

Completed acquisition by Punch Taverns plc of Spirit Group Holdings Ltd

The OFT's decision on reference under section 22(1) given on 5 May 2006. Full text of decision published 19 May 2006.

PARTIES

1. **Punch Taverns Plc** (Punch) is a publicly listed pub company (pubco) which owned a pre-merger portfolio of some 8,150 tenanted pubs across the UK.
2. **Spirit Group Holdings Ltd** (Spirit) is a pubco comprising some 1,830 managed pubs at the time of the acquisition.

TRANSACTION

3. Punch completed its acquisition of Spirit on 5 January 2006. The extended statutory deadline for the OFT's decision is 2 June 2006.

JURISDICTION

4. As a result of this transaction, Punch and Spirit have ceased to be distinct. The parties overlap in the operation of pubcos. The turnover test in section 23 of the Enterprise Act 2002 (the Act) is met given that Spirit's UK turnover exceeds £70 million. The OFT therefore believes that it is or may be the case that a relevant merger situation has been created.

RELEVANT MARKET

Product market

5. The parties overlap in the operation of pubcos.
6. In previous cases a 'pub' has been defined as 'premises operated under a full publican on-licence'. Such a definition includes bars and inns but has so far

excluded clubs and restaurants – some of which have previously operated under a restricted form of on-licence.

7. However, the industry has undergone considerable development since the Beer Orders 1989 loosened ties between pub retailing and brewing and facilitated entry by and competition between brewers, wholesalers and pub retailers.
8. Additionally, changes to the licensing regime¹ in England and Wales, by virtue of the Licensing Act 2003, came into full effect in November 2005.
9. Within the overall pub sector, scope may exist for further segmentation according to characteristics and features that differentiate pubs (or types of pub) such as location, customer profile, product range and branding.
10. On the other hand, some pubs and pubcos have been seeking to expand their business operations to include the provision of higher quality food, a broader range of drinks, entertainment, accommodation, dancing and other amenities. The OFT has therefore also sought information to determine whether previous distinctions between pubs and other types of on-licensed premises are no longer appropriate for the purposes of analysing the competitive effects of this merger.
11. As far as the possibilities for pub segmentation are concerned, evidence gathered from the parties and from third parties indicates that the customer base for most pubs is wide. However, pubcos do segment the pubs in their estates according to various categories which broadly reflect the key customer groups each type of pub seeks to attract.
12. However, there is also a body of comment from third parties which points to ease of supply side substitution between various pub categories.
13. Overall, the evidence on pub segmentation provided to the OFT in this particular case does not argue in favour of segmenting pubs into categories for the purpose of competition analysis at the present time.
14. As to whether the distinction between pubs and other types of on-licensed premises has blurred over recent years, evidence from some third parties, supported by internal documentation, suggests that this has taken place to some extent.

¹ The previous licensing regime consisted of different types of on-licences with different degrees of restriction placed upon them (e.g. full on-licences, restricted on-licences and club on-licences). This has been replaced with a single integrated system for licensing premises which are used for the retail sale of alcohol, the supply of alcohol in clubs, the provision of late night refreshment and the provision of regulated entertainment.

15. Third party views were mixed as to whether, for the purposes of a competition assessment, all on-licenses should be considered together. A minority proposed that this broader market definition would be appropriate. Comments received from the majority of respondents, however, did not agree with this proposition.
16. Third parties were also consulted on the scope for competitive constraint on pubs from outlets licensed for off-sales. Some respondents proposed that the recent decline in prices in the off-trade has acted as an incentive on pubs to improve the quality of their offerings by, for example, upgrading furnishings and facilities. In previous cases, it has been considered that, although on-licensed and off-licensed premises both retail alcohol, they nonetheless constitute separate product markets for the purposes of competition assessment. This is due to the additional service features offered within on-licensed premises and the pricing differentials between the two retail channels. The responses received from third parties did not amount to a body of evidence in favour of taking an alternative view of the product market in this particular case.
17. In summary, the OFT has examined whether the relevant product scope should be wider or narrower than all pubs. In the present case, we have not been persuaded, on the basis of evidence provided, that a change is warranted in the approach taken in previous cases of considering all pubs together. This approach has therefore been adopted in this case.

