the retailer specifically stated that the brands, although substitutable, were not close competitors.

66. The parties also provided a detailed analysis of instances where retailers had either de-listed one of the parties' products or had substantially reduced their orders for it. Of the many instances provided, in only one was it possible to identify direct substitution between Cockburn's and Symington.

(iii) Switching

67. The parties submitted that it is very easy for retailers to switch suppliers given the large volume of spare capacity, the emergence of high/low brands and because there are no 'must stock' brands. The parties submitted evidence to show that switching did occur in the market. On the whole, this was substantiated by third parties who confirmed both that switching occurred and that no brands were considered to be essential for a customer to stock. Although some customers viewed certain brands as being essential to stock, other evidence suggested that some of these were not stocked at all or received limited store penetration, or that customers varied the individual products stocked within each brand.

68. The parties argued that their multiple retail customers could de-list their products with minimal effect on their turnover and profits, given the wide

range of other port products on offer. The parties also argued that the de-listing of product lines is common and provided the OFT with evidence of recent de-listings. Evidence from the multiple retailers confirmed the parties' assertions and indicated that several had indeed switched suppliers in the last two years.

(iv) Spare capacity

69. Evidence was provided by the parties showing a considerable recent decline in global port sales. This, according to the parties, resulted in significant overcapacity of at least 2.87 million nine-litre cases; almost three times total UK consumption. There has been significant over-capacity in each of the last five years. The 2.87 million cases do not include the stock held by the Casa do Douro which holds an additional 1.4 million nine litre cases.

70. Some third party competitors told the OFT that they may have more limited immediate capacity than the parties estimated. On the whole, however, the evidence available to the OFT pointed to significant spare capacity in the industry and indicated that to increase capacity port producers can easily source from other farmers and the Casa do Douro, and make additional harvest time purchases.

(v) Buyer power

71. Most customers were unconcerned about the merger, although a small minority were concerned about the more limited choice they would have post-merger. Most customers believed that there was sufficient choice in the market, especially considering that branding is now less important than in the past and considering that BOBs have increased significantly and provide a strong alternative to branded port. As a consequence, margins on port had been falling significantly and customers considered that they held sufficient buyer power to enable them to be supplied competitively.

72. Consistent with this, the parties argued that the concentration of customers meant that the balance of negotiating power lay with customers for several reasons:

- the concentration of customers meant that a few customer held great negotiating strength
- customers' negotiating strength is enhanced by their ability to switch to BOBs and high/low brands, and
- customers had the ability to easily switch or de-list a product and that there was significant evidence of this (as considered above).

Concentration of customers and negotiation strength

73. Sales of port are highly concentrated through a small number of large sellers. Customers can be split into three broad groups: the large seven supermarkets, which account for nearly 80 per cent of total UK port sales, the off-trade excluding the large supermarkets, including discounters, smaller retail fascias, petrol forecourts, and independent wine merchants, which together account for around 12 per cent of UK port sales; and the on-trade segment, supplied predominantly by large wholesalers, which together account for around 10 per cent of UK port sales.

74. The OFT considers relative bargaining strength to be determined by the mutual dependency of the negotiating parties. We consider it likely that the larger supermarkets are of far greater importance to the parties, in terms of accessing final customers and as a proportion of total Symington sales, than Symington's brands are to the major supermarkets. For example, [ ].

75. Competitors all overwhelmingly supported the parties' assertions, indicating that the balance of negotiating power lies predominantly with the supermarkets.

BOBs and high/low brands

76. The parties submitted that customers' negotiating strength is enhanced by their ability to switch to BOBs and high/low brands. The OFT accepts that the emergence and growth of BOB and high/low brands has facilitated customers switching and reflects the ability of large customers to reduce the strength of consumer brands, shifting a greater degree of negotiating strength to retailers. Similarly, significant evidence was provided showing retailers switching between BOBs and producer brands, as outlined above. That evidence also points to the retailers having developed high/low brands to leverage the producer brand's value to their advantage.

77. There is therefore evidence to suggest that large and small customers have some buyer power.

Conclusion on unilateral effects

78. The combined market share of the merged firm is not low enough to rule out prima facie competition concerns. However, the evidence suggests that there is significant constraint from BOBs and the Fladgate Group. Further, the parties' brands do not compete closely. Customer switching is also easy and there is significant spare capacity for customers to switch to. Lastly, customers have countervailing buyer power.

79. On the basis of the above, therefore, the OFT does not believe that the merger gives rise to a realistic prospect of a substantial lessening of competition on the basis of unilateral effects.

