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The OFT's decision on reference under section 22 given on 9 August 2004

Completed acquisition by Greene King plc of Laurel Pub Holdings Limited

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Please note that square brackets indicate information excised, or exact figures replaced by a range, at the request of Greene King.

## **PARTIES**

1. **Greene King plc (Greene King)** is an integrated brewer, beer distributor and pub company. **Laurel Pub Holdings Limited (Laurel)** was a subsidiary of The Laurel Pub Company Limited, which in turn is owned by Morgan Grenfell Private Equity Limited. Laurel was a vehicle to enable the transfer of the 432 pubs that constitute the Neighbourhood division of The Laurel Pub Company Limited. The UK turnover attributable to Laurel for the year ended 29 February 2004 has been calculated as £235.4m.

## **TRANSACTION**

2. Greene King has acquired Laurel. The parties notified the transaction to the OFT by a merger notice submitted on 9 July 2004. The parties withdrew the merger notice and the transaction completed on 6 August 2004. The revised administrative deadline is therefore 6 September 2004.

## **JURISDICTION**

3. As a result of this transaction Greene King and Laurel have ceased to be distinct. The UK turnover of Laurel exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. A relevant merger situation has been created.

## **BACKGROUND**

4. The UK competition authorities have considered a number of merger cases involving the acquisition of pubs. Following the MMC's approach in its report into the Elders IXL and Scottish and Newcastle Brewers PLC merger,<sup>1</sup> the OFT has in a number of pub cases required the acquirer to divest (or, in some earlier cases, free from tie) a number of pubs so that its share of pubs in any Petty Sessional

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<sup>1</sup> Cm 1227, October 1990.

Division (PSD) would not, as a result of the merger, exceed 25 per cent or, if higher, the pre-merger level (the PSD rule).

## RELEVANT MARKET

### Product market

2. The parties overlap in the ownership and operation of pubs. In previous cases examined by the OFT,<sup>2</sup> the appropriate frame of reference adopted when assessing the competitive effects of mergers in this sector has been considered to be the ownership of pubs.<sup>3</sup>
3. The parties in this case contend (as have some parties in previous pub merger cases) that pubs compete with each other and also with all other forms of on-licensed premises.<sup>4</sup> As a result, they argue that all these establishments should be considered as part of the same product market.
4. The distinction between pubs and other on-licensed outlets, particularly restaurants, has blurred over recent years as pubs have sought to widen their offering to include food, a broader range of drinks, entertainment, accommodation, dancing and other amenities. As a result, pubs increasingly compete on a number of different levels in addition to pricing amongst themselves, and potentially also with other on-licensed premises.
5. An important characteristic of pubs, as opposed to other on-licensed premises, however, is that they allow for the purchase of alcohol without restriction, e.g. without the need for membership, being a resident or the purchase of a meal. Demand side switching to other on-licensed premises by consumers only wanting a drink is therefore limited. On the supply side, different characteristics of different types of licences may make switching difficult in some circumstances.
6. It may also be considered that pubs can be segmented further. Location, customer profile, range of products sold and pub experience are among the features that pub companies use to characterise different segments of the market. Past cases have highlighted the potential distinction between 'local' pubs, which attract residents from a small catchment area, and 'destination' pubs, that offer other features such as entertainment or food that customers are willing to travel further for, particularly at certain times of the week. Furthermore, some pubs could be categorised as 'gastropubs' or pubs with substantial food offerings. These pubs could interact more closely with restaurants than other pubs with lesser food offerings. To an extent, it is possible that pubs may be able to switch between these various categories within the terms of their licences.
7. In previous cases, the competitive constraint from sales from some unlicensed retail premises (e.g. coffee-bars) and off-licensed premises<sup>5</sup> on sales from on-licensed premises has been argued by parties as being sufficient for sales from such venues to be included in the product market. Although on-licensed and off-

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<sup>2</sup> For further discussion, refer to the OFT's advice on the acquisition by Enterprise Inns Plc of assets of Morgan Grenfell Private Equity Ltd namely the Laurel Pub Group Ltd.

<sup>3</sup> A pub is defined as premises operated under a full publican on-licence.

<sup>4</sup> Premises licensed for the sale of alcohol for consumption on the premises.

<sup>5</sup> Premises licensed for the sale of alcohol for consumption off the premises.

licensed premises both sell alcohol, it is generally accepted that sales from on-licensed and off-licensed premises constitute separate product markets owing to the additional service feature of on-licensed premises and the persistent price differences and pricing trends between the two channels. Greene King agrees with the exclusion of sales from off-licensed outlets from the market definition on this basis.