Geographic market

18. On the demand side, many pubs exhibit strong local characteristics since customers are generally willing to travel only short distances (frequently walking distances) to visit a particular pub. Evidence supplied to the OFT indicates that the catchment area for drinks-based pubs is generally small whereas consumers are prepared to travel longer distances to food-based pubs.
19. In previous merger cases involving pubs, individual Petty Sessional Division (PSD) areas have been used as the 'local' geographic basis for assessing the increment in terms of the number of pubs added to the merged entity's estate. Until now, the use of PSD areas had generally been considered to be the only suitable proxy for analysing the extent of local competition and assessing the availability to consumers of alternative pubs.
20. There are, however, some inherent weaknesses in this approach. PSD areas are administrative jurisdictions which vary significantly in size as well as in the number of pubs they contain. It has been suggested that a considerable number (if not the majority) of PSD areas may overstate the distance that most pub-goers

are prepared to travel and are thus unreliable indicators of the geographic scope within which consumers are prepared to switch between pubs.

21. The changes that have been implemented in the licensing regime in England and Wales (see paragraph 8) include the transfer of the responsibility for licensing premises for the on-sale of alcohol from local magistrates to local authorities. As a consequence, Local Authority Areas (LAAs) have now replaced PSD areas as the relevant administrative jurisdictions.
22. There are 408 LAAs as compared to around 505 PSD areas.² This means that LAAs are larger on average than PSDs and provide an even less localised basis for competition analysis.
23. In this and in previous cases in this sector, the merging parties and third parties have been consulted on the most appropriate method for examining the extent of local competition.
24. Most third party respondents propose that LAAs are the most appropriate basis on which to conduct a local competition analysis in the new licensing regime. Although they encompass similar weaknesses to those that pertain to PSD areas, they nonetheless provide for certainty and simplicity given the lack of readily available detailed information on which local concentration analysis can be based in relation to each pub.
25. The OFT agrees that the large number of pubs and the differences in their respective catchment areas makes individual analysis on each pub prohibitive. For the purposes of analysing the impact of the merger on local competition, we used PSD areas as a starting point.
26. In six of these PSD areas, which appeared to be candidates for closer scrutiny, we have also conducted a more detailed competition analysis on the basis of further business documentation and other evidence provided by Punch.
27. Given that the supplementary evidence did not indicate any additional concerns for loss of competition as a result of this merger, the OFT considers that PSD areas (on the basis that information relating to them is available and relevant) remain the most appropriate proxy for assessing the merger's competitive effects at the local level in the present case.
28. On the supply side, in the case of national pubcos, some of the overall business strategy, including certain parameters of competition, may be decided at the

² Independent information sources on pubs calculate on different premises. CGA Centro Data assumes 507 PSDs whereas Enumeration's data is based on 505 PSDs.

national level, for example beer supply arrangements, opening hours, themes, advertising and sales promotions. Consideration will therefore also be given to the impact of this merger on competition at the national level.

HORIZONTAL ISSUES

National level

29. Post-merger, Punch has in the order of 10,000 pubs.
30. Estimates for the total number of pubs in the UK vary. Amongst the available independent data sources, CGA Centro and Enumeration suggest that there are around 66,000 pubs. Bar*Track's estimate is 60,000. As a result of this merger, Punch's share of the supply of pubs at a national level is between 15 per cent and 17 per cent, an increment of around 3 per cent in either case.
31. As part of the overall body of supplementary information provided by Punch, it also estimated its national share of supply on the following bases: (a) the total turnover generated from its share of the pub market is approximately 14 per cent, (b) its share of the number of high street pubs is approximately 9 per cent, and (c) its share of the number of pubs away from the high street is approximately 17 per cent.
32. Only one third party had concerns for the effects of the merger at national level. These concerns are addressed in this decision in the section on Third Party Views.
33. Absent any other adverse comment and having due regard to Punch's post-merger shares of supply and to the small increment discussed in paragraph 31, the OFT does not believe that the merger gives rise to competition concerns at the national level.