Coordinated effects

80. In the current case, the OFT does not consider that the proposed merger creates or strengthen the likelihood of coordinated effects.[30] The cumulative criteria that the OFT uses to assess whether a merger gives rise to a realistic prospect of coordinated effects are (i) that suppliers can reach and monitor the terms of coordination, (ii) that coordination is internally sustainable (for example because suppliers are able to monitor each other's behaviour and punish deviations from the terms of coordination if necessary) and (iii) that coordination is externally sustainable.[31]

81. The OFT received no evidence to suggest that coordination already takes place (on prices, geographic territories or product categories) and several features of the market indicate that the merger is unlikely to change this: (a) there is significant and growing spare capacity in the industry as demand for port declines, (b) competitors have the ability to expand, (c) there is lack of transparency regarding the terms of customer contracts, (d) customers are able to multi-source, (e) there is lack of symmetry (in terms of market shares and cost structures), (f) the majority of supply is through

[30] That suppliers can establish the terms of coordination; that suppliers are able to monitor each other's behaviour and punish deviations from the terms of coordination if necessary; and that there are no external factors present which could disrupt coordination
[31] Merger Assessment Guidelines, paragraph 5.5.9.

large orders, which creates a significant incentive to cheat on any collusive agreement and (g) switching by customers is not quickly or routinely picked up on, hampering both detection and punishment.

82. The OFT does not therefore consider that this merger gives rise to a realistic prospect of a substantial lessening of competition on the basis of coordinated effects.

VERTICAL ISSUES

83. No vertical concerns were raised by third parties and, although the merger creates vertical integration by Symington's by internalising its current supply agreement for Cockburn's, the OFT does not consider that the merger gives rise to a realistic prospect of anticompetitive vertical effects, as explained below.

(i) No foreclosure in distribution and importing

84. Each port supplier uses a different importer to the UK. Symington uses Fells. Currently, Fells imports only Symington ports into the UK and post-merger would also distribute Cockburn's, which is currently imported by Maxxium, Beam's joint-venture distributor. The parties submit that there would be no risk of other port houses being foreclosed from Fells as no other port house would expect or want to be distributed by Fells as long as Fells distributes Symington's ports. There is no prospect of Symington switching distributor as it owns 90 per cent of Fells. There are numerous other wine importers and the parties provided a list of seventeen different port houses and their distributors. All port houses appear to use different distributors and in some cases, they use more than one.

(ii) No customer foreclosure

85. The parties submitted internal documents that showed that one of the rationales for the merger was to rationalise commercial focus and promotional activity [ ].

86. Consistent with this, one small competitor told the OFT that it believed that Symington would be able to block entry of any other brands in sales to small independent retailers post-merger. Another argued that the merged

firm's portfolio of brands may encourage greater use of exclusive supply agreements in sales to the on-trade.

87. However, most customers did not support this theory of harm. No concerns were raised by any of the major wholesalers who all indicated a wide range of alternative suppliers and the ability to easily switch. They stated they source from a number of different suppliers and that this would not change post-merger. Further, neither Symington nor Fells has any exclusive supply agreements with any on-trade customers, nor do other port producers.

BARRIERS TO ENTRY AND EXPANSION

88. Barriers to new entry are likely to be high.[32] However, the parties submitted that barriers to expansion and repositioning are low.

89. The parties submitted that, as discussed above, there are several large global port players who currently hold small UK market shares for whom further expansion into the UK might not be difficult. However, while expansion by other port houses appears to be possible, particularly if the port house owns or can acquire a British brand,[33] the evidence is not sufficiently compelling to suggest expansion could offset any possible competitive effects of the merger.

90. Given the outcome of the competition assessment, the OFT has not found it necessary to conclude on whether entry and expansion would be sufficient to avert any substantial lessening of competition.

THIRD PARTY VIEWS

91. Third party comments have been discussed above where relevant.

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[32] The prospect of entry at the production level appears to be unlikely, given that port needs to be produced in a particular region of Portugal, is highly regulated by the Portuguese government, and the major port houses appear to have existed for a great number of years. At the brand level, an existing port producer would need to invest significantly in advertising and promotion to enter with a new brand with limited prospect of return, given the significant presence of BOBs and high/low brands. There has been no recent history of entry.
[33] for British brands.

ASSESSMENT

92. In the UK, the parties principally overlap in the supply of port.

93. The OFT considered there to be sufficient evidence to suggest that buyers' own brands and high/low brands act as a constraint on branded port.

94. Unilateral concerns do not arise as a result of the proposed transaction. Although the parties' estimated combined market share is around 39 per cent by volume and around 52 per cent by value (with an increment in both cases of around 19 per cent), buyer's own brands have been steadily increasing their market shares in recent years and now account for over one third of the market. In addition, the Fladgate Group holds around a 20 per cent market share. Most competitors were unconcerned by the merger and informed the OFT that they had spare capacity or were able to increase capacity relatively quickly in response to increased demand. The majority of the parties' customers (that is, the major supermarkets) informed the OFT that they believed that they would retain a sufficient degree of choice post-merger and that they possessed sufficient buyer power to enable them to prevent any attempted price increase by the parties.

95. The OFT does not consider that this proposed transaction will increase the likelihood for co-ordinated behaviour in supply of port in the UK, nor did it find evidence to support vertical concerns.

96. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.