8. In previous pub cases the OFT has considered it appropriate to analyse competition on the basis of pubs as a frame of reference. The appropriate focus may, however, be wider and include other on-licensed premises. Conversely, pubs may be segmented further, for example, as between local and destination pubs or between gastropubs and other pubs. However, on the information currently available, there is insufficient evidence to justify deviating from the approach taken in previous cases. The OFT has therefore taken pubs as the appropriate frame of reference against which to assess the competitive effects of this merger.

### **Geographic market**

9. On the demand side, many pubs exhibit strong local characteristics since customers are only willing to travel short distances (possibly within walking distance of their home) to pubs. On the supply side, where national chains exist, certain parameters of competition take place increasingly at the national level, for example, beer supply arrangements are negotiated nationally and many aspects including features of service (such as opening hours, pub themes and fashion and tastes), advertising, promotions and campaign pricing (for managed pub groups) are determined nationally or at least regionally. Some parameters of competition are still determined locally to an extent however. For example, area/house managers of Greene King's managed estate generally determine prices. Prices in tenanted pubs are set locally by tenants.
10. In previous cases involving pubs, the geographic analysis of overlaps for assessing the extent of local competition among pubs has focused on PSDs, as a proxy for the alternatives for local consumers. Where a merger creates or increases a share of 25 per cent or above in any PSD, parties have been required to divest a number of pubs to reduce their share of pubs in any PSD to no more than 25 per cent or, if higher, the pre-merger level.
11. There are, however, some inherent weaknesses in this approach. It is questionable the extent to which PSDs represent the true distance that customers are prepared to travel to a pub. PSDs are administrative boundaries which vary significantly in size as well as in the number of pubs they contain. They are therefore unlikely to reflect fully consumer behaviour. It is also possible that consumers with the ability to switch between premises in different PSDs may create a chain of substitution that links such areas (whether on a sub-regional, regional or national basis). Neither does this approach take any account of the size of the premises involved. However, to the extent that the concern is one of consumer choice, this may not be a significant factor.
12. Under the Licensing Act 2003, responsibility for premises licensing is expected to transfer from local magistrates to local authorities towards the end of 2004. As a consequence of the new licensing regime, the PSD will no longer be the relevant

licensing area. In Enterprise/Unique,<sup>6</sup> the parties and third parties were questioned on the most appropriate method for examining local competition following the removal of PSDs. In general, it was considered that the most appropriate replacement would be the local authority areas. Although it was acknowledged that this would have similar flaws to the PSD methodology, information on the numbers of pubs would, at least, be relatively reliable. Respondents were divided on whether an isochrone approach would be an accurate method of analysing local competition. Flaws identified included difficulties in assessing exactly how far people are prepared to travel to pubs, particularly when pubs have such variable offerings and identifying the appropriate minimum number of outlets within an isochrone. It must also be said that the number of pubs in Great Britain (over 60,000) may create practical difficulties for any isochrone analysis.

13. Despite concerns over the ability for PSDs to capture accurately the geographic scope of competitive constraints on individual pubs,<sup>7</sup> based on the information available and in the absence of a detailed study into local market conditions, PSDs are presently considered to be the most appropriate proxy for assessing local competition.

## **HORIZONTAL ISSUES**

### **National issues**

14. Post merger, Greene King owns 3.8 per cent of pubs in Great Britain (increment 0.8 per cent). Supply of pubs remains very fragmented with the largest twenty pubcos accounting for only 63.2 per cent of pubs in Great Britain. No national concerns therefore arise as a result of this transaction.

### **Local issues**

15. At a local level, this acquisition creates or increases a share of 25 per cent of pubs in seven PSDs (the affected PSDs) involving a total of 13 pubs above the PSD rule level. Greene King has contended that collectively and in each PSD the increment arising from the merger is de minimis. However, the evidence suggests that the local markets concerned are not markets of insufficient importance for the purposes of section 33(2)(a) Enterprise Act. In the affected PSDs the number of pubs ranges from 29 to 164; assuming an average pub turnover of £500,000 per annum (based on figures for Laurel and Greene King pubs), this would suggest that these areas are worth some £14.5m-82m a year, which is both individually and collectively substantially in excess of any de minimis level. Moreover, in each of the affected PSDs, Greene King already had a share of pubs of between 28-38 per cent, therefore the increments arising from this merger are to already substantial levels of concentration. In line with previous cases, the OFT considers that local competition concerns may arise in these areas, potentially resulting in less competition to offer customers value for money.