Local level

34. The methodology applied in previous pub merger cases is based on determining whether the merger either confers or increases a share of more than 25 per cent of pubs within one or more PSD areas. Where that is the case, the parties are required to divest a number of pubs to reduce their share to no more than 25 per cent or, if appropriate, to the share that prevailed prior to the merger.
35. Since completing the acquisition of Spirit, Punch has, according to the above methodology, disposed of a sufficient number of pubs to meet the 25 per cent or pre-merger share requirement in all of the PSD areas where by virtue of the merger it had acquired or increased an existing share of more than 25 per cent of

pubs. The OFT has undertaken further analysis – examining local shares of pubs on the basis of LAAs, all on-licences, high street pubs, non-high street pubs and turnover as well as data on market entry and market exit – but has not uncovered any compelling cause for concern. The OFT therefore considers that any potential competition concerns at the local level attributable in this particular case to the increment of pubs in Punch's estate have been resolved by Punch's disposals.

Third party respondents agreed.

Barriers to entry and expansion

36. In view of the lack of horizontal competition concerns, it is not necessary to reach any views on barriers to entry or expansion within the overall pub sector.

Buyer power

37. In view of the lack of horizontal concerns, it is not necessary to conclude on the existence or otherwise of countervailing buyer power. However, as in previous cases, third parties have been concerned that the merged entity would enjoy enhanced buyer power in relation to the brewers. This point has been addressed in the 'Third party views' section of this decision.

VERTICAL ISSUES

38. The acquisition raises no vertical competition issues.

CO-ORDINATED EFFECTS

39. The fact that competition between pubs takes place on a number of non-price factors may undermine possibilities for sustained co-ordination of prices. Additionally, given that pubcos account for less than half of the total of on-licences, the sector remains fragmented. Overall, therefore, the OFT considers that this merger will not result in increased scope for co-ordination in the sector at the present time.

THIRD PARTY VIEWS

40. Only two third parties raised concerns. The first was concerned that disposals made to Mitchells and Butlers would 'lock out' any other parties. However, since no disposals were made to Mitchells and Butlers, this concern has been dismissed.

41. The second complainant submitted that:

- (a) Punch's increased buyer power would make it harder for other operators to compete;
- (b) smaller brewers would be expected to meet the level of discount that Punch obtains on national beer brands, making it harder for them to profitably supply Punch and thereby reducing the choice of beer for consumers;
- (c) between them, Enterprise Inns and Punch would control over 30 per cent of UK pubs and the acquisition would increase the 'dominance' of these two companies;
- (d) the merger will place pressure on Enterprise Inns to acquire additional pubs to increase its market power to the same level as that of Punch;
- (e) local problems will arise, despite application of the PSD methodology outlined in paragraph 35 above because
 - (i) pubs sold off are likely to retain the same national beer suppliers or be sold for development; this sell-off will not make it any easier for smaller brewers to gain access to the pubs;
 - (ii) Punch is likely to sell off the least profitable of its pubs in order to meet the PSD test.

- 42. The OFT considers that increased buyer power leads to competitive harm only in exceptional circumstances which the OFT does not consider exist in this case. Further, we did not receive any complaints from smaller pub operators regarding increased buyer power or regarding the level of discounts that Punch would be able to achieve on national beer brands. Accordingly, the OFT does not consider that the concerns raised at 41(a) and (b) give rise to a substantial lessening of competition in this case.
- 43. The concern at 41(c) is addressed to the extent that, as discussed above, the OFT does not consider that that the merger will result in increased co-ordination.
- 44. Any future acquisition by Enterprise Inns of additional pubs is a matter separate from the present case. If such a transaction qualified for investigation under the merger provisions of the Act, the OFT will have an opportunity to analyse the competition issues at that stage.

45. The OFT considers that the issue set out in 41(e)(i) is not based on any evidence and does not of itself constitute a competition concern. Finally, the concern raised in 41(e)(ii) is not relevant. The divestments are required to ensure that sufficient consumer choice remains within the relevant PSD area.

ASSESSMENT

46. The parties overlap in the operation of pub companies.
47. Punch has divested a number of pubs in order to ensure that the merger did not confer or increase a share of more than 25 per cent of pubs within a local licensing area defined for the purposes of the present case as a Petty Sessional Division area.
48. At the national level, the merger gives rise to a combined share of pubs of between 15 per cent and 17 per cent and an increment of some 3 per cent. No substantial competition concerns are raised.
49. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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