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<sup>6</sup> See the OFT's decision on the completed acquisition by Enterprise Inns plc of the outstanding equity in the Unique Pub Company Ltd.

<sup>7</sup> For further discussion, see the OFT's advice on the acquisition by Enterprise Inns Plc of assets of Morgan Grenfell Private Equity Ltd namely the Laurel Pub Group Ltd.

## **Barriers to entry and expansion**

16. The main barrier to entry in pub retailing is obtaining a licence to supply alcohol for consumption on premises.
17. Greene King has submitted that entry by opening a new public house has not been a characteristic of the UK beer market. To secure discounts from brewers and wholesalers the new entrant may need to be a significant player or have links to a brewer. Without such discounts the new entrant may find it difficult to compete effectively against some of the larger pubs groups.

## **Countervailing buyer power**

18. The buyer power of individual consumers is considered to be minimal.

## **VERTICAL ISSUES**

### **Foreclosure**

19. In addition to its retail operations, Greene King is also active in the brewing and distribution of beer to the on-trade.
20. Greene King's share of supply of beer brewing in the GB is estimated to be around [0-5 per cent]. It faces a number of larger competitors in this segment including Interbrew, Carlsberg, Scottish Courage, Diageo and Coors, each with more substantial shares of supply than Greene King. Greene King supplies its beer both internally to its own pubs and externally to independent outlets, national pub companies and a small amount to the off-trade. For completeness, the parties have supplied brewing share of supply information by region and by product segment.<sup>8</sup> On this very narrow basis Greene King has a share of no more than [5-10 per cent] in any one region. By segment, its largest presence is in premium ale for which it estimates that it accounts for [10-20 per cent] of supply. In the remaining product segments, Greene King has a share of less than [0-5 per cent].
21. In wholesaling and distributing beer, Greene King is active in supplying some of its own beer and some of that from third party brewers to its own pubs and to independent outlets. It also uses third party distributors to supply some of its own beer to its own and third party pubs and some third party beer to its own pubs. Based on AC Nielsen data, in 2003 Greene King distributed [0-5 per cent] of all beer to the on-trade in Great Britain, around one-fifth of which was distributed to the Greene King estate.
22. Given Greene King's relatively small presence in brewing and distribution and the very small national increment at the retail level, issues of foreclosure are not considered relevant in this case.

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<sup>8</sup> Product segments provided are consistent with those considered by the Competition Commission in Interbrew SA/Bass PLC (2001, Cmnd 5014) namely standard lager, premium lager, standard ale, premium ale and stout.

### **Upstream buyer power**

23. Given the very small increment at the national level this is not thought likely in this case. Greene King's share of beer brewed for the on-trade in Great Britain can be estimated as [0-5 per cent]. No upstream buyer concerns therefore arise in this case.

### **THIRD PARTY VIEWS**

24. No third parties contacted were concerned about the merger.

### **ASSESSMENT**

25. No competition concerns arise on any basis, except with regard to Greene King's ownership of pubs in the affected PSDs, where the acquisition will create or increase a share of 25 per cent, such that the merger may give rise to less competition at the local level to offer customers value for money. Barriers to entry or expansion do not appear to be sufficiently low, or countervailing buyer power sufficiently strong, to offset these concerns.
26. Consequently, the OFT believes 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 for goods or services.

### **UNDERTAKINGS IN LIEU**

27. Where the duty to make a reference under section 22(1) of the Act is met, pursuant to section 73(2) of the Act the OFT may, instead of making such a reference, accept from such of the parties concerned undertakings as it considers appropriate for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it. While it does not believe that the merger does give rise to a substantial lessening of competition, Greene King has offered to divest any pubs required to address any potential competition concerns that might be considered by the OFT to arise. The local competition concerns identified above and the remedy proposed by Greene King to address them, which would involve the divestment of 13 pubs in the affected PSDs, are considered sufficiently clear-cut to be addressed by UIL. Accordingly, the OFT has decided to exercise its discretion to negotiate undertakings in lieu of reference.

### **DECISION**

28. The OFT is not referring the completed acquisition by Greene King of Laurel to the Competition Commission on the information currently available to it because it is considering whether, instead of making a reference, to accept appropriate undertakings from Greene King to address the competition concerns arising from the merger.